Reading Essentials and Note-Taking Guide

STUDENT WORKBOOK

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To the Student

Economics Today and Tomorrow **Reading Essentials and Note-Taking Guide** is designed to help you use recognized reading strategies to improve your reading-for-information skills. For each section of the student textbook, you are alerted to key content. Then, you are asked to draw from prior knowledge, organize your thoughts with a graphic organizer, and follow a process to read and understand the text. The **Reading Essentials and Note-Taking Guide** was prepared to help you get more from your textbook by reading with a purpose.

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Chapter 1, Section 1 (Pages 5–10)

The Basic Problem in Economics

Big Idea

As you read pages 5–10 in your textbook, complete a table like the one below by providing two examples for each term listed in the chart.

Term	Example 1	Example 2
Needs		
Wants		
Goods		
Services		

Notes

Read to Learn

Wants, Needs, and Choices *(page 6)*

Analyzing Information

Write whether a microeconomic or a macroeconomic theory would apply to each situation:

1. ***A government manages its imports and exports.***

2. ***An individual chooses what to buy at the store.***

Economics is the study of how people choose to meet their needs and fulfill their wants with limited resources. Economists recognize that people need some things, such as food and shelter, to survive. These are needs. Wants are different from needs, and to economists, they include anything other than what people need for basic survival.

All individuals have limited resources and unlimited wants. People must make choices. **Microeconomics** is the branch of economics that tries to explain the behavior and decision-making of individuals and businesses. Like individuals, businesses must also make choices. They have to decide what to produce now, what to produce later, and what to stop producing.

Societies and governments also must make choices about how to use their limited resources. **Macroeconomics** is the study of how these large groups make choices and is the branch of economic theory that deals with the economy as a whole.

Notes

Read to Learn

The Problem of Scarcity *(page 7)*

Synthesizing Information

Is famine during a drought the result of scarcity or of a shortage?

____

People do not and cannot have enough income and time to get everything they want. Economists call this problem **scarcity.** Scarcity is the result of limited resources and unlimited wants.

There is a difference between scarcity and shortages. Natural disasters can cause temporary shortages in food, energy, and other goods and services. Unlike shortages, scarcity is not temporary. Scarcity always exists because people have different and competing uses for resources, and at any one moment, there is only a certain amount of any one thing.

The Factors of Production *(page 8)*

Evaluating Information

List three examples of land in your community.

1. ___________________

2. ___________________

3. ___________________

Problems and Solutions

Write one strategy that governments can use to encourage entrepreneurship among their citizens.

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Factors of production are the resources needed to produce goods and services. The four factors of production are land, labor, capital, and entrepreneurship. To economists, **land** is any natural resource not created by people. Land includes water, animals, plants, minerals, and actual surface land—all things found in the natural world.

Labor is also a factor of production. Labor is the work that people do to produce goods and services. **Goods** are physical items that people can buy, such as books or clothes. **Services** are actions done by someone else that people can buy, such as house painting and babysitting.

Capital is another factor of production. Capital is the human-made goods used to make other goods and perform other services. Examples of *capital goods* are computers and railroads. Capital, such as an assembly line, can increase productivity. Land, labor, and capital together greatly increase the value of a product. Think about which factors of production are needed to build a house.

It may be surprising that **entrepreneurship** is also a factor of production. Entrepreneurship is the ability of individuals to develop new products and businesses in order to make profits. Entrepreneurship requires initiative and willingness to take risks.

Some economists believe **technology** is a fifth factor of production. Technology is the use of science to create new products and new ways to produce and to distribute products. For example, debit cards are a faster and easier way to access funds in a bank account than writing checks.

The four factors of production determine the wealth of countries and individuals. Nations and individuals with more land, capital, labor, and entrepreneurship are usually richer than those without them. How equally or unequally these factors are distributed within in a nation reflects the distribution of wealth or income to its citizens.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why are people affected by scarcity regardless of their income?

2. How do nations get wealthier even when available land diminishes over time? Consider the factors of production in your answer.

Expository Writing

Write the steps an individual could take to start a dog-walking business. Include which factors of production the business would require and which factors could increase profits.

Chapter 1, Section 2 (Pages 14–19)
Trade-Offs

Big Idea

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 the opportunity cost of each economic decision you might make.

Decision	Trade-Off	Opportunity Cost
Buying something you want		
Saving your money		

Notes

Read to Learn

Trade-Offs (page 15)

Drawing Conclusions

When you choose to buy something, is the value of the item you buy greater or smaller than the opportunity cost?

When people make economic choices, they exchange one good or service for another. When you choose to buy a product, you are exchanging your income for the right to own the product. Sacrificing one good or service to purchase or produce another is a **trade-off.**

Choices about using resources, including time and income, have trade-offs. When you make a purchase and trade-off, you lose the ability to fulfill other wants. That way trade-offs always have costs. The **opportunity cost** is the value of the *single next best alternative* that you gave up for the item or the action that you chose. Suppose that on Saturday one friend asks you to go to the movies and another friend asks you to go ice skating. If you choose to go to the movies, the opportunity cost is the value of going ice skating. Economists use opportunity cost to measure the value of a trade-off.

Businesses, families, and governments also consider trade-offs and opportunity costs when making economic decisions. For example, businesses consider trade-offs when they hire workers versus buying equipment.

Notes | Read to Learn

Production Possibilities Curve *(page 17)*

Making Inferences

Why do production possibilities curves slope down from left to right?

____

____

____

Evaluating Information

Think of two non-economic factors that small businesses might consider when deciding what products to produce.

1. ______________________

2. ______________________

How do companies and governments that produce more than one item choose how much of each item to produce? Economists use a graph 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. To make a production possibilities curve, plot the dollar value of one good on the side (vertical) axis and the dollar value of another good on the bottom (horizontal) axis.

The production possibilities curve helps companies and governments determine how much of different items to produce. It shows the trade-offs and the opportunity costs involved in decisions. If a furniture maker produces desks and dining tables, the production possibilities curve shows that making any given number of desks has an opportunity cost of a certain number of tables, and vice versa.

The classic example for explaining production possibilities in economics is the trade-off between spending on military defense and on civilian goods. In this situation, people call military goods and services "guns" and civilian goods and services "butter." Governments know they have to give up production of one type of good or service in order to get more production of another. If a government decides to increase the production of "butter" one year, the opportunity cost is the value of the "guns" that cannot be produced.

In the United States, Congress and the president decide how many military goods and civilian goods to produce with the taxes collected. The production possibilities curve helps determine what the opportunity cost will be if the government takes a particular course of action.

Because of the nature of models, the predictions of a production possibilities curve do not always correspond to the real world. For most people, economics is only one of many factors to consider when deciding how to use resources. For example, businesses might also consider the environmental consequences of their decisions.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Can you ever buy something without making a trade-off? Explain.

2. How do you use a production possibilities curve to find opportunity cost?

Persuasive Writing

Do you think the federal government should spend more money on guns (for example, aircraft, ships, and technology) or on butter (for example, public education, cultural institutions, and national parks)? Write a letter to your senator stating your view on how the government should spend taxpayer money.

Chapter 1, Section 3 (Pages 20–25)

What Do Economists Do?

Big Idea

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

Benefits	Drawbacks
1. ______________________	1. ______________________
2. ______________________	2. ______________________
3. ______________________	3. ______________________

Notes

Read to Learn

Economic Models *(page 21)*

Comparing and Contrasting

How is an economic model similar to and different from a model airplane?

similarities

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____

differences

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____

Economics is the study of how individuals, businesses, and nations choose to use their limited resources. The word **economy** describes all the activity in a society that affects the production and distribution of goods and services. Economists use **theories** when they study the economy to help explain and predict economic behavior. These theories are called **economic models.**

In the real world, many factors combine to affect economic behavior. However, economic models can show only the basic factors needed to **analyze** a problem. In order to make models, economists assume that all factors remain constant except the two variables thought to be related.

Economists test their models to see if they do a good job representing reality and explaining behavior. This is similar to how other scientists make **hypotheses,** or assumptions, involving multiple variables, and test them to see if they are valid. Economists can test economic models by gathering data from the real world and comparing the data to their predictions. Businesses and governments use reliable economic models to help them make economic decisions.

Notes | **Read to Learn**

Schools of Economic Thought *(page 24)*

Synthesizing Information

Deciding whether a certain policy is good or bad depends on how you value the __________, or the opportunity cost.

Making Generalizations

As you read, complete the sentence below. It is important for Americans to understand

____

in order to choose a candidate to vote for during an election.

Many factors affect the ways that different economists view and interpret the world. Economists are influenced by their personal opinions as well as by the economic philosophy of the government under which they live. For this reason, economists do not always agree about which theory offers the best prediction. Economists from competing schools of thought claim that their theories describe the real world better than others' theories.

One issue on which economists often disagree is how much government intervention is best for the economy. Some economists believe that the government should maintain a "hands off," or *laissez-faire,* policy in business and consumer affairs to keep the economy growing. Other economists believe that the government should intervene in the economy to reduce unemployment and to prevent rising prices.

For example, lawmakers may agree that there are too many Americans without health insurance, but they will offer very different solutions. Some lawmakers might feel that it is the government's responsibility to provide affordable health care. However, other lawmakers might feel that increased competition between private health-insurance providers would reduce prices. Economists can evaluate each solution by studying data from similar situations in the past and by using economic models. Their evaluation will not be completely objective. They can provide educated predictions about which plan will be more effective; however, they cannot tell you which solution is the right one.

The science of economics helps people make predictions about the effects of different policies and events. However, economics does not judge whether a certain policy is good or bad. Different people have different values, or beliefs, which influence the ways that they interpret economic situations.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why is it impossible for economic models to show all the details about economic events?

2. List two factors that might explain why some economists support a laissez-faire economic policy and others support economic intervention.

Expository Writing

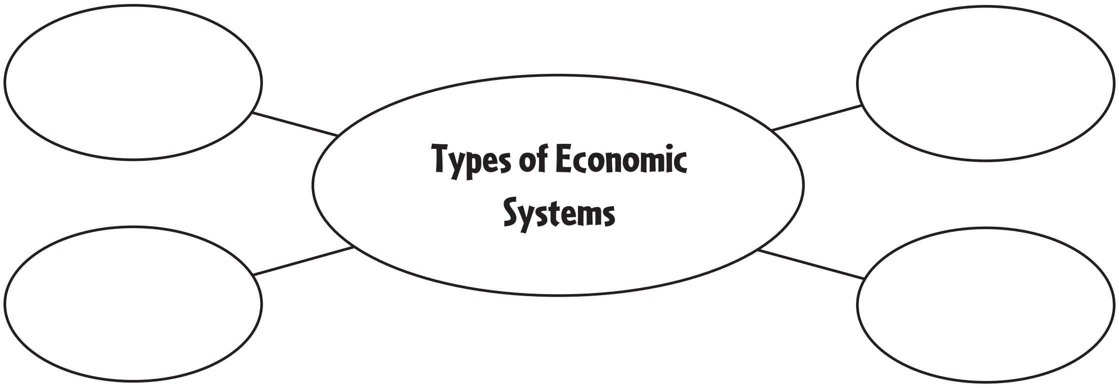
Form a theory, or model, about the relationship between income and access to regular medical care in the United States. Do people with less income receive medical care equal in quality to that of people with more income? Do all people have the same opportunities to receive medical care? Then, explain how you would test your theory. Include the type of data you would gather, and how you would represent the model visually.

Chapter 2, Section 1 (Pages 33–40)

Economic Systems

Big Idea

As you read pages 33–40 in your textbook, complete a graphic organizer like the one below by briefly describing each of the four basic types of economic systems.



Notes

Read to Learn

Three Basic Questions *(page 34)*

Determining Cause and Effect

How does the nation in which you live affect how and if you receive goods and services?

An **economic system** is the way a nation uses its resources to satisfy its people's needs and wants. All economic systems consider the same three basic questions: What should be produced? How should it be produced? For whom should it be produced?

The workings of scarcity and trade-offs affect what goods and services are produced. Because of the scarcity of resources, no nation can produce every good or service that it needs or wants. Nations must make choices. If nations or businesses produce more of one thing, then they must produce less of something else. For example, if nations spend more resources on national defense, fewer resources are available for public universities.

Next, nations decide how to produce the goods and services at the lowest possible cost. They must choose from the possible trade-offs. For example, a public university might offer some courses on the Internet to save capital.

Finally, a nation must decide how to distribute the goods and services. In the United States, distribution occurs through a price system. Other nations distribute goods by sharing them equally, through military force, by majority rule, or in many other ways.

Notes | **Read to Learn**

Types of Economic Systems *(page 36)*

There are four basic types of economic systems: traditional, command (or controlled), market (or capitalist), and mixed. Each system is identified by how it answers the three basic economic questions.

In a **traditional economy,** economic decisions are based on customs and beliefs handed down from previous generations. For example, if your parents were farmers, you would become a farmer. You would also farm and sell your crops the same way as your parents. The advantages of a traditional economy are that you know what is expected of you and that you enjoy strong family and community ties. The disadvantages are that the economy discourages change, production methods are inefficient, consumer choice is minimal, and people's material well-being rarely rises.

In a **command economy,** government leaders control the factors of production and make all economic decisions. Individuals have few choices with regard to what they make or buy, what jobs they do, or how much they earn. The disadvantages of this kind of controlled economy are a lack of incentives to work hard or efficiently and a lack of consumer choices.

In a **market economy,** also called capitalism, individuals control the factors of production and freely make economic decisions based on their own and their families' best interests. The **market**—the process of freely exchanging goods between buyers and sellers—guides decisions. Changes in prices signal how much of which goods and services should be bought and sold. Economists use an economic model called a **circular flow of income and output** to show how resources, goods and services, and income flow in a circle. Businesses sell goods and services to individuals who pay for them. In turn, individuals sell their resources, such as time, to businesses and are paid by the businesses. At the same time, businesses and individuals pay taxes to the government, which provides benefits, such as safety, in return.

The advantages of a pure market system are freedom of economic choice and competition that increases consumer choice and determines costs efficiently. A disadvantage is that survival may be difficult for individuals who are unable to work.

A **mixed economy** combines characteristics of more than one type of economic system. Most nations have a mix of command and market economies—individual ownership of the factors of production and individual decision making are combined with government intervention. For example, in the United States, individuals make most economic decisions, but the government also passes laws to protect the environment or consumers.

Analyzing Information

Why might people's material well-being rarely improve in a traditional economy?

____

____

____

Synthesizing Information

As you read, complete the sentence below.

If the government lowers taxes in a market economy, benefits for individuals and businesses will

____________________.

Making Inferences

In a mixed economy, why might the government have to regulate businesses in order to protect the environment?

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Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why must nations consider trade-offs when deciding what to produce?

2. Why might a market economy be described as the "opposite" of a command economy?

Informative Writing

Write a story about an economic decision you made, such as deciding to buy tickets to a movie, to explain the United States' mixed economy. The story should show how both individual freedom and government restriction affected your purchase. Remember to tell when, where, who, why, and how.

Chapter 2, Section 2 (Pages 42–46)

Characteristics of the American Economy

Big Idea

As you read pages 42–46 in your textbook, complete this graphic organizer by filling in the six major characteristics of the U.S. economy.

U.S. Economy	
1.	4.
2.	5.
3.	6.

Notes | **Read to Learn**

Limited Role of Government *(page 43)*

Making Generalizations

Over time, the United States has decided that Americans benefit from _____________________.

In 1776, the economist Adam Smith described an ideal economic system in which government had a very small part in a nation's economic activity. Individuals, when left alone, would work in their own self-interest. An "invisible hand" would guide them to use resources in a way that achieves the most good for society. Smith's system is called **capitalism,** another name for the market system. Under capitalism, individuals own the factors of production. People also call pure capitalism a **laissez-faire** system, or an economic system in which the government lets individuals and businesses make their own economic choices.

Smith's ideas influenced the Founders of the United States. As a result, they limited the role of government mainly to national defense and keeping peace. However, since the 1880s, the role of government has increased greatly. Among other things, the federal government **regulates** the banking system, the quality of food and drugs, and working conditions. It also imposes taxes to pay for social programs like Social Security and Medicaid. In addition, local governments have expanded their roles in such areas as education and job training.

Notes | Read to Learn

Other Characteristics *(page 44)*

Analyzing Information

How is freedom of choice related to freedom of enterprise?

Evaluating Information

How has the profit incentive driven the growth of businesses that use the Internet?

Predicting

What will happen if the government needs a person's land for a new highway?

In a free market, private businesses and individuals responding to market signals direct economic activity. Other features of market systems show how this works.

People also describe America's capitalist economy as a **free-enterprise system.** In this system, individuals are *free* to own the factors of production and to decide how to use them within legal limits. For instance, individuals are free to start their own businesses and make or lose money in the process. However, the government can place legal limits on economic activity. Fire codes, labor laws, copyright laws, pollution restrictions, and other regulations all restrict free enterprise to protect businesses and/or the general public. Freedom of enterprise pertains to sellers.

Freedom of choice pertains to buyers. It means that buyers determine how much of which goods and services sellers produce. A product's success or failure in the market depends on the number of individuals who freely choose to buy it. However, the government must protect buyers at times. The government sets safety standards for products, such as car seats, and regulates prices in markets with just a few companies, such as electric companies.

Entrepreneurs start businesses to make a **profit**—the remaining amount earned after a business subtracts all of its costs from its total sales. The **profit incentive** driving the American economy is the desire to earn income and fulfill wants. The result of the interaction of profits and losses is an efficient, adaptable, and continually growing economy.

Another characteristic of the American economy is **competition,** or the rivalry among producers or sellers of similar products to win more business. Effective competition requires many independent sellers of similar products, so that customers can choose to buy the product at the lowest price. As a result, businesses aim to keep prices low and profits high. To achieve high profits, businesses keep production costs low. Therefore, competition leads to the efficient use of resources. Competition also requires that businesses can easily enter and exit the market. Barriers to markets in the United States are generally weak.

Private property—property owned by individuals, not the government—is one of the most important characteristics of capitalism. If individuals have the resources, they are free to buy and own what they want and decide how it is used. Property includes anything you can own, from a bicycle to a house. The Constitution protects property rights. The Founders understood that property rights are the engine that creates wealth and prosperity. Thus, the government cannot take private property without paying for it.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What are three general reasons for the increase in the government's role in the American capitalist system?

2. Explain the relationship among profit incentive, competition, and private property.

Persuasive Writing

Write a persuasive essay in which you agree or disagree with Adam Smith's idea*—individuals, when left alone, will work in their own self-interest. An "invisible hand" will guide them to use resources in a way that achieves the most good for society. *Use evidence from this lesson to support your argument.

Chapter 2, Section 3 (Pages 47–50)

The Goals of the Nation

Big Idea

As you read pages 47–50 in your textbook, complete this graphic organizer by listing the individual's rights and responsibilities in the American free-enterprise system.

Rights	Responsibilities
1.	1.
2.	2.
3.	3.

Notes | Read to Learn

Goals of Free Enterprise *(page 48)*

Distinguishing Fact from Opinion

Is the sentence "Americans have one of the highest degrees of economic freedom in the world" a statement of fact or of opinion? Explain your answer.

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The economic goals of free enterprise are freedom, efficiency, equity, security, stability, and growth. The United States shares these goals since it is a free-enterprise, or capitalist, system. The goal of *economic freedom* is to allow each individual to make choices, but there are trade-offs. Americans have one of the highest degrees of economic freedom in the world. However, individuals might make unfair choices. Therefore, Americans also want **economic equity.**

Because of scarcity, the factors of production should not be wasted. Seeking the lowest-cost means to produce any good or service is the way to achieve the goal of **economic efficiency.**

Americans want protection from risks beyond their control. *Economic security* seeks to reduce risks from hardship, and *economic stability* seeks to reduce risks from extreme changes in the standard of living. **Standard of living** is the material well-being of an individual, group, or nation.

Finally, there is the goal of **economic growth.** As the population increases, the economy must **expand** to satisfy additional needs and wants.

Notes | Read to Learn

Rights and Responsibilities *(page 50)*

Formulating Questions

Before you read this passage, write two questions you think will be answered by the text.

1. ____________________

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2. ____________________

____

Predicting

What would happen if individuals did not work to take care of themselves and their families?

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Individuals have both rights and responsibilities in a free-enterprise system. So, in America, they have the right to enter almost any profession or business. They have the right to work as little or as much as they want. They also have the right to buy the products they want and to reject those they do not want.

Americans can choose to take great risks or to risk nothing at all. In our society, people are free to be entrepreneurs or to be workers just looking for a pay check. Once people earn their income, they are free to save it or to spend it how they wish. Americans are protected by the government against discrimination from banks, lenders, and sellers. As a result, anyone who has the income to invest in the stock market, buy a house, or open a savings account is free to do so.

A free-enterprise system gives Americans many choices as to which goods and services to buy. What people choose to buy can reflect their values. For example, some Americans buy organic produce and hybrid cars while other Americans buy prepared food and sport utility vehicles (SUVs).

However, for a free-enterprise system to work, individuals must take on certain responsibilities. They should be able to support themselves and their families. They should use their education to become productive members of society. Moreover, individuals should elect responsible government officials since the government is an important part of the economy. This means individuals should know and understand government policies and how those policies may affect the economy.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What goals attempt to offset the trade-offs of economic freedom in American society?

2. How might an individual meet his or her economic responsibility of electing responsible government officials?

Descriptive Writing

Imagine a small town where most people work in the local textile factory. Describe the factory on the day that the workers learn the factory is closing because it is inefficient. How might the goals of free enterprise affect the workers and the town?

Chapter 2, Section 4 (Pages 51–55)

Capitalism and Socialism

Big Idea

As you read pages 51–55 in your textbook, complete a table like the one below by comparing the advantages and the disadvantages of socialist and capitalist economic systems.

	Advantages	Disadvantages
Socialism		
Capitalism		

Notes

Read to Learn

Pure Socialism (page 52)

Analyzing Information

Underline and number the three characteristics of pure command socialism defined in this section.

Making Inferences

How do we please both U.S. business owners and U.S. workers?

____

Socialism is an economic system in which the government owns the major factors of production and attempts to manage production and the distribution of goods. Under pure command socialism, prices are set by the state and taxes redistribute income. Through central planning, the state makes all economic decisions about what, how, and for whom to produce.

The Industrial Revolution in the 1800s created problems between capitalists and workers. Karl Marx believed that capitalists took advantage of the workers, or **proletariat.** He predicted that through protest by the workers, capitalism would be replaced with socialism and then with **communism.**

In the twentieth century, socialism split into democratic socialism and authoritarian socialism. **Democratic socialism** is a system that works under a constitution to elect socialists to offices. The government usually controls only some areas of the economy. **Authoritarian socialism** more closely follows Marx's beliefs. It supports revolution as a way to overthrow capitalism and bring about socialist goals. A central government controls the entire economy.

Notes | Read to Learn

The Benefits of Capitalism *(page 54)*

Drawing Conclusions

As you read, underline the facts that support this conclusion: There is greater individual freedom under capitalism than under socialism.

Determining Cause and Effect

Why does capitalism distribute income unequally?

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The main benefits of capitalism are economic efficiency and individual freedom. The supporters of capitalism highly value personal freedom, initiative, and individuality. They point out that socialism results in government intervention throughout the economy and, therefore, in people's lives. Capitalism, on the other hand, allows for more efficiency in the marketplace and greater rates of economic growth.

Pure socialism and capitalism both require economic planning. Under pure socialism, planning is limited to a small group; it is centralized. The group's decisions impact all businesses and individuals in the system. In the market system of the United States, many people share the responsibilities of economic planning; it is decentralized.

Private firms, individuals, and government officials plan and make decisions about the economy. For example, the private company Google decided to buy the company YouTube. The government officials who work for the Federal Reserve System, the central banking system of the United States, plan the amount of paper and coin money in circulation at any given time. Stockbrokers decide to buy or sell stock in relation to natural disasters, company earnings, elections, and other factors. The responses of businesses, individuals, and government officials to market signals affect economic activity.

Critics argue that capitalism unequally distributes income. They also point out that capitalism does not provide enough funds for goods and services that benefit the general public, such as universal health care and child care.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What problem does socialism try to solve?

2. How is economic planning carried out in the United States?

Expository Writing

Compare and contrast the responsibilities of a democratic socialist government and the United States government. Consider which government would be more favorable to entrepreneurs and which would be more favorable to individuals with special needs.

Chapter 3, Section 1 (Pages 65–69)

Consumption, Income, and Decision Making

Big Idea

As you read pages 65–69 in your textbook, complete this graphic organizer by filling in the factors that affect your ability to earn income and the factors to consider in deciding how to spend your income.

Earning		→	Available Income	→	Spending	
1.	4.				1.	4.
2.	5.				2.	5.
3.	6.				3.	6.

Notes

Read to Learn

Disposable and Discretionary Income *(page 66)*

Drawing Conclusions

As you read, complete the sentence below.

A healthy person will have

____

earning power than a person with poor health.

Write two facts that support the conclusion.

____

____

A person's role as a consumer depends on his or her ability to make purchases or use services. A **consumer** is any person or group that buys or uses goods and services to satisfy personal needs and wants. The ability to consume depends on a person's available income and what portion of that income he or she chooses to spend or to save.

Income can be both disposable and discretionary. **Disposable income** is the remaining money a person has to spend or save after taxes have been paid. People spend their disposable income in many ways, including child care, education, medical care, and travel. To use their income wisely, most people first pay for what they need to live. These necessities include food, clothing, and housing. The remaining income, or **discretionary income,** can go toward luxuries and wants.

Many factors affect a person's earning power. Education, occupation, experience, and health all impact a person's ability to consume. Where a person lives can affect his or her earning power, too. When a person inherits money or property, his or her resources increase along with earning power.

Notes | Read to Learn

Decision Making as a Consumer *(page 67)*

Identifying the Main Idea

Underline the main idea of the second paragraph.

Analyzing Information

From the example in the passage, what is the opportunity cost of the $300 portable music player?

____

Synthesizing Information

How would the factors of scarce resources, opportunity cost, and rational choice affect your decision whether to go to college?

____

____

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Spending choices involve several decisions. The first decision to make is whether to buy an item. This decision involves knowing the difference between *needs* and *wants* and the trade-offs a person makes in deciding to spend money instead of saving it. Once a person has decided to spend money, there are three main factors to consider when making good consumer decisions.

The first factor is the problem of *scarce resources*. Time and money are scarce resources that are always considered when making a purchase. Before a consumer spends money on a product, he or she must invest time in learning about the product. Such research may involve visiting stores and the Internet to compare brands, models, and prices. Both the time spent on research and the money eventually spent on the product is a cost to the consumer. This time and money cannot be used for anything else.

The second factor is *opportunity cost*. Remember that opportunity cost is the value of the single next-best choice that you did not make. In other words, if a consumer buys a higher-priced product rather than a lower-priced product, he or she will spend more money. The difference between the two prices is money that could have been spent on something else. That spent money and the things it might have bought are the opportunity costs of the higher-priced product.

When comparing opportunity cost, a consumer should think not only about whether to buy the item in the first place but also about the quality of the item should he or she decide to buy it. Generally, a higher-quality product costs more than a medium- or low-quality product. For example, suppose that a person wants to buy a portable music player. One model holds 1,000 songs and costs $300. Another model holds 200 songs and costs $100. The difference in price is $200. The difference in the number of songs each holds 800. The consumer must decide whether the additional song capacity is something he or she really wants.

Rational choice is the third factor in making good decisions as a consumer. It means choosing the alternative that has the greatest **perceived** value. In consumer decisions, rational choice involves choosing the best-quality item with the lowest price from among similar products. Consumers make rational choices when they purchase goods and services they believe can best satisfy their wants. Making rational choices does not mean that all consumers will make the same purchasing decisions. That is because each consumer has different preferences and may perceive value differently.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Is discretionary income also disposable income? Explain.

2. How can employed consumers determine a value for their time?

Descriptive Writing

Imagine that you are in a home-electronics store. Create a vivid image of the store to show how retailers try to influence consumers' decisions. Do retailers help or hinder consumers' ability to make a rational choice? What strategies do they use?

Chapter 3, Section 2 (Pages 70–74)

Buying Principles and Strategies

Big Idea

As you read pages 70–74 in your textbook, complete this graphic organizer by filling in 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.

Notes

Read to Learn

Gathering Information *(page 71)*

Problems and Solutions

What problem does gathering information from multiple sources solve?

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Consumers should be well informed about a good or a service before buying it. Gathering information about a product helps determine a product's perceived value. Consumers can find information about a product by asking friends, visiting stores and talking to salespeople, or searching on the Internet.

Gathering information takes time, however, which makes it costly. Consumers should gather only *worthwhile* information. Information is worthwhile if the value of the time spent gathering the information is less than the value received from choosing the best product.

As a consumer shops for products, he or she begins to develop a consumer knowledge base. Gathering information about purchasing a certain good or service may eventually help a consumer make decisions about purchasing future products.

To quickly gather information about a good or a service, consumers can use the Internet. By using an Internet search engine, consumers will find reviews written by other consumers, Web sites that sell the product, and Web sites that compare prices and features.

Notes | Read to Learn

Using Advertising Wisely *(page 72)*

Formulating Questions

Before you read this passage, write two questions you think will be answered in the text.

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Consumers should carefully consider the claims of advertisers. Advertising is all around us—in magazines, in theaters, and so on. Advertising can be *competitive* or *informative*.

Competitive advertising convinces consumers that a product is different from and better than any other product. Companies use this type of advertisement to keep customers away from competitors or to keep the customers they already have. Competitive ads are also called persuasive ads. They usually appeal to consumers' emotions.

Informative advertising provides useful information about a product for consumers. These ads usually inform the consumer of the price, quality, and special features of the product.

Some companies use false advertising that misrepresents the quality, features, or true price of a product. An example of this sort of advertising is **bait and switch.** The bait is an item with an unusually low price. Once the consumer is in the store, the salesperson speaks badly of the advertised item and then tries to sell the consumer a higher priced product, which is the switch. Bait-and-switch advertising is both misleading and illegal.

Comparison Shopping *(page 73)*

Making Generalizations

In order to make a wise purchase, you must spend your money and ________ carefully.

Synthesizing Information

What is a simple way to save money on everyday purchases?

____

____

Once a consumer has gathered information about a product to buy, the consumer must decide *where* to buy it. A consumer can find the best price for an item through comparison shopping. **Comparison shopping** is the process of getting information on the types and the prices of products available from different stores and companies. Consumers can learn the different prices for a product by reading ads, making phone calls, browsing the Internet, visiting stores, and talking with friends. Knowing the prices for a product allows consumers to negotiate a fair price with a merchant. Similar to gathering product information, comparison shopping takes time. The value of your time and effort should not be more than the difference in price.

Although price is an important consideration, consumers should also consider the **warranty.** A warranty is the promise by the manufacturer or seller to repair or replace the item if the consumer finds it faulty within a certain time. Another factor to consider is whether to buy a brand name or generic product. A **brand name** is a word, picture, or logo on a product that helps consumers tell it from similar products. **Generic brands** do not carry a brand name, which makes it hard to know who made the product.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How can you determine whether gathering information about a product is worthwhile?

2. What is the purpose of comparison shopping?

Persuasive Writing

Write two versions of a classified advertisement for an item you would like to sell. One version should be an informative ad, and the other version should be a competitive ad.

Chapter 3, Section 3 (Pages 76–79)

Consumerism

Big Idea

As you read pages 76–79 in your textbook, complete this graphic organizer by filling in a consumer's rights and responsibilities.

Consumer Rights	Consumer Responsibilities
1.	1.
2.	2.
3.	3.
4.	4.
5.	5.
	6.
	7.
	8.

Notes

Read to Learn

Consumer Rights *(page 77)*

Making Inferences

Do you think many products were recalled by manufacturers before 1960? Explain.

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Laws to protect consumers from faulty or falsely advertised products did not always exist. The **consumerism** movement in the 1960s gave consumers important rights. In 1962, President John F. Kennedy asked Congress to solve the problem of consumer fraud. In his message, he listed four consumer rights to be protected. These consisted of the right to safety—goods should not pose a danger to life or health; the right to be informed—information should be available to allow consumers to make good choices; the right to choose—markets should be competitive and the government should protect consumers in markets where there is no competition; and the right to be heard—the guarantee that the interests of consumers should be considered when the government writes laws. Later, President Richard Nixon added a fifth right—the right to redress. This right allows consumers to ask for and receive payment (in money or goods) from the manufacturer when a product causes physical or monetary damage. As a result, businesses can no longer hide from the responsibility of telling consumers whether a product is unsafe, food is unhealthful, or advertising is untruthful.

Notes | Read to Learn

Consumer Responsibilities *(page 78)*

Distinguishing Fact from Opinion

Is the sentence "Lawmakers used President Kennedy's list of consumer rights as a guide" a statement of fact or opinion? How do you know?

____

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Evaluating Information

If you buy a poorly made product with a credit card, should you pay your credit-card bill? Explain.

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Synthesizing Information

The actions of both the buyer and the seller in a transaction should be

____

and

______________________.

Congress's solution to consumer fraud was to pass consumer-protection legislation. Lawmakers used President Kennedy's list of consumer rights as a guide. Under these laws, unsatisfied consumers can complain to the store owner or the manufacturer. They also have the right to take the case to court.

Several private and government agencies exist with the purpose of helping consumers. Local citizens' action groups and local chapters of the Better Business Bureau inform consumers about products and selling practices. They also help settle disagreements between consumers and sellers.

Consumers should also accept certain responsibilities, such as helping to resolve problems. If there is trouble with a product or service, it is the consumer's responsibility to start the problem-solving process. When consumers have a problem, the Bureau of Consumer Protection advises consumers to follow these steps. First, report the problem immediately to the company responsible. Do not try to fix the product because it might cancel the warranty. State the problem to the merchant or manufacturer, and suggest a fair and just solution. Include important details and the copies of receipts, guarantees, and contracts in all correspondence. Keep a record of all attempts to solve the problem, including names and dates. Consumers should also remain calm, because the person handling the problem probably did not cause it.

Online shopping presents an additional set of problems for consumers. When consumers buy from online merchants, they should be careful to buy only from trusted merchants with good reputations. Consumers should also read all confidentiality and disclosure agreements that are designed to protect the seller or the buyer. Consumers should never give personal or financial information to anyone who has contacted them without their permission.

In turn, responsible consumers demonstrate **ethical behavior** by respecting the rights of sellers and producers. For example, responsible consumers know that using a product decreases its value. As a result, consumers shouldn't return items after they have been used—especially because they found the same items for a better price. Returning items creates work for the seller, so consumers should avoid returns by researching products and prices before making purchases.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How did consumerism change the responsibilities of businesses?

2. Why is keeping records of your efforts important when you have a problem with a purchase?

Expository Writing

Think about a few recent shopping experiences. How did you come to learn about your favorite stores' return policies? Were the policies on the back of receipts or on signs by cash registers? Write about how the consumerism movement may have influenced how sellers inform customers about their policies.

Chapter 4, Section 1 (Pages 87–91)

Americans and Credit

Big Idea

As you read pages 87–91 in your textbook, complete this table by listing the advantages and the disadvantages of using credit.

Using Credit	
Advantages	**Disadvantages**

Notes

Read to Learn

Credit and Installment Debt *(page 88)*

Drawing Conclusions

As you read, complete the sentences below.

When a consumer uses a credit card to buy something, the ________ pays the seller at the time of the transaction.

A consumer will pay ________ interest on a 30-year mortgage than on a 15-year mortgage.

In order for a consumer to make a purchase before she has enough money to pay for it, she must receive credit. When consumers receive credit, they get funds from a bank, credit card company, credit union, or seller, to buy goods or services and promise to repay the funds in the future.

When exchanging credit, the consumer and the lender consider three factors: principal, interest, and period (or term). The principal is the amount of money borrowed. Interest is the price of the service of borrowing money. The term of a loan is the period of time a consumer has to repay both the principal and the interest.

After consumers pay for something with credit, they are in debt. The value of a debt equals both principal and interest. A common type of credit is **installment debt,** in which the price of an expensive item is divided into equal smaller payments. One example of installment debt is a car loan.

Each payment includes some interest, so the fewer payments it takes to repay the debt, the less interest will be paid. Consumers buy property, such as a house, with longer-term installment debts called **mortgages.**

Notes

Read to Learn

Why People Use Credit *(page 90)*

Problems and Solutions

What problem does credit solve?

____

____

Evaluating Information

Circle the items below in which buying with credit would be a wise decision. Explain what the items have in common on the lines that follow.

Dinner at a restaurant

Dishwasher

Video-game

Computer

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People use **durable goods,** such as refrigerators, stoves, and washing machines, every day. These items have two things in common. First, they are often expensive to purchase and may cost several hundred or even thousand dollars. Second, most people do not want to wait to purchase them.

Without credit, consumers would have to wait until they saved enough money to purchase these "big-ticket" items. It might take more than a year to save enough money for one of these appliances. Many appliances save time and effort. For example, a big refrigerator allows you to buy more groceries at one time and shop less often. A washer and a dryer in your home allow you to do other tasks while you do the laundry versus going to a Laundromat where you have to wait until your clothes are clean and dry. As a result, people perceive many appliances as a need instead of a want.

With credit, buyers can purchase a good and pay for it over the service life of the appliance. An installment debt for a washing machine allows a buyer to pay a smaller amount of the washer's total price over many months. Each month, the payment includes a part of the original price of the washing machine, plus interest.

Deciding whether to use credit to make a purchase involves carefully comparing the costs and the benefits of using credit. The benefit to the buyer is having the good or the service right away and being able to use it. The cost is the amount of interest the buyer will have to pay in addition to the price of the good or the service being purchased. Interest is a percentage. If the interest rate and the term of the loan are the same, the greater the price of an item and the greater the total cost of credit. The money paid in interest is money that will not be available to the buyer for future purchases, savings, or investments. Consumers must compare the amount of satisfaction and convenience an item will bring with the amount of interest they will pay in addition to the price of the item.

Credit is offered by a variety of lenders. Consumers should comparison shop to find the best loan. It would be a mistake to pay a competitive price for an item and then pay too much in interest.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain why a buyer will pay more for an item by paying for it in 60 installments instead of in 24 installments.

2. What two things should buyers consider when deciding whether to use credit to purchase a good or service?

Persuasive Writing

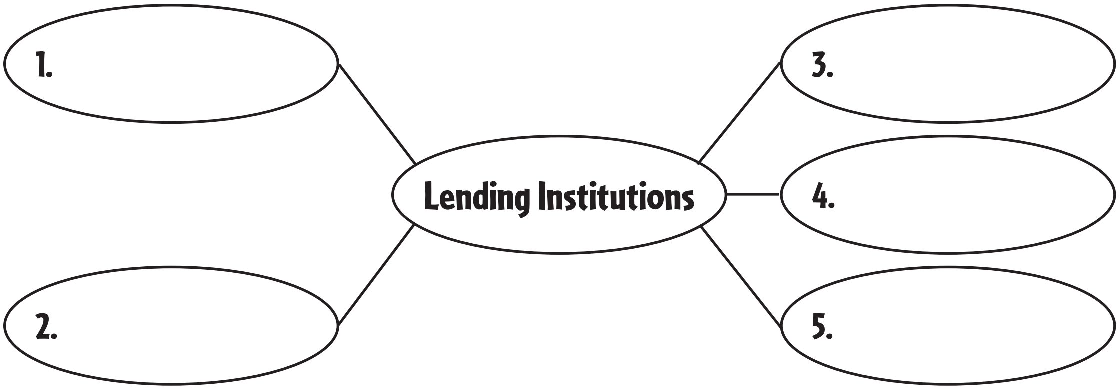
Your friend wants to buy the latest digital camera. She asks you whether she should wait to buy it when she has saved enough money or buy it on credit. The price of the camera is $200. The store offers a payment plan of 24 months with 15 percent interest. Write a persuasive e-mail telling her how she should pay for the camera. Refer to the graphic organizer to help you.

Chapter 4, Section 2 (Pages 92–98)

Sources of Loans and Credit

Big Idea

As you read pages 92–98 in your textbook, complete this graphic organizer by filling in different types of lending institutions.



Notes

Read to Learn

Types of Financial Institutions *(page 93)*

Evaluating Information

If a consumer who has repaid previous loans very late wanted a loan to purchase a car, which financial institution would likely lend him the money?

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Before choosing a lender, a consumer shopping for a loan should compare the requirements, interest, and payment schedules of different institutions. **Commercial banks** offer loans along with a variety of services, such as checking and savings accounts. They control the largest amount of funds. They also transfer, or move, funds among businesses and individuals.

Savings and loan associations (S&Ls) and **savings banks** are similar to commercial banks. S&Ls and savings banks offer mortgage loans and auto loans at a slightly lower interest rate than commercial banks. The other services offered by S&Ls and savings banks vary between institutions.

Union members or company employees can take out loans from a **credit union** to which they belong. Because members own and run the credit union, they can offer a low interest rate.

For some installment debts, consumers can take out loans from **finance companies.** Finance companies manage installment debts for retail stores and may lend money to people who are turned down by other lending agencies. However, they charge higher interest rates than other financial institutions.

Notes | Read to Learn

Charge Accounts and Credit Cards *(page 95)*

Analyzing Information

As you read, compare charge accounts.

1. Regular Charge Account

Advantage: ______________________

Disadvantage: ______________________

2. Revolving Charge Account

Advantage: ______________________

Disadvantage: ______________________

3. Installment Charge Account

Advantage: ______________________

Disadvantage: ______________________

Lenders offer another form of credit that consumers receive before they make a purchase. Credit cards and charge accounts give funds directly to people or businesses without the people or the businesses borrowing the funds first.

Consumers can purchase goods or services from a specific company, such as a store, through a **charge account.** Charge accounts allow consumers to buy goods first and pay for them later. A *regular charge account* requires consumers to pay for all their purchases at the end of each 30-day, or monthly, period. A *revolving charge account* allows consumers to pay only some of the bill after 30 days, but the lender calculates the interest and adds it to the unpaid amount. In the meantime, consumers can continue to charge new items to their account within a set limit. People can purchase expensive items, such as kitchen cabinets or a home theater system, with an *installment charge account.* As with installment debt, people make equal payments over a set period of time.

Credit cards are similar to charge accounts, but they can be used at many different types of stores and even at restaurants. Consumers can use the cards, such as Visa or Mastercard, to pay for purchases or to borrow funds up to a limit set by the credit-card company. Credit cards give consumers access to borrowed funds without having to apply for a loan. Debit cards are not the same as credit cards. Debit cards allow consumers to use money directly from their bank accounts, rather than loaned funds.

Finance Charges and Annual Percentage Rates *(page 97)*

Formulating Questions

Before you read, write two questions you hope will be answered by the passage.

1. ______________________

2. ______________________

Both the finance charge and the annual percentage rate are the cost of the service of borrowing funds. However, lenders express each one in different ways.

The **finance charge** is the cost of credit expressed in dollars and cents. Charge accounts may use the previous balance, the average daily balance, the adjusted balance, or the past-due balance to determine how much to charge for the cost of credit. This means finance charges vary a lot from one lending institution to another, depending on how the lender arrives at the amount to charge.

The **annual percentage rate** (APR) is a percentage, such as 15 percent. It is the yearly cost of borrowing, regardless of the amount of funds. Since it is a percentage, consumers can easily comparison shop for a credit card by seeking the lowest APR offered.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Describe three reasons why consumers might prefer a credit card to a charge account.

2. Why should consumers compare finance charges and interest rates offered by different financial institutions?

Expository Writing

Compare and contrast factors that consumers should consider when choosing credit lenders for buying clothes versus choosing credit lenders for buying a house. Consider types of credit as well as types of financial institutions.

Chapter 4, Section 3 (Pages 99–102)

Applying for Credit

Big Idea

As you read pages 99–102 in your textbook, complete the chart below by listing the steps for obtaining credit and borrowers' responsibilities.

Obtaining Credit		Responsibilities
•		•
•	→ Becoming a Borrower →	•
•		•
•		

Notes

Read to Learn

Will You Be Able to Get Credit? *(page 100)*

Evaluating Information

Number each consumer 1–3, according to credit rating, 1 for highest and 3 for lowest.

____ Derrick has been unemployed twice in the past six years.

____ Juanita has paid her student loans on time.

____ Lee has made ten late payments on five credit cards.

Consumers seeking credit usually fill out a credit application, which allows a lender to gather information about a consumer. Lenders want to know a consumer's creditworthiness, so they can predict whether a consumer will repay the loan.

To determine a borrower's creditworthiness, lenders hire a credit bureau to investigate the consumer. This investigation is called a credit check. It includes information about a consumer's income, current debts, past debts, and details about his or her life. The investigation results in a credit rating of good, average, or poor. The credit rating tells lenders how much of a risk they face if they give credit to a particular individual or business.

Lenders also look at consumers' *capacity to pay* back the debt, *character,* and *collateral.* Collateral is the consumer's capital, or personal wealth, that can be used to pay off a loan.

Collateral may be something of value the borrower owns, or it can be the item purchased with credit, such as a car or a boat. Loans based on collateral are **secured loans.** An **unsecured loan** is not backed by collateral and may have higher interest rates because the lender's risk of not being paid back is greater.

Notes	Read to Learn

Responsibilities as a Borrower *(page 102)*

Synthesizing Information

The lower your credit rating, the ________ the number of lenders that will give you credit and the ________ the cost of credit will be.

Making Inferences

How can lenders benefit when consumers only pay the minimum payment?

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Consumers who borrow funds are responsible for repaying their debts on time. Debts that are not paid on time will hurt a consumer's credit rating and ability to borrow funds in the future. A poor credit rating will affect a consumer's ability to get credit for years. Bad credit may make it difficult to borrow funds for a new car, a home, or even a school loan.

If lenders are not paid back, their funds are lost. To recover the money from consumers who don't pay, the lenders may hire a collection agency. The cost of hiring a collection agency and of lost funds are paid by other consumers through high interest rates.

Responsible consumers keep a record of all the credit they use, how much they have repaid, and how much they still owe. This is particularly important with credit cards and charge accounts. As with most types of credit, consumers receive a bill only once a month that tells them how much they owe. If consumers do not keep track of how much they charge each week, they may charge more than they can afford to repay in a timely manor. When a credit card is lost or stolen, a consumer is responsible for immediately calling the financial institution that issued the card. Credit-card companies must alert stores as soon as possible not to accept the stolen card to prevent fraudulent charges. The cost of fraudulent charges is also paid by consumers through high interest rates.

When consumers borrow more than they can manage, they might only pay the minimum payment. The minimum payment might only cover the cost of credit. In order to pay back the principal and interest, consumers must carefully compare the cost of each debt and repay the debt with the highest interest rate and/or finance charges first. They must also pay more than the minimum payment, or it may take years to repay the debt in full.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain why a financial institution might charge higher interest rates for an unsecured loan than a secured loan.

2. What are two responsibilities that borrowers have when they borrow or buy on credit?

Persuasive Writing

Write a letter to a family member or a friend asking for a small loan. Describe the amount of the loan, what it will be used to purchase, why you need the item, how you will pay the loan back, and why you are creditworthy.

Chapter 4, Section 4 (Pages 104–107)

Government Regulation of Credit

Big Idea

As you read pages 104–107 in your textbook, complete this graphic organizer by filling in some of the ways government regulates credit.

Government Regulation of Credit
↓
↓
↓

Notes

Read to Learn

Laws Protecting Borrowers *(page 105)*

Making Inferences

What do the federal and state laws imply about some lenders' behavior?

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Both consumers and lenders have many responsibilities when they make an agreement. Lenders have the responsibility of following both federal and state laws. The **Truth in Lending Act** requires creditors to inform borrowers of all the costs and conditions of the loan or credit. When a lender's policies change, the lender must keep all borrowers informed of any changes to the cost or conditions of the loan. Another federal law is the **Equal Credit Opportunity Act.** It prevents lenders from denying credit unjustly. It states that a lender cannot refuse a borrower because of that person's race, religion, nationality, gender, marital status, or age. State lawmakers are also watchful of lending practices. State laws protect consumers through **usury laws** that control some of the costs of borrowing**.** These laws limit the rate of interest for some types of credit.

Notes | Read to Learn

Personal Bankruptcy *(page 106)*

Problems and Solutions

What is the first step to avoid bankruptcy?

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Drawing Conclusions

As you read, underline the facts that support the following conclusion:
A consumer who only owes money to the government for student loans and unpaid taxes will not benefit from filing for bankruptcy.

A consumer can take out many forms of credit, such as credit cards, car loans, and a mortgage. Consumers don't always remember to take into account the total cost of these forms of credit. Some consumers do not record purchases made with credit cards. As a result, their monthly bill is more than they expected. Some consumers think that a financial institution will not lend them more credit than they can comfortably repay. However, credit-card companies, for example, often raise the debt limit of consumers who tend to keep a balance on the card. Credit-card companies make more revenue from consumers who do not repay their total debt each month than from consumers who do. It is fairly easy for consumers to take out too much credit and not be able to meet all their financial obligations.

Consumers who have no means to pay their debts can go to court to file for personal **bankruptcy.** Filing bankruptcy allows the court to step in to find a way to pay some amount to the creditors and relieve a consumer's debt. However, filing bankruptcy is a serious step that will affect that consumer's finances for years to come.

Bankruptcy doesn't mean that the court pays the consumer's debt. Instead, the court looks at the consumer's assets—including their home, car, and personal belongings. The debtor gives up most of his assets, which are sold to generate money to help pay back and cancel the debts.

A portion of the money raised is given to each creditor and the debt is cancelled. It is not usually enough money, however, to repay the amount the consumer would have paid if bankruptcy had not been filed. Bankruptcy is a court proceeding that becomes part of the public record. It also goes on a person's credit history for ten years. During that time, creditors may not want to lend the consumer any funds. They do not want to risk the consumer's not paying back the debt. Also, some debts are not cancelled through bankruptcy. Debts from taxes owed to the government are not cancelled and still must be repaid by the consumer.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What does the government hope to prevent by requiring that financial institutions give consumers all the terms and conditions of credit?

2. What effect does bankruptcy have on a consumer's ability to buy a new car five years after filing for bankruptcy?

Persuasive Writing

An older friend has a lot of debt, and she only works part time. She tells you it is the banks' fault for lending her too much money. She asks you if she should file for bankruptcy, instead of getting a full-time job. Write her a persuasive letter explaining why bankruptcy should be her last option.

Chapter 5, Section 1 (Pages 113–117)

Shopping for Food

Big Idea

As you read pages 113–117 in your textbook, complete this graphic organizer by filling in the benefits and the costs of the money-saving habits discussed in the section.

Shopping for Food		
Habit	**Benefit(s)**	**Cost(s)**
Comparison shopping		
Using club warehouse stores		
Using convenience stores		
Buying store brands		
Using coupons		

Notes

Read to Learn

Comparison Shopping *(page 114)*

Making Inferences

How does the price of gasoline affect comparison shopping for food?

It is as important to comparison shop when buying food, as it is when buying something expensive like a digital camera. This is because over the course of a year consumers spend a lot of their income on food. To comparison shop, consumers consider the brands, sizes, and prices of different products before they buy. This helps them decide what to shop for and also where to buy it.

Regardless of the price of the items, comparison shopping should always be worthwhile. For example, suppose a shopper decides to drive one hour away from home to buy produce at a lower price. The value of the two hours spent driving and cost of gas might be greater than the few dollars saved. In that case, it is probably not a worthwhile trip. If a consumer needs to buy milk and eggs, she might choose a supermarket ten miles away over the more expensive general store one mile away because it is worthwhile to drive farther to the supermarket in order to save five dollars. As you have already learned, time has an opportunity cost. The greater the amount of time a consumer spends comparison shopping for food, the less time he or she will have to do other tasks.

Notes | Read to Learn

Trade-Offs in Stores *(page 115)*

Synthesizing Information

As you read, complete the sentences.

Use a convenience store if

____

is scarce and you need only a few items. Use a club warehouse store if

____

is scarce and you need a large quantity of a few items.

Problems and Solutions

How does unit pricing help consumers?

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Detecting Bias

Do you think grocery-store owners use discount cards only to reward loyal customers? Explain.

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Most Americans shop for food in grocery stores or in **club warehouse stores.** Club warehouse stores offer lower prices than grocery stores, but they carry fewer brands and items and most of the food items are sold in large quantities. A consumer who buys a package of 24 cans of tuna fish spends more money in total than he or she would have spent by buying one can at the grocery store. The trade-off in buying 24 cans at once is that the money cannot be used to buy anything else.

Sometimes, a consumer may want to shop at a **convenience store,** such as a 7-Eleven, the Circle K, or the Wawa. Consumers are tempted to shop at convenience stores because the stores are usually on the consumers' route and open 16 to 24 hours a day. They carry fewer items than grocery stores, however, and their prices are higher.

Most food stores carry items with national brand names. Some also carry regional brands. Supermarket chains and club warehouse stores also sell their own store-brand products, or **private-labeled products,** which are less expensive. However, there is often a trade-off between quality and price. Consumers can save even more by buying items such as rice or flour in bulk. Bulk items are sold loosely—the consumer can take as much or as little as he or she wants.

Generally, the larger the amount of a product the lower per-unit price. To help consumers compare prices of products offered in different quantities, most states require stores to provide unit pricing. For example, a unit price on a package of chicken tells how much the chicken costs per pound. With this information, consumers can easily compare the prices of different quantities and of different brands of chicken.

Another way to shop wisely is to redeem manufacturers' cents-off coupons. However, there is a trade-off in using coupons because it takes time to collect coupons and match them to items as the consumer shops. Also, coupons can tempt consumers to spend more money on products that they would not usually buy.

Most grocery-store chains issue store discount cards. Store owners say that the discounts reward loyal customers who use the cards. But some consumer groups claim that the loyal customers actually pay the usual price while others pay a higher price. The store owners also use information from the cards to keep track of customers' spending. That information helps the stores figure out what to offer for sale and at what price. Many people believe that tracking such information is an invasion of privacy.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What should a consumer consider before comparison shopping?

2. In terms of cost, describe the differences among bulk items, national brands, and private-labeled products.

Descriptive Writing

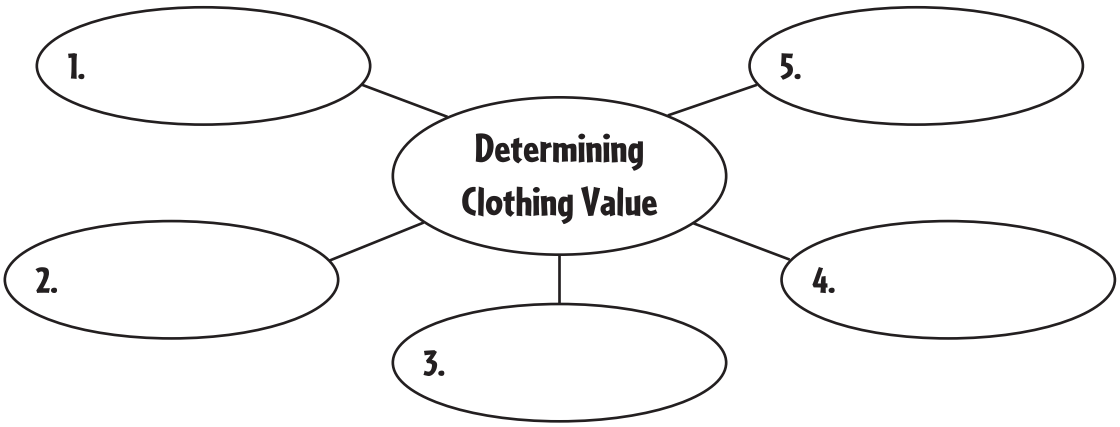
Write a short story that illustrates how comparison shopping is sometimes NOT worthwhile.

Chapter 5, Section 2 (Pages 119–123)

Clothing Choices

Big Idea

As you read pages 119–123 in your textbook, complete this graphic organizer by filling in the factors discussed in this section that determine clothing value.



Notes | Read to Learn

Comparing Clothing Value *(page 120)*

Drawing Conclusions

As you read, underline the facts that support the following conclusion.

Department stores closely track the latest fashion trends.

Comparison shopping for the best price is an important part of buying clothes. Clothing value also depends on at least three other factors: style, durability, and cost of care.

Clothing styles and fashion trends change often, especially for teens and young adults. To meet the demand, department stores carry trendy clothes at reasonable prices. Some also have lower-priced store brands that follow national trends. Cost is not the first thing all consumers think about. Some people will pay more for designer-label clothing, such as Nike, because of the consumers' personal tastes.

Durability may not be a factor when buying trendy items. Durability is the ability of an item to last. It affects the **service flow** a consumer gets from any clothing item. Service flow is the amount of use a person gets over time and the value placed on the use. A coat that will last four years and costs $200 has a cost of $50 for its yearly service flow.

Consumers should also consider cost of care. A jacket that must be dry-cleaned will cost more over time. A jacket that must be hand washed costs more in terms of time.

Notes | Read to Learn

More for Less *(page 122)*

Formulating Questions

Before you read, and based on the title of this section, write a question that this section will answer.

Distinguishing Fact from Opinion

Is the following sentence a statement of fact or of opinion? Explain your answer.

However, every consumer should still look for ways to save on clothing.

Identifying the Main Idea

Underline the main idea of the last paragraph.

The real cost of clothing has dropped a lot over the years. A good suit cost about $40 about 70 years ago. It took the average consumer almost 80 hours to earn that amount of money. But even though a good suit costs around $500 today, it costs the average worker the equivalent of just 40 hours of work. Thus, today the cost of clothing is a smaller part of the average consumer's budget. However, every consumer should still look for ways to save on clothing.

One way to save is to shop at *consignment stores* that sell used clothing at lower prices than new clothing costs. These stores have become more popular with consumers in the past two decades because they can often find trendy clothing at low prices. Consumers can also bring their used clothing to a consignment store. The store will then give that person cash or a store credit. The credit will usually be a higher amount than any cash that is paid because the store wants to encourage the consumer to return and shop at the store.

Sales are another way to save on clothing. Major department stores have frequent clothing sales to move their merchandise. Big sales are often held on and around major holidays because stores believe that people will not be working and will have more time for shopping. Stores also hold seasonal sales. For example, at the end of summer, a store may have a big sale on shorts and bathing suits. It wants to get rid of that merchandise and make room for fall and winter clothes. Consumers can save a lot by planning ahead and taking advantage of both holiday and seasonal sales.

Since there are thousands of clothing Web sites, consumers may also save by shopping online. They can enter "discount clothing" in any search engine to find a great many deals on clothes. Shopping online also has its disadvantages. Shoppers cannot try on the clothes, and sometimes it is hard to judge the quality of the items.

With so many ways to save, however, consumers must be careful not to become bargain fanatics. Those are people who buy things they do not need—simply because the items are low priced or on sale. To avoid this trap, a consumer should make a list before shopping for clothes. The list may help the consumer to stay within spending limits.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How does personal taste affect a consumer's choice of clothing purchases?

2. What are three ways that a consumer can save on the cost of clothing?

Expository Writing

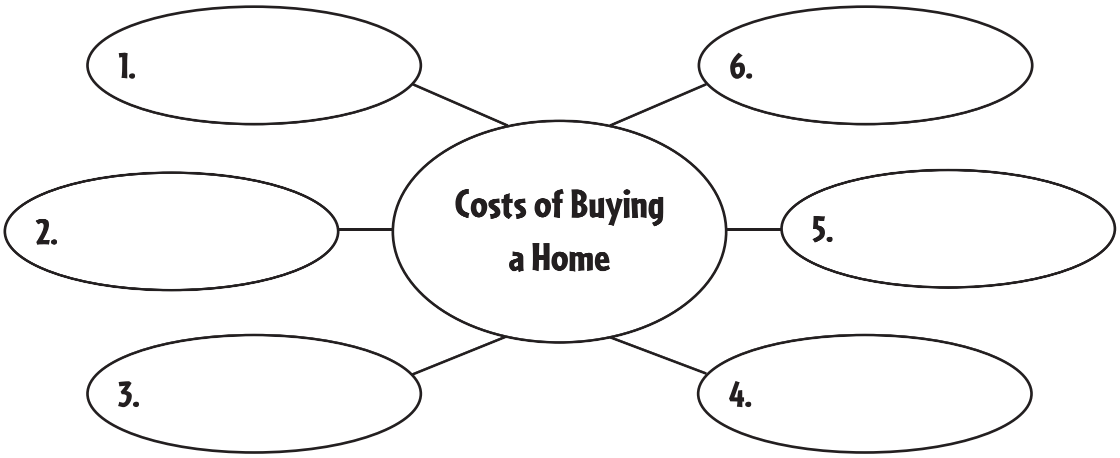
Compare and contrast the factors you should consider when you purchase a more-expensive piece of clothing that should last for some time, such as a winter coat versus a trendy piece of clothing, such as a T-shirt.

Chapter 5, Section 3 (Pages 124–129)

To Rent or to Buy

Big Idea

As you read pages 124–129 in your textbook, complete this graphic organizer by filling in the major costs involved in buying a home.



Notes | Read to Learn

Should You Rent or Buy? *(page 125)*

Making Generalizations

As you read, complete the following sentence. Underline the facts in the passage that support your answer.

People with low incomes will

____

rather than

____

a house.

The cost of housing takes up one-fourth to one-third of an average American family's income. Therefore, the advantages and disadvantages of renting or buying a home should be carefully considered.

People often rent an apartment or a house when they are first starting out on their own. There are many reasons for this. Buying a house requires a large down payment. It may be tens of thousands of dollars. Renting an apartment usually requires only a security deposit and one or two months' rent at first. In addition, renters do not have to pay real estate taxes or the cost of maintaining the apartment. Renters also have more freedom to move when they want to—they do not have to worry about selling their home before they move.

Sooner or later, however, many people choose to buy a home. Home buyers have many incentives. Home owners receive income tax benefits. In addition, houses build up *equity*—the market value of the property less the amount of the mortgage that remains to be paid. Owning a home can also be a good investment because houses often *appreciate,* or go up in value.

Notes | Read to Learn

Renter Rights and Responsibilities *(page 126)*

Analyzing Information

As you read, complete the sentence below.

A renter's payments to a landlord include

____

____

____________________.

A person who rents a home most likely was asked to sign a **lease,** or contract. A lease contains many terms that describe the renter's rights and responsibilities. Renters should read leases carefully to understand them. Most leases are for one to three years and limit how the property may be used. Landlords usually require renters to pay a **security deposit.** Landlords hold these funds to use if tenants do not pay the rent or damage the property. The amount returned when a tenant moves out depends on the property's condition and cleanliness.

A tenant's rights include the use of the property for the purpose stated and the right to privacy. Responsibilities include timely payment of the rent, reasonable care of the property, and notice to the landlord if repairs are needed. If the tenant wants to move before the lease is up, the tenant must give *notice,* or a formal warning in writing. The landlord may ask for rent to cover the period the property is empty.

Landlords must provide services such as hot water, maintain the property so that it is fit to live in, follow building safety laws, and make repairs in a reasonable time. In many states, a tenant may make repairs and withhold the cost if the landlord fails to make repairs.

Purchasing a House *(page 128)*

Drawing Conclusions

As you read, complete the sentence below.

In order to compare the cost of mortgages from different lenders, home buyers must consider both the ______ and the ______.

There are many costs in buying a house. Generally, no more than a third of a person's income should be spent on mortgage payments and other costs. Obtaining a mortgage is a major challenge. The difference between the selling price and the down payment must be covered by a loan. Homeowners repay the mortgage monthly, with interest, to the lender. The mortgage payment also often includes property taxes, homeowner's insurance, and mortgage insurance.

Closing costs must also be paid at the time of purchase. These are costs—such as fees for the title search, loan application, and legal costs—involved in getting the mortgage and transferring ownership of the property.

Another cost is **points,** the fees paid to the lender. Each point equals one percent of the amount borrowed. Lenders charge points to cover their costs and to ensure a profit when they believe interest rates for loans are low, or waive points when interest rates are high. Home buyers should try to reduce or eliminate points during discussions with lenders.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why should a person carefully read a lease before renting an apartment?

2. How does the amount of a down payment affect the mortgage a buyer must obtain to purchase a house?

Informative Writing

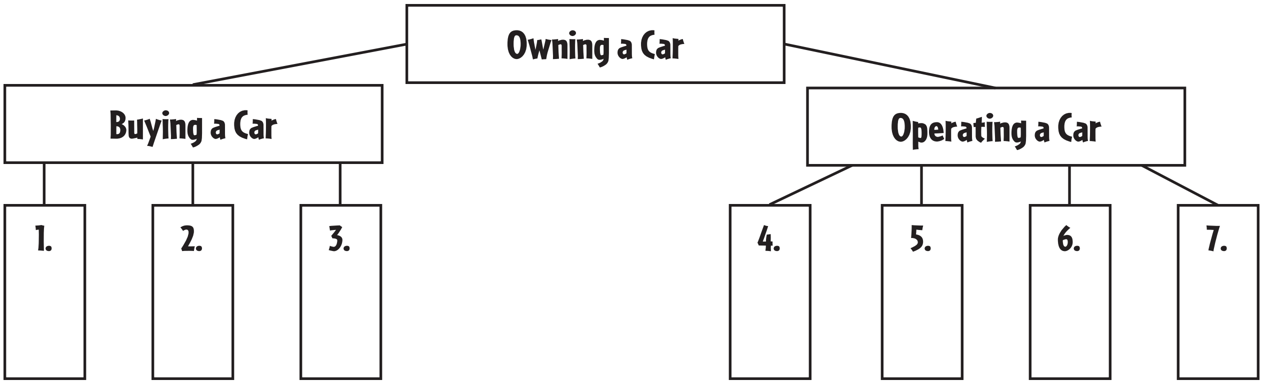
Explain why it is important that consumers carefully plan how much their mortgage payment will be each month. Include how this consideration might affect consumers' decision to buy a new house or an older house.

Chapter 5, Section 4 (Pages 130–133)

Buying and Operating a Vehicle

Big Idea

As you read pages 130–133 in your textbook, complete this graphic organizer by filling in the costs involved in buying and operating a car.



Notes

Read to Learn

Buying a Car *(page 131)*

Evaluating Information

As you read, complete the sentence below.

If you pay ______ when you purchase a used car, it is a wise decision because you will not have to pay the costs of a ______.

Several things should be considered when buying a car. There is the money and the time spent comparing makes, models, and prices of cars, as well as the money and the time spent buying the car. Also, most people need a loan to buy a car. The costs of the loan consist of the down payment, the monthly payment on the principal, and the interest.

First, a person must decide whether to buy a new or a used car. New cars cost more but generally cost less to repair for the first several years. When buying a used car, the consumer should examine the car's repair history and condition before making a decision.

Car owners must pay a state licensing fee, or **registration fee,** to operate the car. Usually, states collect the fee each year.

Except for tune-ups and damage from improper use of the car, warranties for new cars generally protect owners for all major repairs. The warranties usually last a few years or up to a certain number of miles or kilometers. Moreover, buying extended warranty coverage is one way to prevent paying for major repairs after the new-car warranty has expired.

Notes | Read to Learn

Operating a Car *(page 132)*

Comparing and Contrasting

What is the main difference between normal maintenance and major repairs?

Making Inferences

Why do some states require that drivers purchase liability insurance?

Determining Cause and Effect

How does where you live affect your automobile insurance rate?

The costs of operating a car include gasoline, normal maintenance, major repairs, depreciation, and insurance. Examples of normal maintenance are oil and filter changes, battery or spark-plug replacement, and minor tune-ups. How often a car needs these repairs depends on how often and for how many miles you drive the car. It also depends on how well you take care of the car. Major repairs, on the other hand, are usually unexpected and expensive. Such repairs might be replacing antilock brakes or repairing major body damage. To reduce the chances of needing major repairs when you shop for a car, you should research the repair records for different makes, models, and years. When buying a used car, you should first have it checked at a diagnostic center or by an independent mechanic.

Another operating cost is *depreciation.* Depreciation is a decline in value over time as the car wears out. Even a car that sits in a garage and is never driven loses value over time. That is because a car is a durable good, and all durable goods get worse as they age. The amount of depreciation caused by using the car depends on how much you drive the car, the condition of the roads you frequently use, and how well you care for the car. In general, a car's rate of depreciation is 20 percent each year. The technology and the features of newer cars also cause depreciation because they make older models outdated.

Insurance is another major cost of owning a car. Many states require that buyers purchase **liability insurance** before the states will issue licenses. In case of an accident, liability insurance pays for bodily injury as well as property damage. Insurance companies put drivers into different categories based on criteria such as age, gender, and marital status. The price, or rate, you pay for insurance depends on the category into which you fit. The companies base the categories on statistics that show accident rates for the different categories of drivers. For example, because young people and new drivers have more accidents, they generally pay higher insurance rates.

Other factors that affect insurance rates include the safety record of a car model and the cost of repairing it; the rate of thefts and accidents in the area where the car is driven; what the car is used for; marital status (married men and women have fewer accidents); the driver's safety record; grades (some companies give lower rates to teenage drivers who have good grades); and the number of drivers who use the car. Even though many factors affect insurance rates, rates cannot vary too widely. That is because states limit the rates that insurance companies can charge.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the cost advantage to the buyer of purchasing a new car instead of a used car?

2. What is the difference between normal maintenance and major repairs? What steps can you take to prevent major repairs?

Persuasive Writing

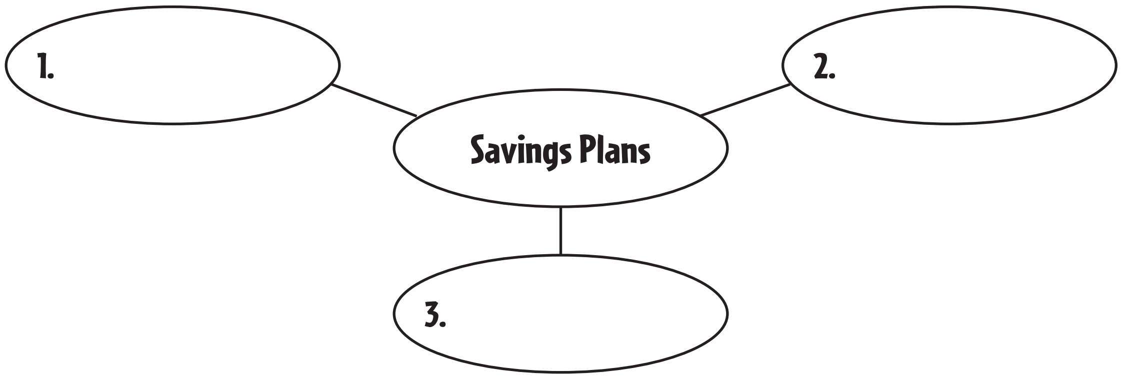
Write a letter to your parent or guardian to convince him or her that you are ready to get your driver's license and use the family car. Explain how you will use and maintain the car in a responsible manner; include how this behavior will affect the family's insurance rates.

Chapter 6, Section 1 (Pages 141–145)

Why Save?

Big Idea

As you read pages 141–145 in your textbook, complete a web diagram below by identifying the different types of saving plans discussed in the section.



Notes

Read to Learn

Deciding to Save *(page 142)*

Making Inferences

Does the economy benefit if an individual puts his or her savings in a safe instead of a savings plan? Explain why or why not.

____

____

____

____

Saving means setting aside income for a period of time so that it can be used later. When an individual saves money in a financial institution, the individual and the economy both benefit.

Many people save in order to gather funds over time for large purchases. When people save money in savings plans, they earn **interest.** Interest is the payment people receive when they lend funds, or allow someone else to use their funds. The amount of interest differs among varying types of savings plans.

Saving also benefits the economy as a whole. Saving money at a bank provides funds for the bank to lend to individuals or to invest in firms. When banks lend money to businesses so they can expand, those businesses may create jobs, raise wages, or lower prices. As a result, businesses raise the standard of living.

People can choose to save their money in commercial banks, savings and loan associations, savings banks, or credit unions. Different institutions offer different savings plans with different benefits and drawbacks. Individuals consider the trade-offs of different savings plans when choosing how to save.

Notes

Read to Learn

Savings Accounts and Time Deposits *(page 143)*

Analyzing Information

Based on information in the passage, list three factors that affect interest rates on different kinds of savings plans.

1. ____________________

____

2. ____________________

____

3. ____________________

____

Making Generalizations

Name the savings plan that is the best fit for each situation below.

1. ***College student who needs regular access to savings to buy clothes and books:***

____

____

2. ***Retirement account when owner does not need regular access to savings:***

____

____

Savings accounts, money market deposit accounts (MMDA), and time deposits are different savings plans with different trade-offs. **Savings accounts** allow consumers immediate access to their funds. Savers can withdraw money from their accounts at any time without paying a fee. The trade-off is that savings accounts earn a small amount of interest.

Like savings accounts, **money market deposit accounts** allow account owners to immediately withdraw their funds. Money market deposit accounts pay higher rates of interest than savings accounts. However, money market accounts have a minimum balance requirement and customers can only write a few checks each month against the account.

Time deposits are savings plans that require savers to leave their funds on deposit for a certain time. The period of time is called the **maturity** and varies from a few days to several years. When a time deposit has reached maturity, the owner can cash it and receive the saved money as well as the stated amount of interest. **Certificates of deposit** (CDs) are also time deposits that 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 savings accounts. The longer the maturity, the higher the interest the bank will pay. Keep in mind that savers who cash a time deposit before it has reached maturity have to pay a penalty.

The U.S. government provides insurance for many savings plans. All deposits in savings accounts at an insured bank—money market deposit accounts, time deposits, and checking accounts—are protected by several government agencies, including the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Association (NCUA). If an insured bank loses its customers' funds, everyone with an account will be paid the full amount of his or her savings up to $100,000 for each account.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why does the federal government encourage people to save by providing insurance for savings plans?

2. Why would someone choose a savings plan instead of a money market account?

Informative Writing

Your parents suggest that you save some of your income from your part-time job now to use as spending money while you are in college. Formulate a savings plan that will earn the most interest and describe it below. Remember you can have more than one account at a time.

Chapter 6, Section 2 (Pages 146–153)

Investing: Taking Risks with Your Savings

Big Idea

As you read pages 146–153 in your textbook, complete the chart below to compare stocks and bonds.

Type of Investment	Definition	When Does It Pay?	Risks
Stocks			
Bonds			

Notes

Read to Learn

Stocks and Bonds *(page 147)*

Synthesizing Information

List one way that stockholders might lose money on their investments.

____

Analyzing Information

Complete this sentence: Two ways that tax-exempt bond owners benefit from their investment are they ________ and ________.

People can invest their savings in a corporation by purchasing shares of stock. These people are **stockholders** and part owners of the corporation. When a corporation is profitable, its stockholders receive a return on their investment, called *dividends.* People also benefit from investing in stock by selling the shares for a higher price than they paid for them, called a **capital gain,** but if the stock is sold for a lower price the loss is called a **capital loss.**

Bonds are another way of investing money. A *bond* is a certificate issued by a company or the government in exchange for borrowed funds. Bonds pay a set rate of interest over a set period of time. When a bond reaches maturity, the company or government repays the borrowed amount in full.

Government agencies borrow money by selling bonds. Local and state governments sell **tax-exempt bonds,** meaning the federal government does not tax the interest earned. The federal government sells **savings bonds,** which are redeemed for twice the value for which they were purchased. The Treasury Department of the federal government issues **Treasury bills, Treasury notes,** and **Treasury bonds,** which all vary in maturity.

Notes | Read to Learn

Stock and Bond Markets *(page 150)*

Drawing Conclusions

Why would a person invest in an index fund instead of a managed fund?

____

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____

____

Evaluating Information

Why don't stock market indexes include every stock on the market?

____

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People can buy or sell stocks through a broker or on the Internet. **Brokers** are agents between buyers and sellers of stocks and bonds, and they earn a fee for their services. Internet brokerage firms charge lower fees than full-service brokerage firms.

Brokerage firms can purchase stock at a stock exchange, such as the New York Stock Exchange (NYSE). Stocks can also be sold in the **over-the-counter market.** The over-the-counter market is for the electronic purchase and sale of stocks and bonds, often of smaller companies, outside the organized stock exchanges.

People can buy or sell bonds over the counter and on the Internet. The New York Exchange Bond Market and the American Exchange Bond Market are the two largest bond exchanges.

Mutual funds are investment companies that pool the funds of many individuals to buy stocks, bonds, or other investments. Losses from some investments are offset by gains from other investments. *Managed mutual funds* are overseen by managers who constantly buy and sell stocks in order to generate the highest total return. They are generally less profitable than *index funds,* which attempt to match the growth of a specific stock index, usually the Standard & Poor's 500. Brokers and stockholders use **stock market indexes** to predict trends in the market by watching what is happening to the price of the stock of a specified list of companies.

Money market funds are mutual funds that make short-term loans to businesses and banks. Most money market funds allow investors to write checks against their accounts. Money market funds are similar to money market deposit accounts (MMDAs). Unlike money market funds, however, the government insures the funds in MMDAs

Government Regulations *(page 153)*

Making Inferences

How can potential buyers use a prospectus to minimize risk?

____

____

____

The Securities and Exchange Commission (SEC) is responsible for administering all the federal laws that regulate the stock market. In reaction to the stock market crash of 1929, Congress formed the SEC in 1934 as part of the Securities Exchange Act. The SEC requires that companies issuing stocks or bonds give potential buyers a statement that lists the amount of stock offered, the price, and the company's projected use of funds, called a *prospectus.* The SEC also monitors any dealings among corporations that affect the value of stocks. In addition to the federal laws on stocks and bonds, states have laws to prevent unfair practices that would take advantage of small investors.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why might financial advisors suggest that investors own both stocks and bonds?

2. How can individual investors buy stocks and bonds?

Expository Writing

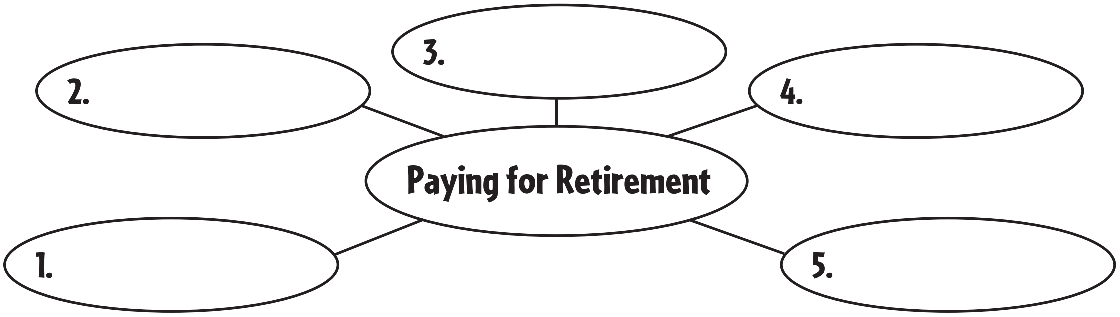
You may have heard the saying "It takes money to make money." Now that you have learned the basics of investing, explain what that saying means.

Chapter 6, Section 3 (Pages 155–159)

Special Savings Plans and Goals

Big Idea

As you read pages 155–159 in your textbook, complete the diagram below by listing five ways to invest for retirement.



Notes | Read to Learn

Investing for Retirement *(page 156)*

Comparing and Contrasting

List one way that 401(k) plans are similar to Keogh plans and one way that they are different.

Same:

____

____

Different:

____

____

Many people invest in their own retirement plans because Social Security only provides a modest income upon retirement. Some people participate in company-supported **pension plans.** One type is a 401(k) plan, in which a portion of a person's paycheck is withheld and the company matches that amount. The **Keogh plan** is a retirement plan for self-employed people. Individuals can save a maximum of 15 percent of their income each year with a Keogh plan.

Another retirement plan is an **individual retirement account (IRA).** The IRA is a private plan that allows people to save a certain amount of untaxed earnings per year. The interest earned on the income invested is taxed when the funds are withdrawn. The **Roth IRA** is a new form of IRA that taxes income before it is saved but does not tax interest on that income when the funds are used upon retirement.

Some people buy real estate, such as land and buildings, as a long-term investment. Buying a home is generally a good investment in the long run. One trade-off of investing in real-estate is that it is not as easy to get cash for property as it is to trade stocks or bonds, or to withdraw from a savings plan.

Notes	Read to Learn

How Much to Save and Invest *(page 158)*

Making Inferences

Why should people pay off debt before beginning to save and invest?

____

____

Drawing Conclusions

As you read, underline the facts that support the following conclusion: As your income increases, you can afford to risk money in investments.

Synthesizing Information

How does owning a variety of investments help decrease risk?

____

____

Like all activities, saving involves a trade-off. Money in savings is not available for immediate spending. However, saving allows people to spend more in the future. Generally, people should pay off debt before beginning to save and invest.

When people save money, they have to choose how much of their savings to risk in investment. Many people choose to save some funds in a savings plan so that it is readily accessible as cash for an emergency. Having access to savings is important when people lose their jobs, become injured, or must take care of a sick family member. Funds that savers deposit in a bank or other financial institution are more secure than funds investors use to buy stocks, bonds, or real estate. People who have very little income cannot afford to lose money through investing. Therefore, they are more likely to put their savings in insured accounts at local banks or to buy U.S. government savings bonds. People with greater income and more savings have greater flexibility to take risks with their savings. Therefore, they benefit from the possibility of greater returns.

Financial planners suggest that people follow the strategy of **diversification,** meaning they should spread out their investments among several different types to lower their overall risk. If one investment loses money, the others may do better. For example, when interest rates rise, the value of stocks may decrease, whereas the return on certain bonds may increase. Mutual funds are an easier way to diversify because some funds own both stocks and bonds.

Different people have different values that may also determine where they invest their savings. People who want to contribute to the development of their communities may choose to put their savings in a local bank that makes loans to community businesses. Other people may choose to invest in stocks issued by socially responsible corporations.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the main difference between company pension plans and IRA's?

2. List two factors to consider when determining how much to save and how much to invest.

Descriptive Writing

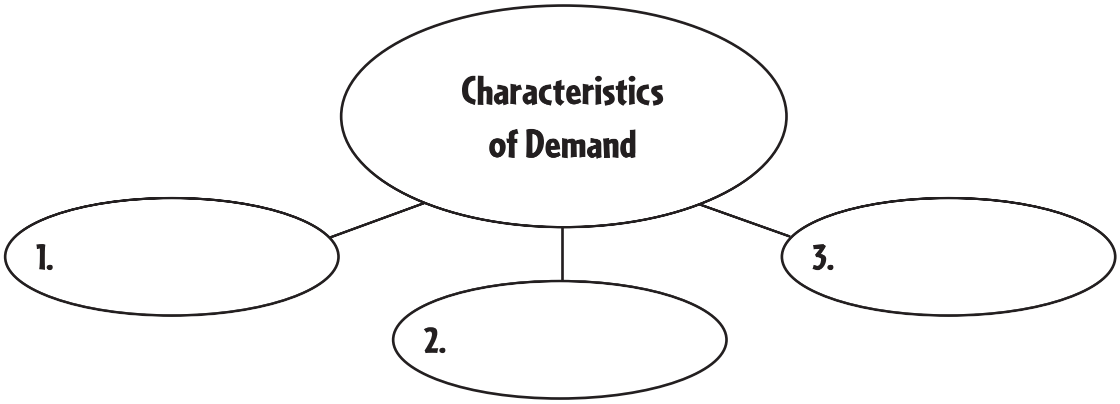
What do you imagine your retirement to be like? In the form of a story, describe where you will live and what you will do. Then try to estimate, in today's dollars, the amount of money you will need each month and each year for 10 years in order to live as you described in your story.

Chapter 7, Section 1 (Pages 169–176)

Demand

Big Idea

As you read pages 169–175 in your textbook, complete this diagram by filling in three factors that affect demand.



Notes | **Read to Learn**

The Marketplace *(page 170)*

Comparing and Contrasting

Think about what factors buyers and sellers consider during a voluntary exchange. Write a list of factors for each in the space provided.

Buyer

____

____

Seller

____

____

A **market** is any place where people come together to buy and to sell particular items. It can be a physical location, such as a supermarket, or a virtual space, such as the Internet. In a larger sense, a market is the unrestricted trade of goods and services between buyers and sellers. In a market economy, the actions of buyers and sellers influence prices. Individual consumers are free to choose what, when, and from whom to buy.

A market economy allows individual sellers to freely choose the number and price of goods to sell. Sellers react to buyers' purchases by changing the price or the quantity in supply; for example, if more people buy a product, then its price will go up. When a buyer and a seller make a transaction to each person's satisfaction, it is called a **voluntary exchange.** A voluntary exchange requires that the buyer and the seller believe they each have something to gain from the transaction.

How do buyers choose how much to pay? How do sellers choose how much to charge? Through supply-and-demand **analysis,** economists study the actions of buyers and sellers that cause and effect changes in price.

Notes

Read to Learn

The Law of Demand *(page 172)*

Predicting

If the price of heating and cooling homes increased and consumers' income stayed the same, how would consumers' behavior change?

___

___

___

Making Inferences

What substitutes might people buy if the price of soda doubled?

___

___

___

Problems and Solutions

Describe one strategy sellers use to offset diminishing marginal utility.

___

___

___

The **law of demand** states that when the price of a good or a service increases, the demand will decrease, and when the price of a good or service decreases, the demand will increase. In economics, **demand** is a value that describes consumers' willingness and ability to buy something at different prices at one period in time. Three economic factors affect the **quantity demanded** of an item that people will buy at a particular price: real income, possible substitutes, and diminishing marginal utility.

All consumers have limited income. Consumers are free to choose how to spend their income. These factors create the **real income effect.** When the price of an item greatly increases and consumers' income stays the same, they must make a choice. For instance, a consumer might choose not to go to the movies if the price of groceries increased. Groceries are a necessity. Going to the movies is a luxury. The real income effect works in the reverse, too. If the price of groceries decreased and consumers' income stayed the same, they might choose to go to the movies more often.

The **substitution effect** occurs when the price of two or more goods that satisfy the same need change. If the price of one product increases, consumers will buy the lowest-priced alternative. Suppose you eat peanut butter and jelly sandwiches for lunch every day. What would happen if the price of jelly went from $2.39 to $8.49 a jar? You might decide to buy honey instead of jelly in order to keep the cost of your lunch the same. If the price of honey also increased, you would look for a less-expensive substitute for honey and jelly.

The **law of diminishing marginal utility** states that the power of a good or a service to satisfy a want decreases with each purchase. **Utility** is the power of an item to meet a need or want. At an amusement park, you may want to ride the roller coaster more than once. With each additional ride on the roller coaster, you have more fun. However, each additional ride is a little less fun than the previous ride. Your total satisfaction, or fun, will increase with each ride of the roller coaster, but the additional satisfaction, or **marginal utility,** lessens with each ride. How would the marginal utility of the roller coaster be affected if the price of each additional ride was 10 percent less than the first ride?

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain how prices are set in a market economy.

2. Keeping the law of diminishing marginal utility in mind, would you predict an increase or decrease in quantity demanded in the same market over time? Explain.

Persuasive Writing

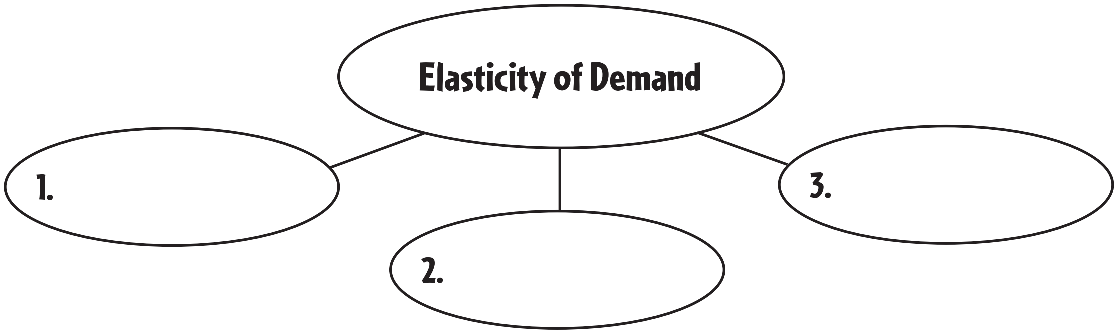
From a seller's point of view, write a persuasive flyer about a luxury item that was recently put on sale, such as a flat-screen TV. The purpose of the flyer should be to persuade buyers that they need the item in order to offset the real income effect of an increase in the amount of money spent on energy.

Chapter 7, Section 2 (Pages 177–185)

The Demand Curve and Elasticity of Demand

Big Idea

As you read pages 177–185 in your textbook, complete the web diagram below by listing factors that contribute to the elasticity of demand for a good or a service.



Notes

Read to Learn

Graphing the Demand Curve *(page 178)*

Synthesizing Information

As you read, complete the sentences below.

Graphs and tables are tools that help economists see ________________.

By recording changes in demand and price, businesses can plot the data on graphs to ________________.

Economists often use tables and graphs to show the relationship between two concepts. The law of demand says that there is an inverse relationship between price and quantity demanded—as price goes down, quantity demanded goes up, and vice versa. The law of demand can be more clearly understood when data is organized in a table or plotted on a graph. A **demand schedule** is a table that lists prices in one column and quantity demanded in another column. Each row in the table shows the demand of a good or a service at a given price.

The same information can be plotted on a graph. The side (vertical) axis of the graph shows the price. The bottom (horizontal) axis of the graph shows the quantity demanded. Each point on the graph marks the quantity of a good demanded at a particular price. Connect the points to form a line called a **demand curve.** The demand curve shows the quantity demanded of a good or a service at each possible price. The demand curve also shows the inverse relationship between price and quantity demanded. With each drop in price, quantity demanded increases, causing the line to slope downward from left to right.

Notes

Read to Learn

Determinants of Demand *(page 180)*

Determining Cause and Effect

For each condition, write L if the demand curve would shift to the left or R if it would shift to the right.

___ ***Increase in population***

___ ***Product becomes a fad***

___ ***Price of substitute drops***

___ ***Price of complement rises***

The points along a demand curve tell us how **quantity demanded** varies with price. When the entire demand curve moves to the right or to the left, it tells us that the demand for a product has changed for some economic reason other than price. These **determinants of demand** include changes in population, income, or consumer preferences. Changes in population or income change the number of people buying goods and the number of goods people buy. Consumer preferences temporarily affect demand as people buy more or less of popular products or fads.

The price and availability of substitutes and complements can also change demand. For instance, when the price of one good increases, people are more likely to choose a lower-priced substitute, thus decreasing demand for the more-expensive good. When two goods are complementary (used or purchased together, such as a printer and an ink cartridge), a price increase of one item would also decrease demand for its complement, even if the price of the complement stayed the same.

The Price Elasticity of Demand *(page 182)*

Making Inferences

As you read, complete the sentences below.

Energy drinks have an ______ demand because they have many ______ and could be considered a ______________.

A steep demand curve indicates that the demand for that product is ______________.

The **price elasticity of demand** tells us how much people react to changes in the price of a good. Demand for an item is **elastic** if a change in its price causes people to change the amount of it they buy. Luxuries have elastic demands. For example, if the price of vacations goes up, people might not go on vacations as often. Products with many potential substitutes also have a more elastic demand. The availability of substitutes increases elasticity because if the price of one good goes up, consumers can buy another good instead.

Demand for a good is **inelastic** when a rise or fall in the price of that good has a very small effect on the quantity demanded. Staple foods or necessities such as medicine have an inelastic demand because people must keep purchasing them, no matter how much they cost.

Another factor that affects elasticity of demand is the percentage of a consumer's total budget spent on a good. When this percentage is small, changes in price are not significant compared with other purchases, making demand more inelastic. Elasticity can also change over time. The more time a consumer has to adjust to a price increase, the more elastic the demand for that good. With time, consumers can make gradual lifestyle changes to decrease their need for one specific product.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What does a demand curve of a product show?

2. Explain why people would probably not buy more salt even if its price were to decrease dramatically.

Expository Writing

Compare how the demand for chalk and the demand for streamers would change at your school if the price of both dramatically increased.

Chapter 7, Section 3 (Pages 186–193)

The Law of Supply and the Supply Curve

Big Idea

As you read pages 186–193 in your textbook, use what you learned in Section 2 and what you read in this section to compare the determinants of supply and demand.

Determinants of Supply and Demand	
Supply	**Demand**

Notes

Read to Learn

Profits and the Law of Supply *(page 187)*

Making Generalizations

Make a generalization about how the profit incentive affects sellers' actions in a market.

____

____

____

Underline the facts in the passage that support your statement.

You learned in Section 1 of Chapter 7 that demand is the willingness and ability of consumers to purchase goods and services at different prices. **Supply** is the willingness and ability of producers to provide goods and services to sell to consumers. The **law of supply** states that there is a *direct* relationship between price and **quantity supplied**—as price goes up, the amount of a good or a service that a producer is willing and able to supply goes up, too. Why are sellers willing to provide more goods and services at higher prices? The profit **incentive** is one motivating factor in a market economy. The goal of a business is to make a profit. The higher the price of a good, the greater the number that producers will want to supply. Selling more goods at a higher price earns more profit and enables producers to cover the costs of producing even more. On the other hand, the lower the price of a good, the less incentive producers have to make more of it, thus reducing the quantity supplied.

Notes | **Read to Learn**

The Supply Curve *(page 188)*

Comparing and Contrasting

List one way that the supply curve is similar to the demand curve and one way that it is different.

Same: ______________

Different: ___________

Just like demand, we can use tables and graphs to show the relationships of supply. A **supply schedule** is a table showing quantities of a good supplied at different possible prices. By plotting the quantities supplied at each possible price onto a graph and connecting the points, you get the **supply curve.** The supply curve shows the direct relationship between price and quantity supplied. Because price and quantity supplied move in the same direction (as one goes up, the other goes up), the supply curve slopes *upward* from left to right.

The Determinants of Supply *(page 190)*

Predicting

What would happen to the supply curve for computers if the number of suppliers increased?

____

____

The points on a supply curve tell us how *quantity supplied* varies with price. A shift of the entire supply curve to the left or the right indicates a change in supply caused by economic factors other than the price of the good. The factors that cause these shifts are called **determinants of supply.** They include the number of firms in the industry, the price of inputs, taxes, and technology.

In a free-market economy, the markets constantly change as sellers enter and leave. The number of firms in the industry impacts overall supply because the more suppliers there are in the market, the more goods they are able to provide, and vice versa.

Inputs, taxes, and technology affect supply by changing the **cost of production,** or how much it costs to make a good. Anything that increases the cost of production causes a decrease in supply, and vice versa.

The Law of Diminishing Returns *(page 192)*

Problems and Solutions

As you read, complete the sentence.

You ______ always increase production simply by ________________.

The **law of diminishing returns** states that the ability of a factor of production to increase the total output decreases with each factor of production added. Factors of production are what go into making a good or performing a service. Total output is the number of goods produced or services performed in a given period of time. If you run an ice cream shop, you might start with two employees. You may increase sales by adding a third employee at peak times. If you hire a fourth or a fifth employee, however, you may not notice as much of an increase in sales. If you kept hiring more employees, at some point your sales would decrease.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain the difference between supply and quantity supplied. How does the supply curve help you visualize the difference?

2. What economic factors, other than price, might prevent a seller from producing enough goods to meet the anticipated demand?

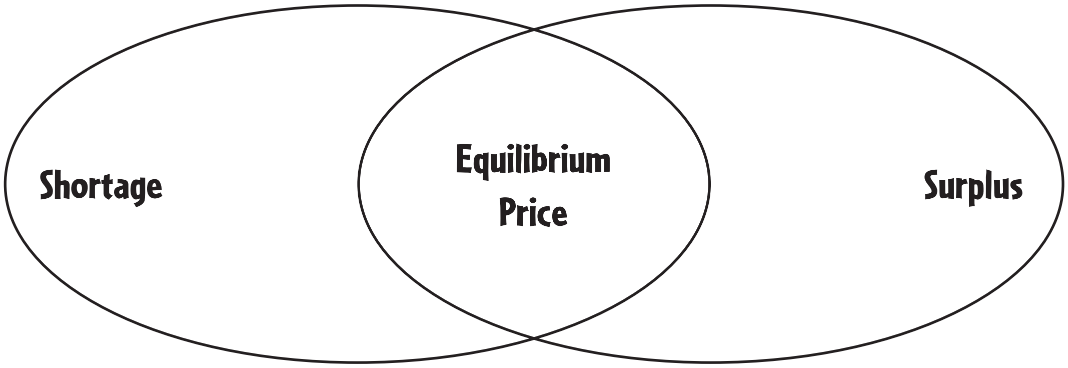
Expository Writing

Suppose you are the product manager for a new electronic talking toy priced at $32.99. Your job is to decide how many of the new toys to produce to sell in November and December. Write a report that explains which determinants of supply and demand would influence your decision and how.

Putting Supply and Demand Together

Big Idea

As you read pages 194–199 in your textbook, use the Venn diagram below to define each economic term listed.



Notes | Read to Learn

Equilibrium Price *(page 195)*

Predicting

Predict whether the equilibrium price would rise or fall.

If supply increases or if the supply curve shifts to the right:________________

If supply decreases or if the supply curve shifts to the left:_______________

Supply and demand always work together in the real world. When the price of a good is too high, there are fewer buyers, so the quantity supplied is greater than the quantity demanded. When a good is priced too low, there are more buyers, so the quantity supplied is less than the quantity demanded. Is there a price at which quantity supplied and quantity demanded are the same? Yes, and it is called the **equilibrium price.** You find it by plotting both the supply curve and the demand curve on one graph to see at which price the two lines intersect.

Any changes in either demand or supply affect the equilibrium price. Recall the major determinants of supply and the major determinants of demand. Any single factor or combination of factors will affect the equilibrium price. For instance, an increase in consumer income would increase the demand for flat-screen TVs, shifting the entire demand curve to the right. The shift would raise the equilibrium price. On the other hand, if producing flat-screen TVs became more expensive, the supply would decrease, shifting the supply curve to the left. This shift would lower the equilibrium price.

Notes

Read to Learn

Prices as Signals *(page 196)*

Synthesizing Information

Setting prices above the equilibrium price increases the quantity of goods ______, creating a ______.

When the market is unrestricted, **market forces** affect the actions of producers and consumers, keeping the supply and the demand in balance at equilibrium price. Prices signal both producers and consumers to change the quantity supplied or demanded. Rising prices signal producers to increase supply more and consumers to decrease demand. Falling prices signal producers to decrease supply and consumers to increase demand. As a result, market forces eliminate both shortages and surpluses.

Surpluses and shortages are created when prices are set above or below the equilibrium price. High prices motivate producers to make more goods and consumers to buy less. This creates a **surplus,** when more goods are produced than are demanded. To reduce surpluses, producers lower their prices to encourage consumers to buy more. Prices set below the equilibrium price motivate producers to make fewer goods while signaling consumers to buy more, causing a **shortage** of goods. The market reacts by increasing prices, which signals consumers to buy less and producers to make more.

Price Controls *(page 198)*

Drawing Conclusions

Consumers might ask the government to set a ______________, while producers might ask the government to set a ______________.

Governments set a price floor usually to ______________

When the market operates without outside limitations, certain groups of people might be disadvantaged. For this reason, the government sometimes finds it necessary to protect consumers or producers by imposing price restrictions. Price ceilings and price floors are two ways that the government can regulate prices. A **price ceiling** is the highest price that can be charged for a product or a service. When price ceilings are set below the equilibrium price, a shortage occurs. Shortages can lead people to seek ways outside the market to purchase a good. This can create **black markets**—where people sell goods illegally at prices above the price ceiling. To reduce shortages, the government may use **rationing** to limit or control the distribution of goods. For example, if there is a shortage of flu shots, only people who need the shots the most, such as children and the elderly, may be allowed to have the shots. A **price floor** is a government-set lowest price. A price floor set above the equilibrium price causes a surplus. The government sets some price floors to protect farmers. When there is a price floor for a particular crop, more farmers will grow that crop than the market demands. However, without a price floor, farmers might not want to grow the crop at all, which may cause a shortage of an important food.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What are the two main market forces? How do they determine the equilibrium price?

2. How might the government reduce a surplus of labor caused by a minimum-wage law?

Informative Writing

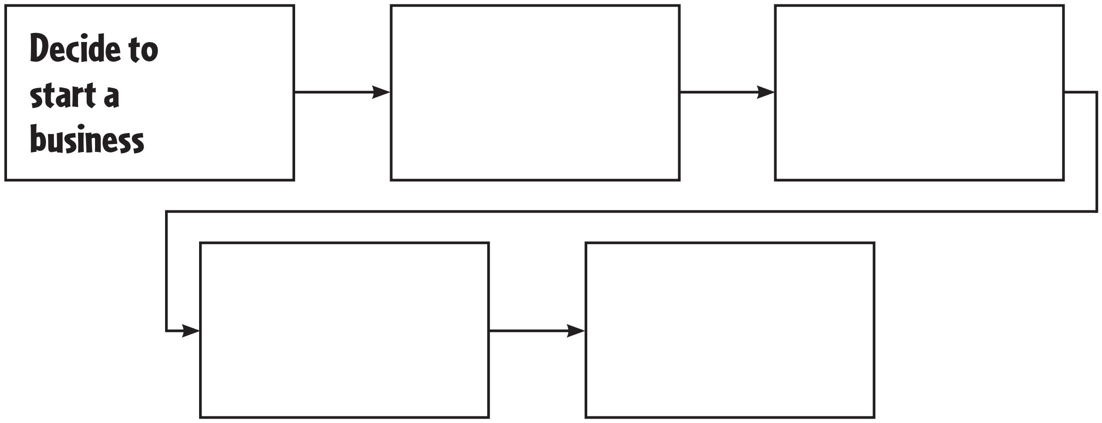
From the point of view of a political candidate, write a short radio address about your plan to stop the increasing costs of electricity. Explain how and why your plan will work.

Chapter 8, Section 1 (Pages 207–212)

Starting a Business

Big Idea

As you read pages 207–212 in your textbook, complete the diagram below by listing the steps a person must go through to start his or her own business.



Notes

Read to Learn

Getting Started *(page 208)*

Synthesizing Information

What kind of information should entrepreneurs gather in order to set prices wisely?

____

____

____

How do people start a business? First, people think of ways to use their knowledge and abilities to provide a product or a service that fills a need or a want. These people are **entrepreneurs.** They are willing to take risks, make decisions, organize, and manage how the business operates. Dreams of big profits, being his or her own boss, or creating something motivate entrepreneurs. For instance, say that you are creative, good at making accessories, and love animals. You decide to start a business making special pet collars.

Once an entrepreneur has an idea, he or she has to turn it into a profit-making business. So your first step is to decide if you are going to be in business on your own, with a partner, or as a corporation. You also need to gather your **factors of production.** What materials or tools do you need to get started?

Entrepreneurs research the market in which they will sell their product, including potential consumers, competitors, and government regulations. Luckily, they can seek help from the Small Business Association, a **small-business incubator,** or even the Internet.

Notes | Read to Learn

Elements of Business Operation *(page 210)*

Comparing and Contrasting

As you read, list one advantage of keeping an inventory and one advantage of buying supplies on an as-needed basis.

Keeping an inventory:

____

____

____

____

Buying as-needed:

____

____

____

____

Problems and Solutions

If you wanted to reach as many people as possible but don't have much money, where would you advertise?

____

____

____

____

____

Every business must manage four important areas—expenses, record-keeping, advertising, and risk. **Expenses,** or cost of running a business, vary depending on the business. For example, to produce pet collars, you might need materials (leather, fabric, buckles, rhinestones, pet tags, etc.) and tools (grommet kit, glue gun, scissors, etc.). You could buy materials only as you need them, or you could keep an **inventory** of extra supplies. Other expenses may include rent, insurance, taxes, utilities, and wages.

An efficient **record-keeping** system allows a business owner to track funds as they flow into and out of the business account. The **receipts** are the *income* that a business takes in from sales. The receipts pay for *expenses,* including the owner's wage and all taxes. The remaining funds are the profit. Today, affordable computer software programs help keep detailed records. The software can create reports that show profits and losses or net worth (the difference between what you own and what you owe). Accurate record keeping is also necessary to do your taxes. The government taxes your *net* business income, which is your total sales income *minus* any legitimate business expenses.

Consumers will learn about your product through **advertising.** When choosing how to advertise, consider both the cost and the type of consumer you are trying to reach. A good choice for your new pet-collar business might be to post flyers around your neighborhood. As the business grows, you might place an ad in a magazine or an online newsletter for pet owners.

All entrepreneurs take **risks.** When people start businesses, they might give up jobs, savings, or further education in the hopes of making more money in the future through wages and profits. Of course, a business's success is not guaranteed. Each dollar and hour invested in a business must be recouped in sales. For example, if you bought enough green leather to make 100 pet collars but only sold 50, the money spent on the remaining green leather could not be used toward other expenses, so it would be a loss.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why do people start their own businesses?

2. Entrepreneurs need to be mindful of which four areas of running a business?

Informative Writing

A new sporting-goods store opened in your neighborhood. The owner is looking for a partner to help with managing the operation of the store. Write a cover letter to the owner that shows your knowledge of starting and running a new sporting-goods store.

Chapter 8, Section 2 (Pages 213–216)

Sole Proprietorships and Partnerships

Big Idea

As you read pages 213–216 in your textbook, complete the table below by listing the advantages and the disadvantages of three common types of business organizations.

Business Type	Advantage(s)	Disadvantage(s)
Sole Proprietorship		
Partnership		
Limited Partnership		

Notes

Read to Learn

Sole Proprietorships *(page 214)*

Synthesizing Information

As you read, complete the sentence below.

An entrepreneur who starts a sole-proprietorship type of business risks not only his or her direct investment in the business but also _______________ in the event of future problems.

A business in which one person is the only **proprietor,** or owner, is called a **sole proprietorship.** This is the most common type of business organization in the United States.

There are many advantages to being a sole proprietor. The owner makes all the decisions, enjoys creative freedom, and directs the growth of the business. A sole proprietor keeps all the profits, and his or her personal taxes are low since the government only applies income tax to the profits.

On the other hand, there are also significant disadvantages to a sole proprietorship. It takes a lot of time and energy to run a business alone. Most importantly, a sole proprietor bears all the responsibility and risk. A sole proprietor faces **unlimited liability.** This means that the owner is personally liable, or responsible, for legal or financial trouble the business might face. For example, if the business lost a lawsuit or could not pay its debts, the owner might lose all his or her personal **assets,** or belongings, including his or her house, car, and savings.

Notes

Read to Learn

Partnerships *(page 215)*

Comparing and Contrasting

1. List one way in which a partnership can be less efficient than a sole proprietorship.

2. List one way in which a partnership can be more efficient than a sole proprietorship.

Drawing Conclusions

As you read, underline the passages that support the following conclusion:

A joint venture exists to accomplish a specific goal.

A **partnership** is a business with two or more owners, or partners. The partners sign an agreement describing their responsibilities, how the profits will be divided among them, and who will get what assets in case the partnership ends.

There are many benefits to forming a partnership. Partners can combine their resources of knowledge, time, and assets. This results in greater borrowing and purchasing power, which allows the business to expand by making investments in tools, employees, property, or equipment. Partnerships can also be more efficient when each partner has a specific talent to contribute. For example, one partner might know a lot about advertising and record keeping, while the other partner might know a lot about production and how to evaluate risk. Making decisions in a partnership can be more difficult, however, because more than one person is in charge.

A partnership is similar to a sole proprietorship in some ways. Each partner in the business is taxed individually on his or her share of the profits and faces unlimited liability on his or her personal assets. There are three specialized types of partnerships and each have their own advantages: the limited partnership, the limited liability company, and the joint venture.

In a **limited partnership,** the liability is split unequally among the partners. There is one partner, called the *general partner,* who takes on most of the risk and all the daily responsibilities of running the business. The other partners, called *limited* partners, contribute money or property to the business but have no control over how it is run. In return, these limited partners share in the profits and enjoy limited liability—they risk losing *only* the assets they voluntarily contribute to the business, not all their personal belongings or property.

A **limited liability company** is a hybrid of a partnership and a corporation. As with a corporation, certain fees, taxes, or paperwork may be necessary. In this organization, *all* the participants (called *members* instead of partners) benefit from limited liability. Unlike a corporation, however, a limited liability company is taxed as if it were a partnership.

A **joint venture** is when two or more businesses temporarily cooperate for the purpose of running a project together. For example, two film companies may form a joint venture to produce a TV show. Like a partnership, both parties contribute money or assets and share in the revenues, expenses, and control of the enterprise. The joint venture ends once the project is completed.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why do you think sole proprietorships are the most common form of business organization in the United States?

2. Why might a sole proprietor take on a partner instead of hiring an employee?

Expository Writing

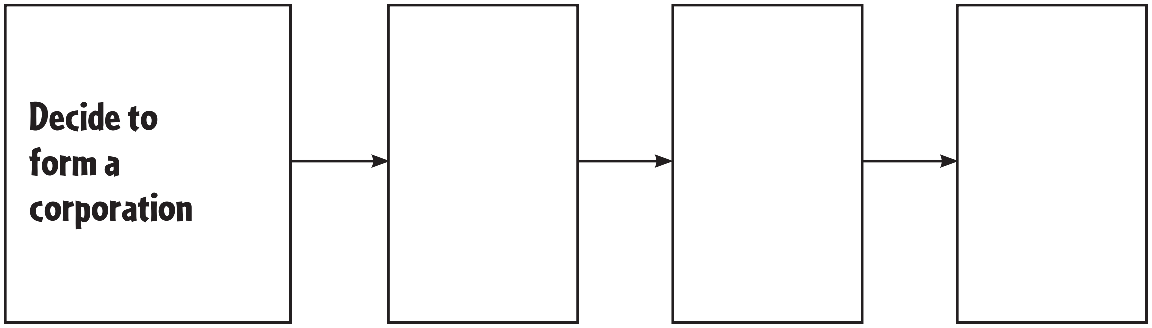
Write a brief article for young entrepreneurs. In it, explain the challenges sole proprietors face when they consider whether to expand their businesses.

Chapter 8, Section 3 **(Pages 218–223)**

The Corporate World and Franchises

Big Idea

As you read pages 218–223 in your textbook, complete the flowchart below by filling in the steps necessary to form a corporation.



Notes

Read to Learn

Corporations and Their Structure *(page 219)*

Synthesizing Information

What is the main goal of forming a corporation?

____

Comparing and Contrasting

Name one advantage and one disadvantage of owning preferred stock.

Pro: _______________

Con: _______________

A corporation is a business organization owned by many people but treated as a separate legal entity. Corporations have substantial growth and profit potential, while protecting its owners from personal liability. A corporation is more heavily taxed than other business structures, and certain requirements must be met.

First, a business owner must **register** the corporation, submitting articles of incorporation, or information about the corporation, to the state in which he or she is *incorporating* (forming the corporation). Specific information varies but usually consists of the name and the purpose of the company, the names of board members, and the amount of capital to be raised through **stock.** The state then provides a license, or **corporate charter.**

Next, the corporation must raise capital by selling either *preferred* stock or *common* stock. Preferred stock guarantees a dividend, while common stock grants voting rights. Finally, you must appoint an initial **board of directors,** whose members are subsequently elected by stockholders. The board oversees the corporation, sets the **bylaws,** and hires its senior officers.

Notes | Read to Learn

Franchises *(page 222)*

Making Inferences

1. ***Why would a franchise business grow faster at the very beginning than an independently owned business?***

2. ***When might the goals of the franchisor conflict with the goals of the franchisee?***

Hotel and fast-food chains are common examples of franchises, which have been very popular in the United States since the 1950s. A **franchise** is a commercial agreement in which the *franchisor,* the existing parent company, grants the rights to sell its products to the *franchisee,* the person or group of people seeking a business opportunity. This usually requires that the franchisee pay an initial fee as well as a percentage of the franchise's yearly profits to the franchisor. In return, the franchisee receives a variety of support from the franchisor.

Franchise owners increase their chances of success and reduce their risk by following a predefined, pretested formula of selling a standardized product or service, sometimes under a well-recognized name. The franchisor provides business expertise, including marketing and advertising plans, management guidance, financing assistance, choosing a location, administrative support, and/or training. In addition, entrepreneurs benefit from advertising paid for by the franchisor.

For example, iSold It on eBay is a franchise. It is a retail store that provides the service of posting and selling things on eBay. The cost of the service provided is a percentage of the total sale of the item. For $85,000, you can open a fully functional store. Some of this franchise's features include specialized software, fast check processing, and easy store construction.

There are disadvantages to opening a franchise, too. Franchise owners cannot run their business however they wish—they can be legally bound by the franchise contract to perform even simple tasks in a very specific way. Both the franchisee and the franchisor can fail to abide by the contract, which can result in legal expenses or problems.

Corporations also benefit from granting franchise rights. The franchisees expand the business while sharing the cost and the risk. Franchises allow corporations to compete in more markets and reach more consumers.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What does a business owner gain and lose by incorporating??

2. Why does a franchise pose less risk than other types of business to entrepreneurs?

Descriptive Writing

Write a short story about what it might be like to work at a franchise restaurant versus an independently owned restaurant. What does the restaurant look like? What do you wear to work? How are you trained? How do your managers treat you?

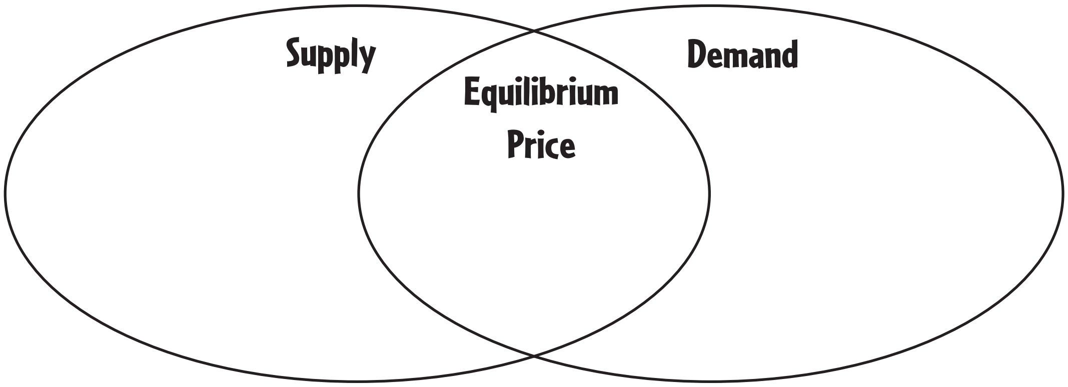
Chapter 9, Section 1 (Pages 231–235)

Perfect Competition

Big Idea

As you read pages 231–235 in your textbook, use a Venn diagram like the one below to explain how the concepts listed affect price under perfect competition.

Prices Under Perfect Competition



Notes | Read to Learn

Market Structure and Perfect Competition *(page 232)*

Formulating Questions

Before you read, write two questions you have about market structure and perfect competition that you think the passage will answer.

1. ____________________

____

2. ____________________

____

In addition to categorizing businesses as a sole proprietorship, partnership, or corporation, businesses can also be categorized by the structure of their markets. The amount of competition a business faces determines its **market structure.**

Perfect competition is one of four types of market structures. It exists when a market includes so many sellers that each one is a small part of the total market. A market must meet the following five conditions for perfect competition to exist: 1) the market is large; 2) the products are almost identical; 3) businesses can easily enter and leave the market; 4) producers and consumers can easily learn about the market; and 5) businesses cannot cooperate to affect prices.

The workings of supply and demand control the prices in a perfectly competitive market, instead of a single seller or buyer. Perfect competition requires a large number of suppliers of a nearly identical product and a large number of buyers who know the market price of the good or service. In a perfectly competitive market, supply and demand are allowed to interact to reach the equilibrium price.

Notes | Read to Learn

Agriculture as an Example *(page 234)*

Analyzing Information

As you read the second and third paragraphs, think about which of the five factors of perfect competition are related to the facts. Label the facts by writing the corresponding number in the margins.

Synthesizing Information

As you read, complete the sentence below.

Perfect competition forces the price to equal the ______ possible price the seller will accept and the ______ the buyer will pay.

Making Inferences

What is the motivation for producers to become as efficient as possible?

____

____

Few perfectly competitive industries exist in the United States. The agricultural market comes close. This market is an example of perfect competition because farmers have almost no control over the market price of their goods.

No single corn farmer, for example, can significantly affect corn prices. The workings, or interactions, of supply and demand set the market price for corn. Farmers must accept the market price. Farmers who raise their price above the market price will not be able to sell their corn. Buyers can easily obtain the market price, and they only want to pay that price for corn. On the other hand, farmers can also obtain the market price, and they do not want to sell their corn for less.

The total demand for many agricultural products is somewhat different from the demand for other products. People's demand for corn is relatively inelastic. This means that even if its price rose or fell, the quantity demanded would not change very much. The supply side of most agricultural markets is also **unique.** The supply of goods such as corn, wheat, and soy beans greatly depends on factors over which farmers have little or no control. These factors include bad weather, insects, and disease.

Perfect competition forces prices to decrease to an amount that equals the production costs plus a small profit. Consumers benefit from this price because they are only paying for what has been put in to make those products—in other words, the opportunity cost of the use of land, labor, capital, and entrepreneurship. The market price of products under perfect competition is an accurate reflection of the value of those products in society.

Perfectly competitive markets reach economic efficiency. Producers use all inputs in the most advantageous way possible—with as little waste as possible. As a result, both consumers and producers enjoy efficient use and distribution of resources.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why do products need to be almost identical in a perfectly competitive market?

2. Why do farmers in a perfectly competitive market have to accept the market price for their products?

Descriptive Writing

From the point of view of a farmer, write a descriptive letter to a friend explaining how you are coping with a natural disaster. Include vivid details about the crops that were lost, the crops you can sell, and if you expect to cover your costs.

Chapter 9, Section 2 (Pages 236–243)

Monopoly, Oligopoly, Monopolistic Competition

Big Idea

As you read pages 236–243 in your textbook, complete this table by describing how much competition the seller faces and how much control over price the seller has in each type of market structure listed.

	Competition	Control Over Price
Monopoly		
Oligopoly		
Monopolistic Competition		

Notes

Read to Learn

Monopoly *(page 237)*

Comparing and Contrasting

Think of the four types of monopolies. In the space below, tell how they are alike and how they are different.

Alike

____

____

Different

____

____

There are three types of imperfect competition: monopoly, oligopoly, and monopolistic competition. A pure **monopoly** occurs when a single seller controls the supply of a good or a service and decides its price. **Barriers to entry,** or obstacles, protect monopolies by making it difficult for competitors to enter the market.

There are four types of pure monopolies: natural, geographic, government, and technological. *Natural monopolies* occur when the government gives exclusive rights to companies that provide things like utilities. These companies are large and have many potential buyers, so they benefit from the **economies of scale.** A *geographic monopoly* occurs when a business is in a small and isolated market. Competitors do not enter the market since the potential profit is also small. A *government monopoly* is when the government itself provides goods or services. Government **patents** and **copyrights** create *technological monopolies* by protecting people and companies from competitors stealing their ideas or selling identical products for a certain number of years.

Notes | Read to Learn

Oligopoly *(page 240)*

Predicting

In the case of a price war, what actions will consumers most likely take?

An **oligopoly** exists when several sellers, who have some control over prices, dominate an industry. Companies set the prices on the basis of **product differentiation** instead of supply and demand. Product differentiation means consumers choose one product over another by the product's perceived or real value versus price alone.

In an oligopoly, companies are interdependent. Whatever one company does, other companies follow. For example, when one seller decides to lower prices, the other sellers lower prices. This action leads to a price war, which is good for consumers. If prices drop too much, however, some companies might go out of business. As companies go out of business, there is less competition in a market, and prices might rise over time.

Sometimes businesses within an oligopoly hope to monopolize the market by acting together like one company. The businesses might decide to decrease production, which would create a shortage, increase demand, and raise prices. When businesses within an oligopoly work together, it is called a **cartel.** Cartels can control the prices, production, and distribution of their products. Cartels are illegal in the United States and punishable by heavy fines and even time in prison.

Monopolistic Competition *(page 242)*

Making Inferences

If there are already many similar products in a market, why would new businesses continue to enter it?

In **monopolistic competition,** there are a large number of sellers who have similar products that are slightly different. This is the most common market structure in the United States. In this type of competition, each business has some control over prices.

Monopolistic competition and oligopoly are similar in many ways. The major difference is that in monopolistic competition there are *many* (instead of a few) producers selling slightly different products.

Advertising is critical to success in this market structure. How do you choose among brands of sneakers, jeans, cereal, and drinks? Brands such as Reebok, Levis, Kellogg's, and Snapple use advertising to build loyalty. They try to persuade consumers that their products are different and better than the others. By building brand loyalty, some businesses are able to charge more for their products.

Some critics argue that advertising makes people spend more on products simply because of brand loyalty. Others insist that brand names ensure the quality of a product. They think advertising is useful in helping consumers compare brands of products.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain the barriers to entry of each of the four types of monopolies.

2. Why is effective advertising important to succeed in the market structure of monopolistic competition?

Persuasive Writing

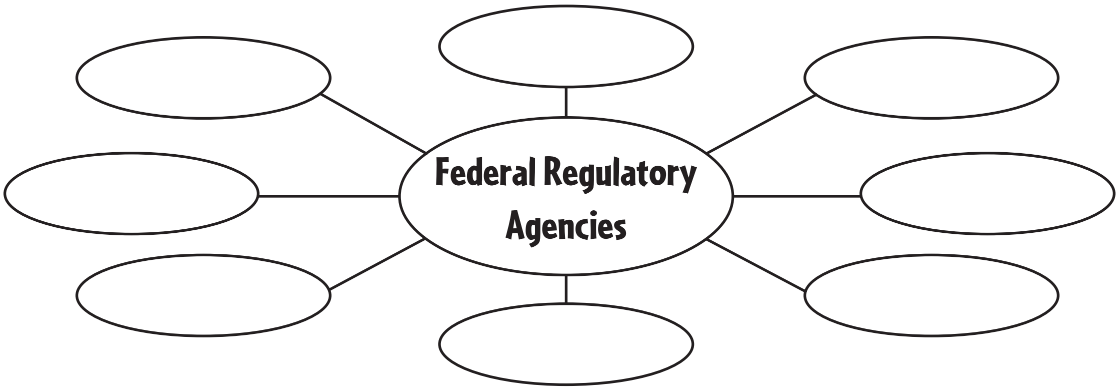
You are a seller of designer jeans for teens in a monopolistic competition market structure. Write a script for a TV advertisement persuading teens that your jeans are the best on the market.

Chapter 9, Section 3 (Pages 245–249)

Government Policies Toward Competition

Big Idea

As you read pages 245–249 in your textbook, complete this diagram by listing examples of federal regulatory agencies.



Notes

Read to Learn

Antitrust Legislation and Mergers *(page 246)*

Analyzing Information

Identify how each type of merger could affect a market in a negative way.

1. Horizontal merger

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____

2. Vertical merger

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____

3. Conglomerate

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____

The United Stated government has historically encouraged competition, including making monopolies act more competitively. In 1890, Congress passed **antitrust legislation** to prevent the formation of new monopolies, or trusts, and to break up existing ones. These laws limit or prohibit specific business strategies that decrease competition. One business strategy, called **interlocking directorates,** resulted in the same people controlling competing companies. Of course, these companies were reluctant to compete with one another. Without competition, a monopoly formed.

Most antitrust laws attempt to limit the negative effects of **mergers.** A merger is when two or more companies combine into one corporation. There are three types of mergers. A *horizontal merger* is one that combines companies that are in the same business. A *vertical merger* combines companies that each have a role in making a product, such as a car manufacturer purchasing a tire company. Another type of merger is the *conglomerate merger.* A **conglomerate** is a huge corporation involved in four or more unrelated businesses.

Notes

Read to Learn

Government Regulation *(page 248)*

Problems and Solutions

Describe one strategy the government uses to protect consumers from unfair business practices.

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Determining Cause and Effect

Regulatory agencies' power over industries has ______ now that the government sees that more regulation does not always result in _______________.

Along with antitrust laws to encourage competition, the United States government uses direct regulation of business to monitor pricing and product quality. The government monitors businesses through regulatory agencies that are responsible for specific industries or business practices. The Federal Trade Commission oversees product warranties, advertising, and competition in interstate commerce. The Food and Drug Administration monitors the safety and purity of foods, drugs, and cosmetics. The Federal Communications Commission regulates the communication industry, satellite transmissions, and cable TV. The Securities and Exchange Commission regulates the sale of stocks, bonds, and other investments. The Equal Employment Opportunity Commission works to reduce workplace discrimination. The Occupational Safety and Health Administration oversees safety and health in the workplace. The Environmental Protection Agency enforces environmental standards air, water, and toxic waste. The Nuclear Regulatory Commission regulates the nuclear power industry.

The goal of regulatory agencies is to promote efficiency and competition. The government discovered that rather than protecting consumers from unfair business practices, regulations had decreased competition. As a result of this new understanding, the government has **deregulated** many industries, reducing restrictions on business activity.

Many economists believe that with regulations removed, prices might rise. Higher prices and profits would encourage other sellers to enter the market. In today's global market, high prices might draw foreign firms into the domestic market. Consumers would benefit from this, because when there are more sellers, there is more competition. Greater competition leads to lower prices.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How is antitrust legislation good for the United States' economy?

2. How do federal regulatory agencies benefit consumers?

Expository Writing

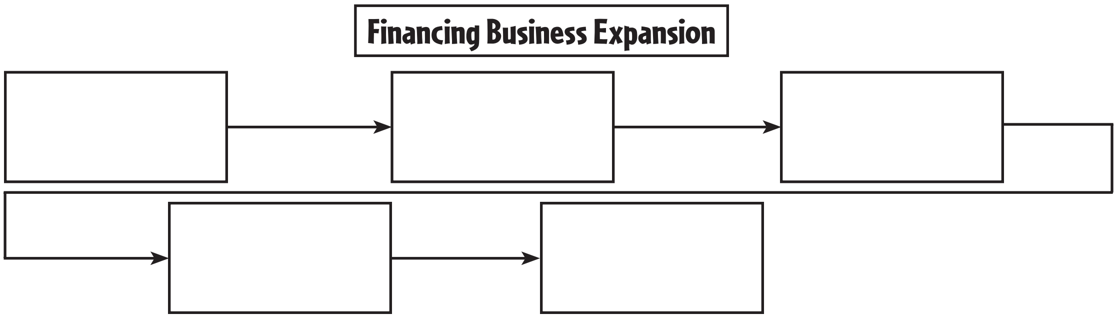
Suppose you own an Internet radio station that is very profitable, and you want to expand. Would you look for a horizontal, vertical, or conglomerate merger? Write a proposal to your board of directors about which type of business(es) you should buy. Remember to include how it will affect overall sales and profits from advertising, as well as utilize capital goods you already own.

Chapter 10, Section 1 (Pages 259–263)

Investing in the Free-Enterprise System

Big Idea

As you read pages 259–263 in your textbook, complete the flowchart below by listing the steps that savings dollars go through when financing business expansion.



Notes

Read to Learn

Before You Pursue Financing *(page 260)*

Predicting

If a cost-benefit analysis shows that expected profits would be less than the cost of financing, what will a business most likely do? Explain.

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In order for their businesses to grow, entrepreneurs must look for ways to expand. Expansion requires money capital. **Financing** means getting funds or money capital for a business. Financing business growth and operations is an integral part of the free-enterprise system.

Suppose you own a corporation consisting of 20 floral shops in the Southwest. You wish to open ten stores in the Midwest, but you need funds to expand. First, however, you must decide *if* you should expand.

Businesses make a **cost-benefit analysis** to help them decide if they should expand. A cost-benefit analysis has five steps: (1) estimate the total cost of expansion—including hidden costs, such as the loss of productivity during construction; (2) calculate expected **revenues**—income from sales after expansion; (3) calculate expected **profits**—revenues minus costs of expansion and operating the business after expansion; (4) calculate the cost of borrowing funds to finance expansion; and (5) determine whether expected profits are greater than the cost of financing the expansion.

Notes | Read to Learn

Why People Are Willing to Finance Investment *(page 262)*

Comparing and Contrasting

Think about the differences and similarities between savers and investors. Write their characteristics in the spaces provided.

Saver:

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Investor:

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Both:

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Businesses seek financing so they can expand and make higher profits and income. People invest in businesses indirectly and directly. Either way, these people earn income, too. For example, people invest in business indirectly when they deposit funds into a savings account or a certificate of deposit (CD). The bank pays savers interest on the amount of funds in their accounts. Savers might not intend to finance business investments, but the bank loans the funds to businesses and shares the interest of the loan with the savers.

A person who buys a corporate bond or a company stock invests in a business directly. That person also earns income. On the other hand, investors—people who buy stocks or bonds—intend to finance investment by making funds available directly to an expanding business.

Businesses in a market economy compete for scarce financial resources. If one company receives financing, it uses funds that another company might have used. The business then pays interest to the financial institution.

The general cost of financing affects the number of businesses that seek it. When the cost of financing is high, fewer businesses' cost-benefit analysis will show that expansion is the right choice. When the cost of financing is low, a greater number of businesses will determine that expansion is the right choice. As with loans to consumers, a lending institution must decide, in each instance, whether to lend funds to a business for expansion.

Several methods of financing expansion are available to businesses. Corporations, for example, can sell stocks or bonds to finance investment. Businesses can also borrow from banks, finance companies, or other institutions. Businesses can even use the Internet to find financing.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why should a business complete a cost-benefit analysis before expanding?

2. How do people invest in business directly and indirectly?

Informative Writing

Write a report to your board members about whether the corporation of floral shops should expand to the Midwest. Include a list of all the costs of expansion, how you see the expansion increasing profits, and where the corporation should seek financing.

Chapter 10, Section 2 (Pages 264–269)

Types of Financing for Business Operations

Big Idea

As you read pages 264–269 in your textbook, complete a table similar to the one below by filling in definitions and examples for the types of financing listed.

Debt Financing		
Type of Financing	**Definition**	**Examples**
Short term		
Immediate term		
Long term		

Notes

Read to Learn

Three Kinds of Financing *(page 265)*

Drawing Conclusions

If a business wanted funds for a merger, what type of financing would it seek? Explain.

____

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Similar to a consumer, a business must follow certain steps when borrowing funds, including proving creditworthiness, paying interest on loans, and repaying loans within a certain time. Borrowing funds for a business is also known as **debt financing.**

The three kinds of debt financing are short term, intermediate term, and long term. **Short-term financing** is when businesses borrow funds for less than one year. There are four types of short-term financing: trade credit, unsecured loans, secured loans, and a line of credit. A business might choose this type of financing when it receives a large order but will not receive the payment until it delivers the product. **Intermediate-term financing** refers to borrowing for one to ten years. There are two types: a loan with a repayment period between one and ten years, and leasing. **Long-term financing** is a loan with a term of ten years or more. Stocks and bonds are examples of long-term financing. Businesses use this type of financing for major expansion, such as building a new plant or buying expensive, long-lasting machinery. Usually, only large corporations sell bonds.

Notes | Read to Learn

Choosing the Right Financing *(page 268)*

Predicting

Assume that a company has a great deal of debt and that interest rates are high. Do you believe that the company's financial manager will recommend that the company expand? Why or why not?

Making Generalizations

What is the most important factor to consider when choosing financing?

Underline the facts in the passage that support your statement.

How does a company decide what kind of financing to get? A company's financial manager looks for the best mix of financing to get the most favorable rates for the company. Four factors affect the manager's decision about what types of financing to get: interest rates, the company's financial condition, the overall economic climate, and the opinions of the company's owners.

Financial managers often look first at interest rates. These rates are the costs of borrowing the money capital. If interest rates are high, a business has two choices. One choice is to take out several short-term loans at high rates. If interest rates drop, the company can then take out a long-term, low-interest loan to pay the short-term loans. The other choice is to delay expansion until interest rates drop.

Interest rates also affect a company's decision to sell bonds. The lower the interest rates, the lower the rate of return on a company's bonds. A company must offer higher rates of interest on its bonds when rates are high.

The second factor is the financial condition of the company. Are the company's profits and sales stable? Is the company's current debt small? If so, then the company is in good financial condition. A cost-benefit analysis can show the company's financial manager if the potential profits will more than cover the cost of financing expansion.

The third factor financial managers examine is the market climate. The climate of a market is how buyers and sellers feel about the current prices and how prices will change in the near future. Slow growth in the market as a whole can lead investors to choose safer investments, such as bonds, instead of riskier investments, such as stocks.

The fourth factor is the opinion of the company's owners. Who owns the company? For instance, the people who own common stock also own part of the company. They have a vote in matters of financing as well as in company elections. Financial managers might have to gain approval from the owners of common stock. Most preferred stocks, however, do not have voting rights attached to them. Bondholders also do not have voting rights in a company.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is a potential disadvantage of short-term financing??

2. Under what circumstances would a company need to offer high rates of interest on its bonds?

Persuasive Writing

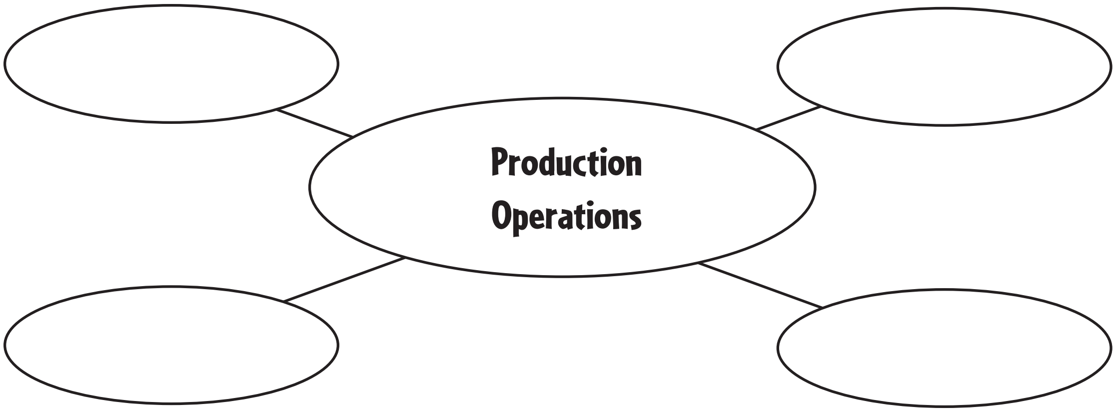
Assume that you are the financial manager for a company with little debt and strong sales; however, interest rates are high. Write a report to the board that makes a solid argument recommending that the company sell stock to expand.

Chapter 10, Section 3 (Pages 271–275)

The Production Process

Big Idea

As you read pages 271–275 in your textbook, complete this diagram by filling in the four production operations discussed in this section.



Notes | **Read to Learn**

Steps in Production Operations *(page 272)*

Determining Cause and Effect

How do you know that it is very important to business owners to buy inputs at the best price?

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Production is the process of changing resources into goods. Businesses can produce **consumer goods,** which are goods sold directly to people to be used, or capital goods, which are products used to create other goods.

The production process also includes planning, purchasing, and quality and inventory control. Planning involves choosing a location and scheduling production. Distance from markets, raw materials, labor supply, and transportation facilities affect where a business locates.

The people who buy goods for a business (often called *purchasing agents*) decide what to buy, from whom, and at what price. They consider the price and quality of what they are buying, as well as insurance and shipping rates.

Different types of products require different quality control systems. For example, some track product freshness, while others oversee that products meet government safety standards.

Many businesses maintain inventories of materials they use to make their products or provide services, which are kept as small as possible to keep funds available for other needs.

Notes | Read to Learn

Technology and Production *(page 274)*

Drawing Conclusions

As you read, complete the following sentence.

Entrepreneurs welcomed

____

because it increased the efficiency and lowered the

____

of production.

Predicting

Do you believe that automation and robotics will be used more frequently or less frequently in the future? Why?

____

____

____

In the 1700s, the Industrial Revolution combined the labor of people and large power-driven machines. This combination is known as **mechanization.** Mechanization allowed entrepreneurs to replace skilled workers with machines that unskilled laborers could run. Before the mechanization of the textile industry, skilled craftspeople hand-wove cloth on looms. During the 1700 and 1800s, many inventions transformed the process of making cloth. One invention that dramatically changed the production of cloth was the power loom. Similar developments in other industries greatly increased the rate of output per labor hour—the number of goods produced per hour of labor.

Mechanization and use of interchangeable parts led to the invention of 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. The development of the assembly line greatly improved the efficiency and quality control of the production process. This greater efficiency has led to much lower costs of production.

The breaking down of a job into small tasks made the assembly line possible. This is known as the **division of labor.** When the needed labor is divided, a different worker performs each small task.

Mechanization combines the labor of people and machines. **Automation** takes this process a step further—machines do the work and people oversee them. You probably would not be surprised to learn that many car assembly lines are automated. What you may not realize is that automation also performs useful services throughout our society. For instance, home security systems are examples of common everyday automation in American society.

Computer-controlled machinery known as robotics also operate many production processes. In some industries, robotics control every step of the process. Robotics greatly improves the efficiency of manufacturing, much as mechanization improved production efficiency when entrepreneurs introduced it many years ago.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Describe the different aspects of the production process.

2. Why would a manufacturer want to break down a job into small tasks?

Descriptive Writing

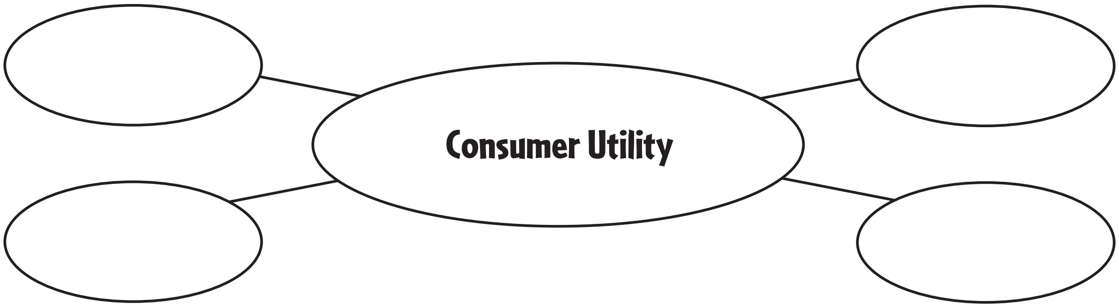
Suppose you are managing a toy factory 100 years in the future. Write a short story describing how the toys are made and what a typical day is like.

Chapter 11, Section 1 (Pages 283–288)

The Changing Role of Marketing

Big Idea

As you read pages 283–288 in your textbook, complete this web diagram by filling in the major types of utility.



Notes

Read to Learn

The Development of Marketing *(page 284)*

Formulating Questions

Before you read, write two questions about marketing that you think the passage will answer.

1. ____________________

____

2. ____________________

____

Marketing includes everything producers do to create consumer demand for their products and to move products from producers to consumers. Since 1900, the importance of marketing has grown considerably. Companies spend a lot of money on marketing. In fact, some economists estimate marketing costs are equal to 50 percent of the price of a product. Production, sales, advertising, and **consumer sovereignty,** or the role of consumers in determining the kinds of goods and services produced, are just some areas where companies focus their marketing efforts.

Marketing's main goal is to persuade consumers that a particular product has the ability to satisfy a need or want. The amount of satisfaction consumers receive from a good or a service is called the **utility.** There are four major types of utility: form, place, time, and ownership. Form utility means making the product in a form consumers can use. Place utility means making the product available where consumers need it. Time utility means making the product available when consumers need it. Sometimes consumers are satisfied just to own a product. This is ownership utility.

Notes

Read to Learn

Market Research *(page 285)*

Problems and Solutions

Describe two ways that companies can find out which consumers are most likely to buy a new product.

Predicting

What might happen if a business did not invest in market research?

Through market research, businesses can determine what products consumers are likely to buy and at what prices. First, businesses must find out the kinds of products that fulfill consumers' wants. Next, businesses must find out how the products can most satisfy those wants.

Some companies specialize in finding out about consumers' needs, wants, preferences, and buying behavior. These companies provide **market research** to other businesses. This information answers the many questions businesses have: Are there enough buyers for the product? Where and to whom should the product be sold? What features should the product have? How should the product be promoted? For this reason, some businesses conduct market research before the development of a new product or before an existing product goes through changes to make it better.

At this stage, marketing companies may use a **market survey** to gather information on the types of consumers that might buy the product. One type of market survey uses questionnaires. A questionnaire usually asks consumers whether they are satisfied with a product or how they found out about the product? In another type of market survey, marketing companies gather people into small groups called focus groups to discuss certain types of products. The consumers' responses from market surveys will help marketers find out if the product satisfies consumers' needs.

Usually market research continues even after the release of a new product. Marketers may conduct research on the product itself or on the advertising designed to sell the product. Researchers can gather important information by tracking units sold at various locations and comparing the numbers to the advertising campaigns in those locations. They often test market a product in a small area for a set period of time. This will tell the marketing company more about how the new product will sell when it is available in a larger area or nationwide. Companies may use the test-market results to decide to make changes to a product or even to decide not to continue producing a product.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Give an example of a good or a service for each type of consumer utility.

2. Describe the steps businesses take to develop a new product.

Informative Writing

Choose a product you use at home, such as a shampoo, a cereal, or another everyday item. Describe how the product satisfies your needs and wants and how it could be improved.

Chapter 11, Section 2 (Pages 289–294)

The Marketing Mix

Big Idea

As you read pages 289–294 in your textbook, complete this chart by filling in each of the four elements involved in developing an effective marketing strategy.

	The Four "Ps" of Marketing
Product	
Price	
Place	
Promotion	

Notes

Read to Learn

The "Four Ps" of Marketing *(page 290)*

Making Inferences

Why would it be unwise to sell a new product at a higher than usual price?

____

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____

In order to be successful, businesses must develop a marketing strategy, or decide how they will sell a product. A marketing strategy is based on the "four P's" of marketing: product, price, place, and promotion. When considering the product, businesses also consider what accompanies the product and the *product identification*. For example, most electronic products come with a warranty; some toys come with batteries. Product identification is the packaging and labeling in which a product is sold.

Businesses might try **penetration pricing,** in which they attract customers by offering a product at a very low price at first. Alternatively, they may use coupons or sale prices to persuade consumers to try a new product. **Price leadership** results when one major company changes its prices and other companies follow its lead.

The product's place and **promotion** are two more factors of successful marketing. The place includes the type of store and the specific market or geographic location where the product will be sold. Promotion includes how consumers learn about a product. One form of promotion is **direct-mail advertising.**

Notes | Read to Learn

Product Life Cycle *(page 294)*

Analyzing Information

As you read, think of a specific product in each of the following categories. Then determine if it will have a short, medium, or long product life cycle.

Computers
Product:

____

Cycle length:

____

Cleaning products
Product:

____

Cycle length:

____

Toys
Product:

____

Cycle length:

____

Most products go through a four-stage life cycle consisting of introduction, growth, maturity, and decline. This is called a **product life cycle.** During the introduction stage, promoting the product is very important. The product might be offered at a low price. Generally, there is less competition. However, many products fail at this stage.

The growth stage of a product follows the introductory stage. Competition increases during this stage as other businesses seek new opportunities. Promotion continues to be important as businesses aim to distinguish their brands from other brands. Sales grow at a steady pace while prices are relatively high.

In the next stage, maturity, the product is an established brand in the marketplace. The sales reach their peak. Then something unexpected happens, consumer habits change, another business introduces a new, more satisfying product, or the market becomes weak. Any of these events results in declining sales. Businesses start lowering prices and reducing their marketing efforts.

Although the four stages of a product's life cycle are consistent, the length of time of each stage can vary significantly among different products. Some products stay at maturity for a long time, such as the staple food Cheerios. Others may mature quickly and pass into the next stage of decline, such as the fashion trend of long, full skirts. Some products in decline can be put to new uses. Sometimes new packaging or new promotion can prevent a product from being removed from the marketplace. For example, Nabisco has chosen some of its popular snacks and packaged them into individual, 100-calorie servings.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the purpose of considering the "four P's" of marketing?

2. Why would a company want to find new uses for a product that is in decline?

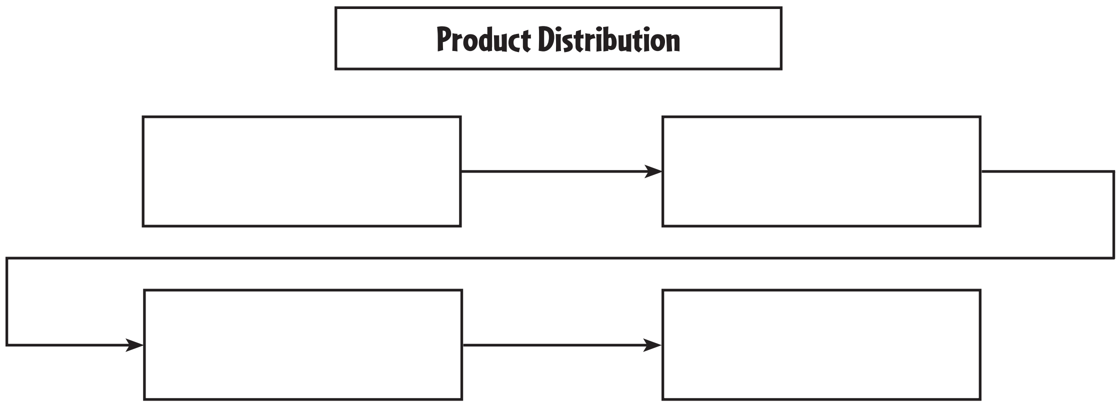
Informative Writing

Suppose you are marketing a new video game. Write a paragraph describing the life cycle of the product and what you might do at each stage of that cycle.

Distribution Channels

Big Idea

As you read pages 482–488 in your textbook, complete this graphic organizer by filling in the causes and effects of anti-immigrant prejudices.



Notes

Read to Learn

Wholesalers, Retailers, Storage, and Transportation *(page 297)*

Determining Cause and Effect

If the transportation of goods is interrupted, what effect might this have on producers and consumers?

Marketing includes deciding how to move, or distribute to consumers, the goods that producers make. Frequently, goods pass through wholesalers and retailers before they reach consumers. In rare instances, consumers buy goods directly from a producer. The routes by which goods travel from producers to consumers are known as **channels of distribution.**

A **wholesaler** is a business that purchases large quantities of goods directly from manufacturers and then sells the goods to other manufacturers or retail stores.

Retailers include physical stores like supermarkets, bookstores, and clothing stores, as well as mail-order companies and online stores. A retailer is a business that sells goods directly to consumers. Online stores are **e-commerce** retailers who sell their goods through a Web site on the Internet.

The storage and the transportation of goods are also part of the distribution process. The producer, wholesaler, or retailer may store goods while waiting for them to be moved or for consumers to make a purchase. Weight, size, and type of good must be considered when choosing how and where it is moved and stored.

Notes

Read to Learn

Other Distribution Channels *(page 299)*

Analyzing Information

What are the trade-offs consumers make when they shop in a club warehouse store?

Making Inferences

Why would a retailer choose to sell goods through mail-order catalogues and the Internet?

The number of channels of distribution continues to expand with the recent addition of club warehouses and direct marketing. Consumers shop at club warehouse stores to save money by buying goods from wholesalers directly. How do club warehouses, such as BJ's, Sam's Club, and Costco sell products for lower prices and still make a profit? They purchase only a few brands of products from manufacturers in very large quantities. Since it is desirable for manufacturers to sell large amounts of their products quickly, the club warehouse stores can negotiate a very good price. The stores can then pass their savings on to the consumer. In turn, consumers usually buy goods in larger quantities than at other retail stores. Goods are packaged in large quantities; for example, a supermarket may have individual rolls of paper towels packaged to sell, while a club warehouse store will have 12 rolls of paper towels packaged to sell. Club warehouses build and operate their stores at lower cost. Consumers are willing to overlook the no-frills retail space and to do without assistance from salespeople in order to save money. Both the manufacturer and the club warehouse store make a profit by selling more goods quickly, even though the profit margin is less per item than at other retail stores. In addition, club warehouse stores make money by charging a membership fee.

Most direct-marketing companies, such as Amazon.com, Lands End, and MacMall, sell goods to consumers through mail-order catalogues and/or the Internet. Consumers benefit from the convenience of shopping at home and the money saved by not having to pay sales tax if the seller is located in another state. Direct marketing allows rural consumers to have the same choices of products that urban consumers enjoy. Retailers benefit by reaching customers in many regions without investing the capital money to build, staff, and operate multiple physical stores.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Describe the steps that a raw material, such as wool, takes to get to a consumer in the form of a sweater.

2. How would a manufacturer's decision to sell its product at a wholesale club affect the product's identification (packaging)?

Descriptive Writing

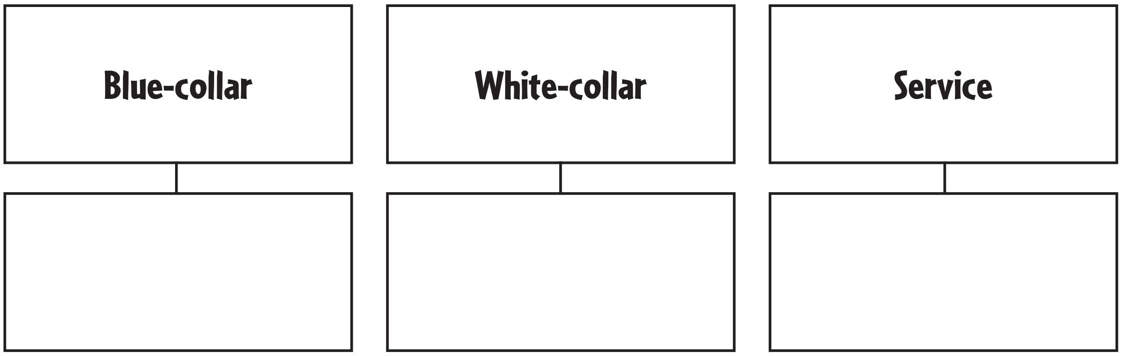
From the point of view of a perishable good, such as a gallon of ice cream, write a story that shows both problems and solutions that businesses face along a channel of distribution.

Chapter 12, Section 1 (Pages 307–313)

Americans at Work

Big Idea

As you read pages 307–313 in your textbook, complete this diagram to describe the types of workers discussed in this section.



Notes

Read to Learn

The Civilian Labor Force *(page 308)*

Analyzing Information

As you read, complete the sentence below.
Most white-collar workers are

____

while service workers may be

____

workers,

____

workers, or

____________________.

The **civilian labor force** refers to the total number of people 16 years or older who are employed or actively looking for work. Those not in the civilian labor force include people with disabilities, full-time students, homemakers, members of the armed forces, prisoners, and patients in mental institutions.

Economists may categorize workers by the type of work they perform: **blue-collar workers, white-collar workers,** and **service workers.** Blue-collar workers consist of people working in crafts, manufacturing, and nonfarm jobs. White-collar workers include bank officers, real estate agents, and other highly trained people. Service workers provide services directly to other people.

Economists also categorize workers by the skills needed to do their jobs. They are divided into **unskilled workers, skilled workers, semiskilled workers,** and **professionals.** Unskilled workers do not need specialized training; semiskilled workers need some training; skilled workers need to learn a trade or craft; and professionals need a college degree to do their job and usually have additional education or training. Workers do not always fall into one category and may change categories.

Notes

Read to Learn

Supply and Demand in the Labor Market *(page 311)*

Making Generalizations

How does the prospect of receiving high wages motivate people in the labor market? Underline facts in the passage that support your answer.

Determining Cause and Effect

If the minimum wage increases, how do workers benefit? How are some workers then disadvantaged?

Supply and demand also affects the labor market. Suppliers are the workers who offer their services to employers. Demand comes from employers who need workers. Three factors that affect supply and demand in the labor market are skill, type of job, and location.

Skill may come from talent, training, education, experience, or initiative. Usually the demand for skilled or talented individuals is high, and the supply is scarce. This creates a "tight" labor market resulting in high wages. For example, popular entertainers have high wages because the demand for their skills is high, while the supply is low.

The *type of job* affects the wages that an employer will pay and that a potential employee will accept. Dangerous or unpleasant jobs often pay higher wages than other jobs with equal levels of skill. The demand for workers to fill these jobs is usually high, and the supply of workers willing to do these jobs is usually low. In contrast, other types of jobs are highly desirable so that people will accept them for low pay. The demand for workers in this case falls, while the supply of workers waiting for such desirable positions rises.

The *location* of jobs and workers also affects wages. In an area where workers are scarce, employers must pay high wages to attract workers to move there. On the other hand, in heavily populated areas with a large number of available workers, employers can hire workers for relatively low wages.

Yet, supply and demand are not the only factors that affect wages. Two factors restrict the influence of supply and demand on wages. These are the **minimum wage law** and the process of wage negotiations between organized labor and management. Set by the federal government, the minimum wage is the lowest legal hourly wage that an employer can pay to certain types of workers. The purpose of the law is to help workers, but in some cases, it may have the opposite effect. When the minimum wage increases, some firms hire fewer unskilled workers. Low-pay workers are unable to acquire job skills and then find it more difficult to find work.

Wage negotiations between organized labor and management also restrict the influence the supply and demand have on wages. Other factors more influential than supply and demand include a company's ability to pay higher wages, the length of the negotiated contract, and the length of time on a job.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How does knowing about job-skill levels help a person who is searching for a job?

2. Explain how wages are affected by supply and demand.

Persuasive Writing

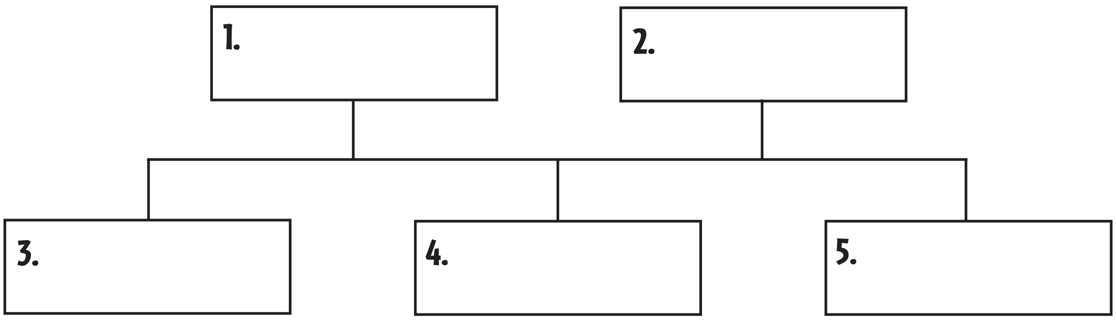
Choose a desirable job that pays a high wage. Suppose there is a job opening and you can apply for it. Write a cover letter for your application, which includes your experience, education and training, and qualifications for the position. Your letter should present evidence of why you are the best person for that particular job. You can make up education and skill qualifications.

Chapter 12, Section 2 (Pages 315–319)

Organized Labor

Big Idea

As you read pages 315–319 in your textbook, complete this graphic organizer by filling in at least five major events in the organized labor movement from the late 1800s to the mid-1900s.



Notes

Read to Learn

Development of Labor Unions *(page 316)*

Making Inferences

1. ***Why were businesses in the 1800s reluctant to improve wages and working conditions?***

2. ***Why would workers need to work together to change working conditions?***

Many workers in the 1800s experienced miserable working conditions. The buildings were unhealthy and some machinery was dangerous. Employees worked long hours for low pay; they did not receive health-care benefits or unemployment insurance. Hoping for better pay and working conditions, many American workers formed **labor unions.** Labor unions staged **strikes** to force employers to give in to their demands. It wasn't until the mid-1930s that Congress passed the first laws to regulate labor-management relations.

Organized labor in the United States was divided into two groups: craft unions and industrial unions. A **craft union** consists of skilled workers in a specific industry, such as bricklayers. The first organization of national craft unions was the American Federation of Labor (AFL). **Industrial unions** include all skilled and unskilled workers in an industry. The first significant effort to unionize unskilled and semiskilled workers was the formation of the Congress of Industrial Organizations (CIO).

In the mid-1950s, the AFL and the CIO merged, believing the labor movement would benefit the most if the unions worked together.

Notes

Read to Learn

How Unions Are Organized *(page 318)*

Comparing and Contrasting

Think about the kinds of local shops. What are the differences between a union shop and an agency shop?

Evaluating Information

Why might an employee prefer to work in a state that does not have a right-to-work law?

Today, labor unions exist on three levels: the local union, the national or international union, and the federation. Union members in a particular factory, company, or geographic area belong to a **local union.** Local unions negotiate contracts with companies. Their job is to make sure that companies meet the terms in a contract.

Local unions vary from one another. Their differences include their membership requirements and how management relates to union members. For example, in a **closed shop,** companies can only hire union members. The government banned closed shops with the Taft-Hartley Act of 1947. The second type of local union is a **union shop.** In a union shop, a new employee must join the union after a certain period of time, usually three months. Last, an **agency shop** is a local union where employees do not have to join the union but must still pay dues.

Should unionized companies require their employees to pay union dues? Supporters of union and agency shops believe that non-union employees should pay dues because they benefit from contracts that the union negotiates. Opponents, however, believe employees should not have to join a union.

Some states pass **right-to-work laws,** which forbid union shops. Right-to-work laws let employees work in particular jobs without joining a union. In states with these laws, even non-unionized workers must receive the benefits negotiated by the unions. As you might expect, unions in such states have less power than in other states.

National unions are individual craft or industrial unions that represent locals nationwide. National unions are a level above local unions. A union with members in Canada or Mexico is called an international union. Employees turn to nationals or internationals for help in organizing locals. Nationals also provide lawyers and other staff members to negotiate contracts between local unions and a particular company. In some industries—the steel and mining industries, for instance—the national union negotiates the contract for the entire industry.

The AFL-CIO is a union at the highest level, the federation level. Since 2005, its main competitor has been the Change to Win Federation. This new union consists of members of seven unions and seeks to promote and increase union membership in the United States.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the relationship between a local union and a national union?

2. What is the history of unions at the federation level?

Persuasive Writing

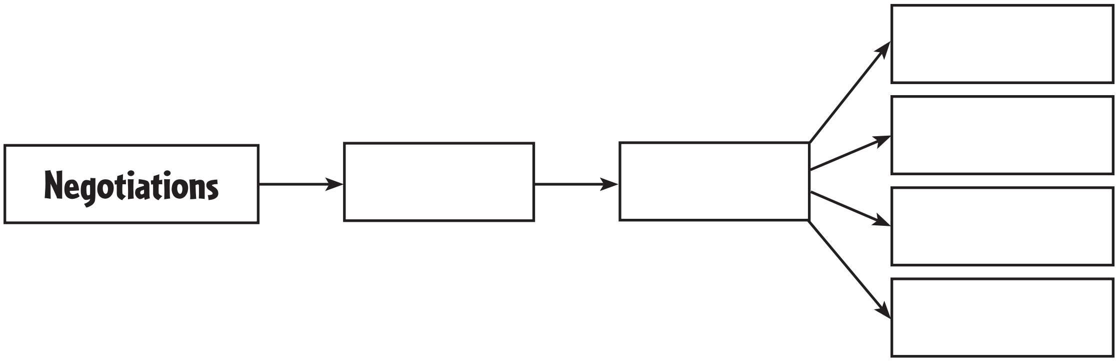
Imagine that the year is 1910. Write a letter to your cousin explaining why you joined the new labor union in your cotton mill. Include vivid details that describe the mill's poor working conditions and dangerous safety conditions. Use as many aspects of the five senses—sight, sound, taste, smell, and touch—to describe your working conditions as possible. Be specific about the benefits that the workers have experienced since unionizing.

Chapter 12, Section 3 (Pages 320–325)

Collective Bargaining

Big Idea

As you read pages 482–488 in your textbook, complete this graphic organizer by filling in the causes and the effects of anti-immigration prejudices.



Notes

Read to Learn

Negotiations *(page 321)*

Problems and Solutions

Describe one way that labor and management can solve issues that they cannot agree upon.

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Companies strive to hold labor costs down by keeping wages and benefits low, to remain competitive. Unions, however, want to increase the wages and benefits of their members.

Unions and companies reach compromises through **collective bargaining.** This is the process of negotiating the conditions of employment. Labor and management meet to discuss working hours, fringe benefits, and a **cost-of-living adjustment (COLA).** Most of the time, negotiations remain friendly, and everyone involved feels satisfied.

Sometimes negotiations become hostile, or compromise is impossible. In this instance, labor and management might try **mediation,** in which a neutral person helps both sides to agree. The Federal Mediation and Conciliation Service (FMCS), or a state or private mediator, can help resolve problems. A mediator suggests solutions and works to keep the two sides talking.

If mediation fails, then the process goes to **arbitration,** where both sides submit the unresolved issues to a third party for a final decision. Both sides agree beforehand to accept the arbitrator's decision, even though, in the end, they might not be happy with it.

Notes | Read to Learn

Strikes and Management *(page 322)*

Synthesizing Information

As you read, complete the sentence below.

Companies and workers are motivated to reach an agreement because workers lose ____ and companies lose ____ during a strike.

Making Inferences

How can boycotts increase the economic pressure on companies?

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Most of the time a contract negotiation results in a settlement. If a compromise cannot be reached, a union may strike. **Picketing** occurs when strikers walk in front of their workplace with signs that state their disagreement with the company. The purpose of picketing is to keep nonunion workers from crossing the picket line and working for the company, to embarrass the company, and to build public support for their strike.

Striking unions employ other strategies, too. They might call a **boycott** by urging the public not to purchase goods or services produced by the company. Boycotts add to the economic pressure felt by the companies. In most cases, strikes end when labor and management return to negotiations, but strikes can last for months or even years.

Management can choose several strategies to discourage or end a strike. One strategy is the **lockout,** in which management prevents workers from returning to work until they agree to a new contract. Another strategy is to hire "strikebreakers," or people who cross the picket line to work for the terms the company offers. Strikers call strikebreakers "scabs." A third strategy is an **injunction**—a court order that prevents an activity. Management must request an injunction to limit picketing or to prevent a strike from continuing or occurring. The two sides must try to reach a settlement during the injunction.

Decline of Unions *(page 324)*

Distinguishing Fact from Opinion

Is the statement "Declining union membership is a good thing for the economy" a fact or an opinion? Explain.

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Since the 1940s, union membership has declined for several reasons. Unions have accomplished many of their goals, such as better wages and working conditions. In addition, supporters believe that collective bargaining has brought more order and fairness to the workplace. Collective bargaining has clarified the rights and responsibilities of both management and labor.

Another reason for declining membership is the changing nature of the economy. Jobs in the service sector and in the white-collar sector have increased, while blue-collar jobs have decreased because of automation.

Opponents claim that unions have grown so large that they do not know their members' needs. Other critics say that higher wages result in higher prices, which consumers must pay. Employers claim that union rules decrease productivity. Additionally, corruption among certain labor leaders has damaged the reputation of organized labor.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why might both labor and management believe that collective bargaining is a good way to compromise?

2. Why might picketing be an effective tool for strikers?

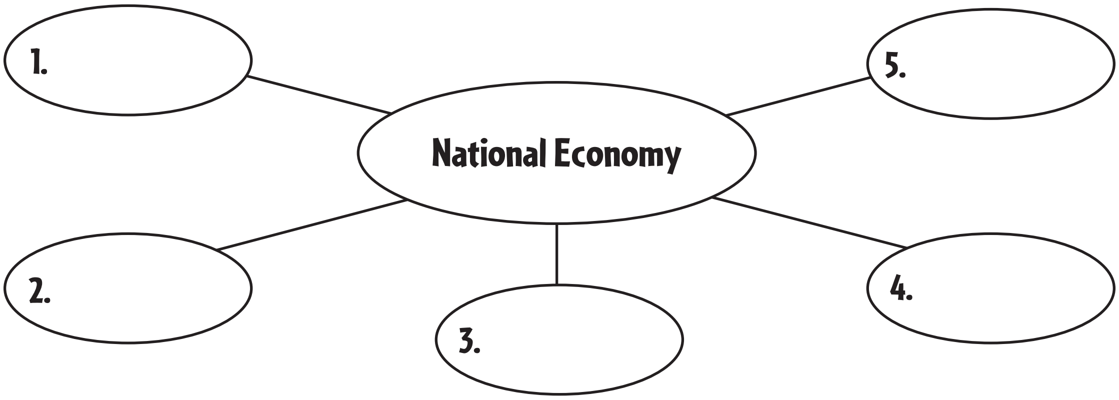
Expository Writing

Imagine that you are a manager in a large company in charge of training managers who are new to the company. Write a speech that explains the different methods of dealing with a strike and the advantages and disadvantages of each method.

National Income Accounting

Big Idea

As you read pages 335–340 in your textbook, complete this web diagram by filling in five major statistics used to measure the national economy.



Notes

Read to Learn

National Income Accounting, GDP and NDP *(page 336)*

Evaluating Information

What areas of the GDP might be hard to measure?

A nation's economic strength is measured using **national income accounting,** which involves five major statistics: the gross domestic product, the net domestic product, national income, personal income, and disposable personal income.

The **gross domestic product (GDP)** is the total dollar value of the final goods and services produced in a nation during one year. Note three important distinctions. First, the value of goods and services is their dollar value. Second, economists only count final goods and services. For instance, an engine is part of the value of a finished car. Finally, economists only count new products produced during one year.

To find the GDP, economists add the total purchases by consumers, investors, the government, and **net exports.** Net exports is the difference between a nation's exports and imports. The GDP is not 100 percent accurate, but the GDP is needed to find the value of the other statistics that measure the national economy. For example, the **net domestic product (NDP)** is the value of the GDP minus the wear and tear, or **depreciation,** of goods.

Notes

Read to Learn

Measurements of Income *(page 339)*

Distinguishing Fact from Opinion

Is the following statement about NI a fact or an opinion? Explain.

"It is not easy to calculate, however, because people earn income in many different ways."

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Comparing and Contrasting

Is the amount of an individual's personal income greater or less than their disposable personal income?

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National income accounting addresses the overall economy's output and its income. GDP and NDP measure the nation's output. Economists consider three types of income statistics. These consist of national income, personal income, and disposable personal income.

The **national income (NI)** is the total amount of income earned by everyone in the nation's economy. It is not easy to calculate, however, because people earn income in many different ways. The NI is the sum of five types of income. As a result, the NI represents both the income earned through labor and the income earned through ownership or control of factors of production. The most common type of income is wages or salaries. Another type of income is the profit of small businesses and the income of the self-employed. Individuals also earn income on investments in corporations and from interest paid on savings accounts. Corporate profits are a form of income. Economists even count the money earned through the rental of property as part of the NI.

Personal income (PI) is the total amount of money that an individual receives before he or she pays taxes. Economists find PI by first subtracting the following from the NI: corporate income taxes, profits that businesses reinvest, and businesses' payments to Social Security. The second step in finding PI is to add government **transfer payments,** including welfare, Social Security, or unemployment compensation, to the NI.

The third income statistic is the **disposable personal income (DPI).** This is the amount of income left after an individual has paid all taxes. An individual's income is subject to federal and state income taxes, Social Security, and Medicare. An individual's wage may be $10 an hour. However, after a payroll manager subtracts all taxes, that person's take-home hourly wage may be $7.50. This is the DPI; the amount of income an individual can choose to save or spend.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How are the GDP and the NDP similar? How are they different?

2. Why would you want to include payments such as Social Security as personal income?

Informative Writing

Suppose you own a large corporation that sells products to consumers. One year your sales decrease, which could happen for many reasons. One national income accounting statistic would help you determine whether your sales decreased because of a change in consumer spending. Identify that statistic and explain how it can be useful to large corporations.

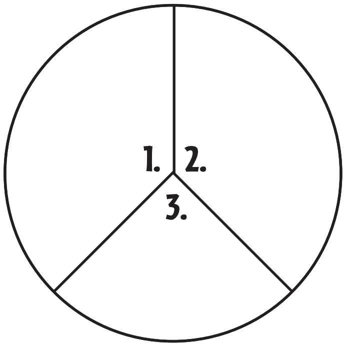
Chapter 13, Section 2 (Pages 341–345)

Correcting Statistics for Inflation

Big Idea

As you read pages 341–345 in your textbook, complete this diagram by filling in the three most commonly used measurements of inflation.

Measuring Inflation



Notes

Read to Learn

The Purchasing Power of Money *(page 342)*

Drawing Conclusions

If deflation increases the purchasing power of the dollar, why isn't it good for the economy?

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From one year to the next, the amount of goods and services you can buy with a dollar decreases slightly. In other words, over time a dollar's value, or **purchasing power,** decreases. For example, a pair of sneakers may cost $38 dollars one year, but a year or two later, a similar pair of sneakers with the same utility will cost $40. This is due to **inflation,** which is a prolonged rise in prices for goods.

Today, the purchasing power of a dollar is almost always affected by inflation, although in the past, the purchasing power of a dollar increased due to **deflation.** Deflation is the opposite of inflation. It is a prolonged *decline* in general prices.

Economists consider inflation or deflation when calculating the GDP. Inflation results in increased prices for goods and services, which can be mistaken for an increase in the number of goods and services purchased, or a rise in GDP. Deflation results in decreased prices for goods and services, which can be mistaken for a decline in GDP. An accurate assessment of the nation's output can be determined by factoring in the current value of the dollar when calculating the GDP.

Notes | Read to Learn

Measures of Inflation *(page 343)*

Analyzing Information

Why does the producer price index show inflation before the consumer price index does?

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Distinguishing Fact from Opinion

Decide whether the statement below is a fact or an opinion. Explain your answer.

"The price producer index is the most accurate measure of inflation."

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Inflation affects the prices consumers pay for goods and services. When studying the economy, the government usually measures inflation using the following three statistics: the consumer price index, the producer price index, and the implicit GDP price inflator.

Each month the government determines the **consumer price index (CPI).** This is a measurement of the average price of specific goods and services. Typical consumers in city areas around the country purchase these 80,000 specific goods and services. Economists call this group of products the **market basket.** You may have guessed that the market basket includes groceries, clothing, and personal items. It also includes housing, medical care, transportation, and entertainment. About every ten years, economists evaluate the market basket and revise it to reflect the typical consumer's purchases.

To find how inflation has changed over time, the employees of the federal Bureau of Labor Statistics (BLS) must compare a month's CPI to something. They start with prices from a **base year.** Consequently, the CPI can be used to find the rate of inflation for any period of time. Currently, the BLS's base year is the average price from 1982 to 1984. They gave the base year a value of 100, thereby making it easier to calculate the rate of inflation.

A second measurement of inflation is the **producer price index (PPI).** It is a group of indexes, or comparisons of data, that measure the average change in prices that United States producers charge customers. The customers include both consumers and other producers. This index shows inflation before the same inflation is seen in the consumer price index.

The **GDP price deflator** adjusts the GDP for inflation so that the overall economy can be accurately compared between different years. When economists apply the GDP price deflator to the GDP, the result is the **real GDP.** By comparing the real GDP from one year to another, the government can asses how the nation's outputs have increased or decreased over time.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Will a consumer who works for a fixed wage be able to purchase more during a time of inflation or deflation? Explain your answer.

2. How are the CPI, PPI, and GDP price deflator similar and different?

Expository Writing

Suppose you work at the federal Bureau of Labor Statistics. You have been asked by a local school to make a presentation for Career Day. Write a speech that describes how the BLS measures the overall economy and why your job is important.

Chapter 13, Section 3 (Pages 347–350)

Aggregate Demand and Supply

Big Idea

As you read pages 347–350 in your textbook, complete this table by filling in the factors that cause changes in aggregate demand and aggregate supply.

	Increase	Decrease
Aggregate demand		
Aggregate supply		

Notes

Read to Learn

Aggregate Demand and Supply *(page 348)*

Evaluating Information

Why would the GDP price deflator be used as the price level to measure supply and demand?

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Aggregate demand and aggregate supply curves plot the price level versus total output. An **aggregate** is the sum of all the individual parts of the economy. **Aggregate demand** is the quantity of products demanded for the entire economy. To measure aggregate demand, economists use the *price level,* which is the average of all prices as measured in a price index, usually the GDP price deflator. As a result, the **aggregate demand curve** shows the relationship between the price level, plotted on the side (vertical) axis, and the real domestic output, plotted on the bottom (horizontal) axis. The aggregate demand curve slopes downward to the right.

Aggregate supply is the real domestic output of producers in the economy based on the changes in the price level. As price levels go up, producers make more of a profit, which they use to increase output. If price levels fall, then the producers make less profit and reduce their output. The aggregate supply curve slopes upward to the right.

When the aggregates for supply and demand meet, an equilibrium price level is established. As the aggregates for supply and demand change, the equilibrium price level changes.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Describe how the aggregate demand differs from individual demand.

2. Explain how the law of demand and the law of supply also apply to aggregate supply and aggregate demand?

Informative Writing

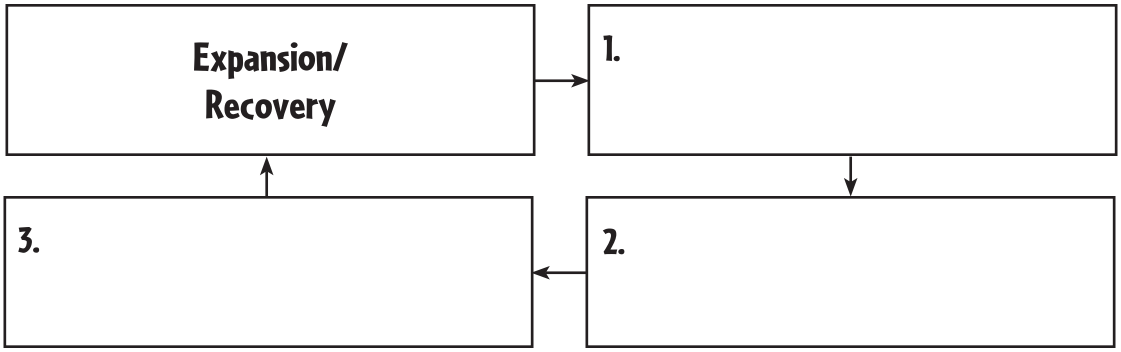
Your local representative wants to pass a law to create a national sales tax of 10 percent. Write an article for your school newspaper describing how the law would affect equilibrium price level.

Chapter 13, Section 4 (Pages 351–355)

Business Fluctuations

Big Idea

As you read pages 351–355 in your textbook, complete the flowchart below by filling in the steps of an idealized business cycle.



Notes

Read to Learn

Model of the Business Cycle *(page 352)*

Analyzing Information

Why would a family postpone making purchases during a period of recession?

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Economic ups and downs, or **business fluctuations,** are part of the **business cycle.** The business cycle is a cycle of irregular changes in the total level of output measured by the real GDP. The most favorable business cycle would include periods of growth leading to economic **peaks** or **booms,** or a period of prosperity. This cannot continue forever, so eventually the economy levels off, experiences a **contraction,** and may begin a period of **recession**—any period during which the real GDP declines for six months in a row.

A recession results in a decrease in production, loss of jobs, and decrease in demand. Consumers make fewer purchases since they may be in danger of losing their jobs. Consequently, manufacturers produce less because of a decrease in demand. If a recession continues to slow the economy, a **depression** results. Millions of people will lose their jobs, and the economy will function far below its capacity. At some point, the economy will arrive at the lowest point in the business cycle, a **trough,** as the GDP stops decreasing. This signals a return to a period of prosperity called an **expansion,** or **recovery.**

Notes

Read to Learn

Ups and Downs of Business *(page 353)*

Identifying the Main Idea

As you read about business cycles, write the main idea of each paragraph.

1. ______________________

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2. ______________________

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3. ______________________

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4. ______________________

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Synthesizing Information

How did the law of demand affect the price of stocks in the 1920s and the dot-com stocks in 2001?

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Business cycles are not predictable. The economy can fluctuate significantly or very little over the course of one year or several years. In periods such as during the 1920s, prices remained stable while wages for individuals increased. This increased consumers' purchasing power and improved their standard of living.

The 1930s, on the other hand, is an example of a period of economic decline. In fact, it was the largest economic decline in the history of the United States—the Great Depression. It began with the stock market crash of October 1929. Investors who had paid too much for corporate stock tried to sell their stock as quickly as possible as stock prices fell. This caused stock prices to fall even faster. During the Great Depression, many people lost their businesses, jobs, and homes. The business cycle did not start to recover until World War II, which created a strong demand for military supplies and equipment.

Although World War II pulled the nation out of a severe depression, war is not the best solution to economic problems. World War II greatly increased the total national output, or GDP; however, goods produced did not go to consumers. Actually, the average American's standard of living did not really increase until the late 1940s.

After World War II, the economy continued to fluctuate with minor ups and downs until a recession hit in the early 1980s. Following this downturn, the economy recovered once again, except for the stock market crash in October 1987. The late 1990s brought an economic boom, but it could not last forever, and the nation's economy experienced a lull in the spring of 2001. The growth of the Internet provided a whole new frontier for business innovation. Similar to the Great Depression, many people paid too much for stock. This time the overvalued stock was of companies run by people with little business experience. Eventually, stock prices began to drop. People scrambled to sell shares of the inflated stock. The terrorist attacks of September 11, 2001 followed shortly thereafter. Unlike the Great Depression, however, the resulting recession only lasted eight months.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Do all contractions become recessions? Do all recessions become depressions? Explain why or why not.

2. What is the relationship between businesses investment and economic peaks and contractions?

Informative Writing

Suppose you manage a large corporation that makes prepared food, such as soups, frozen dinners, and frozen breakfast foods. Newspapers have predicted that the economy will experience a contraction in the next six months. You are concerned that people might sell shares of your stock. Write a letter to your stockholders explaining why they should keep the stock. You may invent details about the company to support your argument.

Chapter 13, Section 5 (Pages 356–359)

Causes and Indicators of Business Fluctuations

Big Idea

As you read pages 356–359 in your textbook, complete the time line below by filling in the three broad categories of economic indicators and when they occur relative to an economic change.

	Economic Change	
1.	2.	3.

Notes

Read to Learn

Causes of Business Fluctuations *(page 357)*

Determining Cause and Effect

What might cause a business to decide to lay off workers or to decrease its investment in providing more goods and services?

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Economists believe that four main forces cause economic fluctuations: business investment, government activity, external factors, and psychological factors. Businesses make decisions based on their predictions of trends in the business cycle. Businesses that predict a prosperous economy might decide to increase the goods or services they produce. They hire more workers and buy more equipment or materials. This expansion results in more income for consumer spending. Likewise, **innovation**—turning an invention into something humans can use—has a positive effect on the economy.

On the other hand, businesses that predict the economy will decline may decrease production, stop hiring workers, and decrease spending on materials. When businesses decrease their capital investment, they can push the economy into recession.

Economists also believe that the government, which controls taxes, money supply, and wartime spending, plays a major role in business cycles. Economists also study external factors, such as the availability and the price of raw materials, and people's psychological reactions to events to explain changes in the business cycle.

Notes | Read to Learn

Economic Indicators *(page 358)*

Analyzing Information

Which set of indicators would economists use to predict a change in the economy six months in the future?

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Making Inferences

Why do economists need coincident indicators? What might prevent them from accurately measuring the economy at any given time?

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The government and economists analyze overall business activity and predict economic trends in order to help business leaders make wise economic decisions. To study business activity, they use **economic indicators,** which are statistics that measure variables. Some variables that economists study are the price of stocks and the amount of debt consumers have. The U.S. Department of Commerce and the Conference Board, a private company, gather statistics for all aspects of the U.S. economy each month.

Economists study **leading indicators** to predict business activity in the future. Some of the ten major leading indicators that American economists watch closely are the average weekly hours that manufacturing employees work, new orders for consumer goods, stock prices, and the number of contracts and orders for capital goods. When production workers work more hours each week, it signals that demand for products has increased.

Another type of indicator used to study the U.S. economy is called a **coincident indicator.** Coincident indicators usually change at the same time the overall business activity changes. If the coincident indicator is declining, the economy is declining. As the economy is growing, the coincident indicator shows growth. Some of the main coincident indicators are the number of nonagricultural workers employed, personal income minus transfer payments, rate of industrial production, and the sales of manufacturers, wholesalers, and retailers. When sales are generally strong, it is a good sign that the economy is strong as well.

Lagging indicators follow, or lag behind, changes in overall business activity. They give economists an idea of how long a phase of the business cycle might last. Lagging indicators are the last aspects of the economy to reflect changes in the business cycle. For example, it might take time for the inventory of a manufacturer to decrease when the economy is declining. When sales decline, it takes some time for businesses to decrease the quantity of goods they make. At first, inventories would increase as more goods are produced than sold. Then inventories would level off again as businesses respond. Finally, when sales and demand increase, inventories would decrease before a business could respond by increasing production. This is how the size of manufacturing inventories functions as one of the lagging indicators.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why would businesses pay attention to financial news about leading indicators?

2. Which indicator shows how long a phase of the business cycle will last? Explain.

Expository Writing

Suppose you are an economist studying leading indicators of business activity. You find that interest rates are rising, stock prices are steady, and there is a steep increase in new claims for unemployment insurance. Write an article for a business magazine outlining the direction of the economy over the next six months. Organize your article around cause-and-effect relationships.

Chapter 14, Section 1 (Pages 367–371)

The Functions and Characteristics of Money

Big Idea

As you read pages 367–371 in your textbook, complete this graphic organizer by filling in the functions, characteristics, and types of money.

Money

I. Functions
   A. Medium of exchange
   B.
   C.
II. Characteristics
   A.
   B.
   C.
   D.
   E.
   F.
III. Types
   A.
   B.
   C.
   D.

Notes | Read to Learn

The Functions of Money *(page 368)*

Problems and Solutions

In a voluntary exchange, why is using money easier than bartering?

A market economy is based on voluntary exchange. One way of making this exchange is by using **money**—anything that functions as a medium of exchange, a unit of accounting, and a store of value.

Money is a **medium of exchange** because a seller will accept it in exchange for a good or service. If money did not exist, people would have to **barter,** that is, exchange goods and services for other goods and services. This requires that each party wants exactly what the other party is offering.

Money acts as a **unit of accounting** because it can be used to compare the values of goods and services. Each country has a basic unit to measure such values. In the United States, it is the dollar—a price indicates an item's value in terms of dollars.

Money acts as a **store of value** because it can be used to store purchasing power for later use. For example, a person can sell a house and save the money he or she receives and use money, or the value of that house, at a later time. However, when there is rapid and unpredictable inflation, money's ability to act as a store of value decreases.

Notes | Read to Learn

Characteristics of Money *(page 370)*

Evaluating Information

Determine whether or not each of the following items is as easy to use as money. Explain.

1. Diamonds

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2. Salt

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3. Whale teeth

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At different times, shells, gold, salt, sheep, cattle, gems, animal hides, and tobacco have been used as mediums of exchange. Based on their characteristics, some items are better than others. For example, it is hard to transport sheep, but they are durable.

There are six characteristics that any item should have for people to easily use it as money. Money must be *durable*—it has to withstand being passed from person to person. Although paper money lasts about a year, old bills can be easily replaced. Money must be *portable*—it must be easy to carry. Money must be *divisible*—it has to be able to be easily divided into parts so that things can be bought at any price. Money must be *stable in value*—in order to store value, money's value cannot change quickly over time. Money must be *scarce*—money has value because it is not easily available. Money must be *accepted*—anything that is used as money must be acceptable to others as a medium of exchange in payment for debts. In the United States, people accept paper money, coins, and checks because they know others will continue to accept them in exchange for goods and services.

Types of Money *(page 371)*

Drawing Conclusions

As you read, underline the facts that support the following conclusion.

Unlike commodity money, which can be gathered, herded, or cultivated, fiat money must be issued through a centralized system.

Mediums of exchange such as sheep and salt are known as **commodity money.** In other words, besides their value as money, they also have value as a commodity, or good. **Representative** money is money that is backed by a valuable item such as gold or silver for which it can be exchanged.

In the past, the United States government used paper money in the form of gold and silver certificates to issue representative money. Also, private banks took deposits of gold bars or silver ingots, or bullion, in exchange for a form of paper money called banknotes. The notes represented a bank's promise to convert the paper money back into gold or silver whenever the note holder demanded it. People believed banks would keep an equal value of gold and silver on hand as the issued banknotes. Unfortunately, sometimes people were wrong.

Today, all money in the United States is **fiat money.** It is not backed by gold, silver, or any other commodity. Instead, its face value is set through government *fiat,* or order. It has value because the government has ordered that it be acceptable for payment of debts. This makes the money **legal tender**—money that by law *must* be accepted for payment of public and private debts.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. In the past, some Native American cultures used wampum—beads made from shells—as money. Explain how wampum fulfilled the functions of money.

2. If fiat money, unlike commodity money and representative money, is not backed by something of measurable value, why can it be trusted to store value?

Persuasive Writing

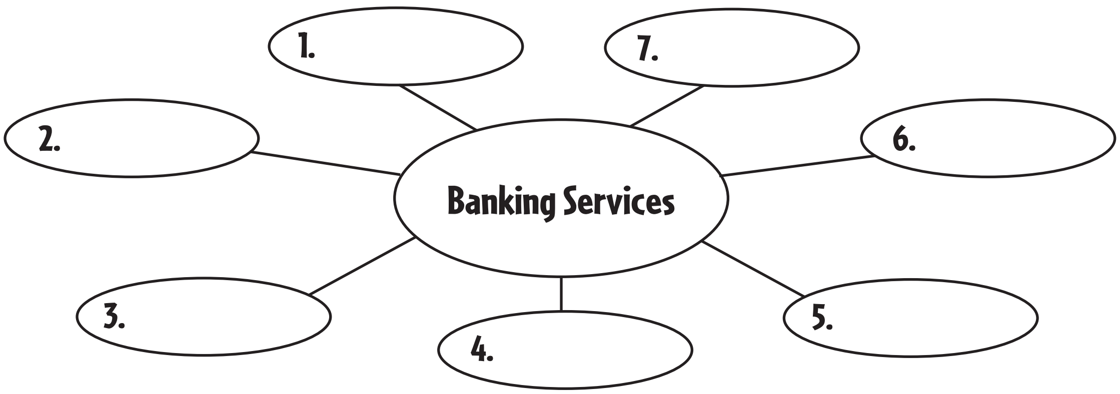
Suppose that the governor proposes that your state make its own money. Write a letter to the editor of a newspaper that opposes the governor's proposal by showing how it might affect the functions of money in the United States.

Chapter 14, Section 2 (Pages 373–377)

History of American Money and Banking

Big Idea

As you read pages 373–377 in your textbook, complete this graphic organizer by filling in the seven present-day banking services described in this section.



Notes

Read to Learn

History of American Banking *(page 374)*

Evaluating Information

From reading about the history of banking and money, answer the following question.

Which type of money fosters a more stable economy: fiat money or representative money?

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In colonial times, bartering was common because England did not allow colonists to print money or mint coins. During the Revolutionary War, the government issued bills of credit called Continentals, but so many were in circulation that they became worthless.

Between 1788 and 1792, the government created the First Bank of the United States, the U.S. mint, and made the dollar the national currency. State banks grew from 1811 to 1816 at the end of First Bank's charter. This led to instability. As a result, the Second Bank put pressure on state banks' practices. The government issued fiat money to pay for the Civil War, which led to safe, uniform currency backed by government bonds.

In the late 1860s to the early 1900s, the monetary standard shifted back to gold. The unregulated banknote supply resulted in money shortages, and after four financial panics, banks closed. In 1913, the government created the Federal Reserve System. Unfortunately, it did not prevent the Great Depression from 1929 to 1940, but the Depression led to the Federal Deposit Insurance Corporation and the return to fiat money.

Notes | Read to Learn

Banking Services *(page 376)*

Making Generalizations

As you read, underline the facts that support the following generalization.

Banks in all 50 states offer overdraft checking.

Analyzing Information

As you read, complete the following sentence.

Electronic funds transfer made features such as

____

and

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possible.

Making Inferences

Consumers who use online banking services should be mindful of changes in their account balance to ensure they are not held responsible for

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____________________.

Today, banks and savings institutions offer many different services. These services include checking accounts, interest on certain kinds of checking accounts, automatic deposit and payment, storage of valuables, transfer of money, and **overdraft checking.** If you have an overdraft checking account, you can write a check for more money than you have in your account. This is a type of credit in which the bank lends you the difference between the amount in your account and the amount of the check. Like other forms of credit, you must pay the money back; however, the interest rate is usually high.

The kinds of banking services that are offered around the country are generally the same. However, the terms and conditions of the services vary from state to state because each state has its own banking laws. A customer should get information on service charges whenever choosing a bank or savings institution.

In the late 1970s, the introduction of the computer led to use of **electronic funds transfer (EFT).** This is a system of directly moving funds from one account to another without paper receipts or money changing hands. **Automated teller machines (ATMs)** are one of the most common uses of EFT. They allow consumers to bank without a teller's help.

Banks also use EFT for online banking. Through the Internet, bank customers can check account balances, transfer funds between accounts, pay bills, and apply for a loan. Some banks do all their business over the Internet.

On the other hand, EFT has some disadvantages. Since all records are stored in a computer, it is easier for criminals to steal information or tamper with accounts. By knowing how to get around a bank's EFT system's safeguards, a criminal could access a bank account anywhere in the country. Identity theft is also a big problem. A criminal who obtains knowledge of a person's Social Security number and other information could use that knowledge to access the victim's accounts or open credit card accounts in the victim's name.

Because of these and other concerns, the Electronic Transfer Act of 1978 was passed. It describes the rights and the responsibilities of participants in EFT systems. One way that the act protects customers is by limiting a customer's losses. Customers are only responsible for $50 in losses when their ATM cards are stolen or used illegally, provided they report the cards as missing within two days. If they fail to timely report the missing cards, however, customers might be responsible for as much as $500. The Electronic Funds Transfer Act also protects customers against losses that occur because of computer errors.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why did an increase in state banks generally lead to instability?

2. What is the purpose of the Electronic Funds Transfer Act of 1978?

Informative Writing

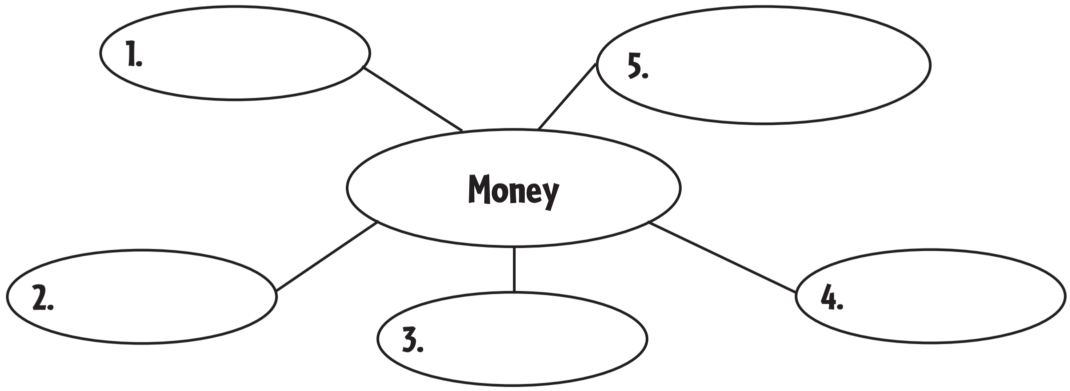
As you read about the history of money and the history of banking, you may have noticed that today many people take the stability of the dollar and of banks for granted. Write a speech for a radio talk show that describes our present-day attitudes about money and how they are different from the attitudes of the 1930s.

Chapter 14, Section 3 (Pages 378–383)

Types of Money in the United States

Big Idea

As you read pages 378–383 in your textbook, complete this graphic organizer by filling in five different forms that money can take in the United States.



Notes

Read to Learn

Money and Near Moneys *(page 379)*

Making Inferences

Keeping in mind the six characteristics of money, why might debit cards someday replace cash?

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There are several forms of money. One form is currency. Most of the nation's currency consists of Federal Reserve notes, or dollar bills made by the Treasury Department.

Checks are another form of money. People can write checks for any amount. When a check is deposited, the bank transfers the funds from one **checking account** to another account, or exchanges it for cash. The funds in checking accounts are called **checkable deposits.** Commercial banks and **thrift institutions**—mutual savings banks, savings and loan associations, and credit unions—hold checkable deposits.

Credit cards represent future claims on money, or funds, that a person will have through a loan by the card issuer. On the other hand, a **debit card,** like a check, automatically withdraws funds from a checking account through an electronic transfer. Using a debit card does not create a loan.

Many other types of funds that store value, called **near moneys,** are almost like money. They can be easily turned into money without risking the loss of value. Time deposits and savings account balances are examples of near moneys because they pay interest and cannot be withdrawn by check.

Notes

Read to Learn

The Money Supply *(page 383)*

Synthesizing Information

As you read, complete the following sentence.

In terms of speed of growth, M2 has grown at a

____

rate than M1.

Predicting

As you read, complete the following sentence.

During the December holiday season in the United States, the size of M1 will probably

___________________.

Determining Cause and Effect

Why has M2 grown more than M1?

____

____

____

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Measuring the amount of money in the United States today is not an easy task. Economists must first agree on a definition of *money supply.* They now use two basic definitions—one narrow and one broad—although other definitions exist. The first is called M1, and the second is called M2.

M1 is the narrowest definition of the money supply. It consists of moneys that can be spent immediately and against which checks can be written. Included in M1 is all currency in circulation. To be in circulation, currency must be in peoples' hands, not in banks. Currency includes all $1, $5, $10, $20, $50, and $100 bills, plus coins, which include pennies, nickels, dimes, quarters, and dollar coins. Also included in M1 are checkable deposits and traveler's checks. Traveler's checks are used like currency, but they have insurance attached to them—if the checks are lost or stolen, the issuer will reimburse the check holder.

In the early 1980s, the government lessened the restrictions on banking services. As a result, different financial institutions created new types of accounts. The definition of the money supply was enlarged to include these new types of accounts, Thus, **M2** is a broader definition of the money supply. It includes all the moneys in M1. But in addition, M2 includes near moneys such as savings deposits, small-denomination time deposits, money market deposit accounts, retail money market mutual fund balances, and other more specialized account balances.

Since M2 is broader than M1, the dollar amount of M2 is greater than M1. In fact, in terms of dollars, the size of M2 is trillions of dollars greater.

The Board of Governors of the Federal Reserve System keeps track of the nation's money supply. Over the years, the difference between M1 and M2 has increased. In 1994, the difference was about 23 trillion dollars. In 2006, the difference had increased to about 54 trillion dollars.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why would some people prefer to receive currency instead of checks for transactions?

2. What can you find by subtracting M1 from M2?

Expository Writing

Compare and contrast which types of "money" are best for different transactions. For example, what form of money would you use to buy a car? What form would you use to buy a movie ticket or to pay rent?

Chapter 15, Section 1 (Pages 392–396)

Organization and Functions of the Fed

Big Idea

As you read pages 392–396 in your textbook, complete the diagram below to illustrate the organization of the Federal Reserve System.

Federal Reserve System

1.

2.

3.

4.

5.

Notes

Read to Learn

Organization of the Federal Reserve System *(page 392)*

Synthesizing Information

What is the purpose of the Fed?

Congress created the Federal Reserve System (or **Fed**) in 1913 as the nation's central banking organization. The Fed conducts **monetary policy,** or plans whether to change the rate of growth of available money to affect the cost and supply of credit. The purpose of the Fed is to stabilize the economy and to encourage businesses and consumers to trust banks.

The Fed is a system, or network, of banks with many parts. The **Board of Governors** oversees the Federal Reserve System. The president appoints the 7 members, but the members implement policies without the review of the president or Congress. The **Federal Advisory Council (FAC)** has 12 members who report quarterly on general business conditions to the Board of Governors. The **Federal Open Market Committee (FOMC)** also has 12 members, including the Board of Governors. The FOMC meets eight times a year to develop strategies that will encourage steady economic growth. These strategies greatly affect the U.S. economy and financial markets around the world. The Board of Governors also oversees 12 Federal Reserve district banks and its 25 supporting branch offices.

Notes | Read to Learn

Functions of the Fed *(page 395)*

Synthesizing Information

As you read, complete the sentence below.

The Fed can increase or decrease business activity gradually to prevent _____________ changes in the market.

Making Generalizations

As you read, complete the sentence below.

The Fed is truly the nation's central banking system since it regulates and provides services to _____________ and advises and provides services to _____________.

The functions of the Fed consist of clearing checks, acting as the federal government's banker, supervising banks, holding reserves and setting reserve requirements, supplying paper and coin currency, and regulating the money supply. The Fed's most important function is regulating the money supply. As the nation's central bank, the Federal Reserve controls the amount of money in circulation. This enables the Fed to influence the overall economy. Businesses carefully monitor the Fed, and the Fed's actions can increase or decrease business activity.

The Fed provides financial services to banks, including circulating currency, clearing checks, and lending funds. **Check clearing** is the process of moving money from one bank to another when consumers write or deposit checks. This is a very complex process in which Federal Reserve Banks credit or debit the reserve accounts of the banks involved in the transaction.

As the government's fiscal agent, or banker, the Fed tracks federal tax deposits and processes government checks (for payments such as Social Security, tax refunds, and veterans' benefits). The Fed is the government's financial advisor, too. For example when unemployment rises and economic activity slows, there are a number of actions officials can take to help the economy grow. Some actions are the responsibility of the Fed, such as lowering interest rates. Other actions are the responsibility of the government, such as lowering taxes. The Fed aims to coordinate its actions with the federal government.

Another important function is regulating and supervising financial institutions. The Fed protects consumers by setting standards, such as truth-in-lending legislation requiring that lenders inform borrowers of the terms of their loan. It also regulates all state banks that belong to the system, holds funds that checks are drawn against, and maintains a majority of the nation's paper money.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Name the four parts of the Federal Reserve System and their specific responsibilities.

2. Why is it important that the Fed is the government's fiscal advisor?

Persuasive Writing

An older friend of the family tells you that he does not trust banks, so he does not deposit his savings in a bank account. Instead he keeps his savings in cash in a safe. Write him a persuasive letter that describes how the Federal Reserve System works to enable Americans to trust banks. Also include why it is good for the economy as a whole for consumers to deposit their savings in banks.

Chapter 15, Section 2 (Pages 398–401)

Money Supply and the Economy

Big Idea

As you read pages 398–401 in your textbook, complete the flowchart below to contrast the effects that a loose or a tight money policy can have on the economy.

Loose Monetary Policy →	1. 2. 3. 4. 5. →	
Tight Monetary Policy	1. 2. 3. 4. 5.	

Notes

Read to Learn

Loose and Tight Money Policies *(page 399)*

Making Inferences

How do the laws of supply and demand apply to monetary policy?

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The goal of the Fed's monetary policy is to help the economy grow steadily without causing inflation. If the Fed perceives that the economy is too sluggish (moving toward *recession*), it adjusts the monetary policy to encourage consumers and businesses to spend and borrow funds. Through a **loose,** or "expansionary," **money policy,** the Fed takes action, which indirectly lowers **interest rates** or increases the amount of funds banks can loan. Lower interest rates and higher money supplies make credit less expensive and easier to obtain. Moreover, consumers and businesses can buy more.

On the other hand, too much money can lead to high *inflation*. In this case, through a **tight** or "contractionary," **money policy,** the Fed takes actions that indirectly increase interest rates or reduce the amount of funds banks can loan. As a result, economic growth is restricted and inflation is controlled. When the money supply contracts, credit is said to be tight. Restricted money supplies and high interest rates make credit more expensive and harder to obtain; therefore, consumers and businesses decrease their spending.

Notes | Read to Learn

Fractional Reserve Banking *(page 400)*

Synthesizing Information

As you read, complete the sentence below.

If the Fed increased the percentage that banks keep in reserve, that would be a _________ money policy.

Problems and Solutions

What problem does fractional reserve banking solve?

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Evaluating Information

How is fractional reserve banking a good use of the scarce resource of money?

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Fractional reserve banking is a system in which banks are only required to keep a fraction of their checkable deposits in reserve, either in their own vaults or as deposits in their Federal Reserve district bank. This means that banks must set aside only a portion of the money that customers deposit, leaving the remaining funds available to loan to businesses and individuals. Lending money is how banks make a profit, because they charge consumers and businesses interest as their cost for borrowing the money. It is important that the Fed requires banks to keep some of their deposits in reserve because customers might need to make large and sudden withdrawals. The Fed sets the **reserve requirements,** or the percentage of checkable deposits that banks must keep on reserve. Although this percentage varies, it is currently around 10 percent for most institutions.

The fractional reserve banking system increases the amount of money in circulation through a process called the multiple expansion of the money supply. Keep in mind the following points as you read about how this works: banks use the remaining 90 percent of the money deposited by customers to make loans, and loans are banks' main source of revenue. Suppose Bank A sells a government bond to the Fed and receives a check for $1,000. When the Fed's check is deposited in Bank A, the $1,000 is essentially "new money." The Fed created the money by writing a check; the money was not in circulation before. The Fed requires Bank A to keep only 10 percent of the $1,000 in reserve, or $100. Bank A then decides to loan the remaining $900 to an electronics store. The electronics store buys MP3 players from Apple Computer. Next, Apple Computer deposits the $900 check in Bank B. Since the Fed only requires Bank B to keep 10 percent of the deposit in reserve, or $90, Bank B loans the remaining $810 to Mr. Richards to renovate his house. Richards pays $810 to the builder who deposits Richards' check in Bank C. This continues until the money cannot be divided any further.

Through these three transactions, a $1,000 check from the Fed is now $2,710 in circulating funds and $271 in reserve, a total of $2,981. Each bank along the chain of transactions loans the nonrequired reserve portion of deposits to businesses and individuals. This process of multiple expansion is central to how the Fed regulates the nation's money supply.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How does a loose money policy affect customers?

2. How does the reserve requirement limit banks?

Informative Writing

Think about the state of the economy today. If you were on the Board of Governors of the Fed, would you recommend a loose monetary policy or a tight monetary policy? To help you make your recommendation, consider the unemployment rate and whether it is easier to buy or to sell a house.

Chapter 15, Section 3 (Pages 402–407)

Regulating the Money Supply

Big Idea

As you read pages 402–407 in your textbook, complete the diagram below by filling in the tools the Fed uses to regulate the money supply.

Controlling the Money Supply

1.

2.

3.

Notes | **Read to Learn**

Changing Reserve Requirements *(page 403)*

Evaluating Information

Why might changing the reserve requirement not be the best strategy to make small adjustments in the economy?

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Raising or lowering the reserve requirement is one way that the Fed can affect the economy. The interest that banks earn on loans motivates banks to loan as much money as possible. When the reserve requirement is raised, banks must gather funds to put in reserve, which then decreases the money supply. As a result, banks might ask borrowers to repay their loans, sell their investments, or borrow funds from another bank or the Fed. If the Fed lowers the reserve requirement, banks have more money to loan, which then increases the money supply. Since all banks have to abide by the same reserve requirement, raising or lowering it significantly changes the amount of money available. Therefore, the rate of growth of the economy slows or accelerates.

The Fed has chosen not to use this tool recently—even a small change in the reserve requirement can cause major repercussions in the money supply. For this reason, changing the reserve requirements may not be a precise enough means to fine tune the economy.

Notes	Read to Learn

Changing the Discount Rate *(page 404)*

Analyzing Information

Name the two types of interest rates that banks pay for loans.

1. ____________

2. ____________

Determining Cause and Effect

What eventually happens to mortgage rates when the Fed raises "the" interest rate?

____

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Another tool that the Fed can use to affect the money supply is to change the **discount rate.** When a bank cannot meet the reserve requirement, it can get a loan from its Federal Reserve district bank. The discount rate is the interest rate that banks are charged when they borrow money from the Fed. The bank, in turn, raises the interest rates that it charges customers to cover the increased cost. It even raises the **prime rate,** or the interest rate that banks charge their most creditworthy business customers. This action discourages borrowing and contracts the economy by restricting the growth of the money supply. On the other hand, a low discount rate will encourage the bank to borrow more, increasing the money supply.

Changing the discount rate is no longer used very often by the Fed. Instead, when the Fed announces that it is going to change "the" interest rate, it is referring to the **federal funds rate,** or the interest rate that banks charge one another for loans. When a bank falls short of meeting the reserve requirement, it is more common for one bank to borrow from another, especially if the discount rate is high. This market of banks' loaning each other money is very active. As a result, changing the federal funds rate has more effect on controlling the pace of economic growth than on changing the discount rate.

Open-Market Operations *(page 406)*

Making Generalizations

As you read, complete the sentence below.

Determining monetary policy to ensure steady growth of the economy is

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____________.

The main tool that the Fed uses to control the money supply is buying and selling government securities, a practice known as **open-market operations.** An open market is for private businesses, so it is not controlled or owned by the government. The Fed buys securities when it wants to increase the money supply and sells securities when it wants to decrease the money supply. When the Fed *buys* from a securities dealer, it pays for the securities by making a deposit in the dealer's bank, thereby increasing the bank's reserves and the funds the bank can lend. When the Fed *sells* securities to dealers, the money paid for them is withdrawn from the bank's reserve accounts, thereby decreasing the bank's reserves.

No matter which method the Fed uses to influence the economy, its effects are not fully felt until 12 months later. Some critics think the Fed should merely increase the monetary supply at the same rate each year. However, it is not the only factor affecting the economy. The government's fiscal policy is also at work.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain why it is more effective to change the federal funds rate than to change the discount rate or the reserve requirement.

2. Why are open-market operations the Fed's primary method of implementing monetary policy?

Expository Writing

Respond by agreeing or disagreeing with the following excerpt from a speech by Chairman of the Board of Governors Ben S. Bernanke at the Annual Convention of American Bankers Association, October 16, 2006: "Making good regulatory policy requires that we take a broad view of the way our rules affect our economy and our society, while maintaining a suitable degree of humility about our ability to accurately quantify the relevant benefits and costs."

Chapter 16, Section 1 (Pages 413–417)

Growth in the Size of Government

Big Idea

As you read pages 413–417 in your textbook, complete this graphic organizer by filling in the time line with key events and dates that led to increasing government size and spending.

1.

2.

3.

4.

Notes

Read to Learn

Government Growth *(page 414)*

Comparing and Contrasting

How is the government's role today different from its role in 1929?

In the past 80 years, the size of the government has grown significantly. Federal, state, and local governments employed about 3 million civilian workers in 1929. But during the Great Depression, demand for government services increased. Now, the federal government employs 2.7 million people. With state and local employees, the total number of government civilian workers is over 22 million.

The number of employees has increased because the number of government functions has increased and the population that the government serves has grown. Government functions include paying for transportation and education, regulating product and worker safety, and collecting taxes.

In the late 1960s, the federal government spent more than state and local governments. It paid for national defense, federal salaries, and **public-works projects**—publicly used facilities such as schools and highways built with tax dollars. Then, around 1970, federal funds began to diminish, while state and local spending rose rapidly to pay for things like sewers, roads, and schools. Today, state and local spending is greater than federal spending.

Notes | **Read to Learn**

Why Has Government Grown? *(page 416)*

Evaluating Information

1. Which of the following factors had the greatest effect on the growth of the government: increased population, increased wealth, or increased demand for services?

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2. Do you agree that "private sector" spending required by law should be included in the size of government? Explain.

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Making Inferences

As you read, complete the sentence below.

One major distinction between political candidates may be their views on ______________________.

Economists have offered a number of reasons to explain the growth in government spending. There appeared to be a need for more government services during the Great Depression. Then, in the 1940s, the government spent billions of dollars for World War II. Still, without similar and recent emergencies, the government has continued to grow. One theory that may explain the continued growth is that as the wealth of the nation increased in the late 1960s and early 1970s, Americans demanded more government services. People wanted to lessen the difference between the very rich and the very poor.

Total government purchases today are about 19 percent of GDP. However, this figure does not include items such as the interest on the national debt that the government has to pay. Total government spending exceeds one-third of GDP.

Government spending alone is not a true measure of the actual size of government in the economy. For example, the taxes used to pay for **Medicare**—a government program that provides health care for the aged—are included in government spending. However, some state governments require employers to provide health insurance for their employees. Using this example, it is easy to see that the true size of government may be greater than the government estimates. That is because some laws require the "private sector" to spend.

Government in the United States grew in the 1900s, but it has grown even faster in the 2000s. Government taxing and spending have opportunity costs: an increase in government activity along the production possibilities curve means there must be a decrease in private economic decision making. Remember that the production possibilities curve shows the maximum combination of goods and services that can be produced with a fixed amount of resources. Moreover, private economic decision making is the core of creating wealth and a higher standard of living for all citizens.

Government spending levels are a reflection of political decisions regarding which goods and services the public or private sectors should produce and/or provide. These decisions answer two basic economic questions: "How should it be produced?" and "For whom should it be produced?" For example, Americans do not agree about the proper level of government involvement in social spending. A case in point is the issue of whether the government should provide universal health care, as many industrialized nations do. Some Americans see access to health care as a right. Others believe that the quality of care would worsen if the government controlled health care.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. After the 1960s, how have the roles of state and local governments and the federal government changed?

2. What is the true relationship between government spending and GDP?

Descriptive Writing

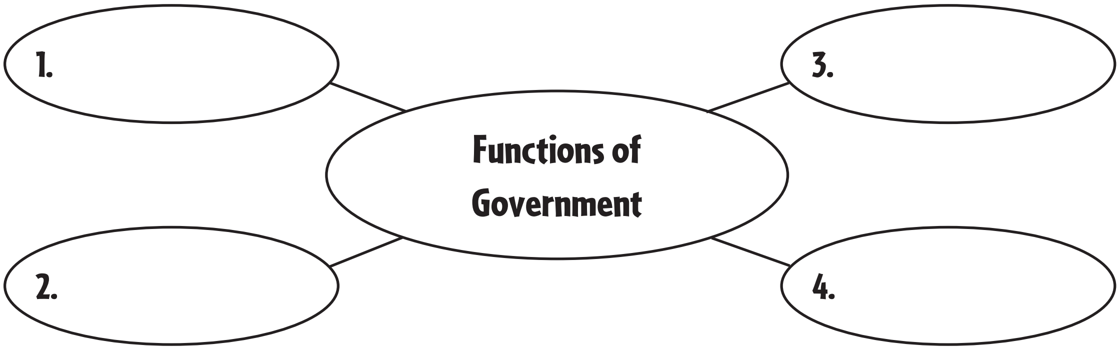
Suppose you lived during the Great Depression. Choose a rural or urban setting of that time and write a story illustrating why Americans wanted more government intervention.

Chapter 16, Section 2 (Pages 418–423)

The Functions of Government

Big Idea

As you read pages 418–423 in your textbook, complete this graphic organizer by filling in the major functions of government.



Notes

Read to Learn

Providing Public Goods *(page 419)*

Analyzing Information

As you read, complete the sentence below.

The goal of government policies involving public goods, merit goods, and demerit goods is to promote the

____

of all citizens.

Public goods are goods or services that can be used by many people at the same time without reducing the benefit each person receives. Usually, the federal, state, and local governments share the responsibility of providing and maintaining public goods. For example, all levels of government maintain separate systems of courts, correctional facilities, and law enforcement. However, only the federal government can provide national defense. The most important public good that only government can provide is the preservation of property rights. People could not own the factors of production and take entrepreneurial risks without it.

Merit goods are certain goods and services that government leaders consider to be socially desirable. Although the demand for the goods, such as parks and museums, may not be high, the community greatly benefits from their existence. The government may fully or partially pay for merit goods. Thus, everyone can enjoy them at less than market price.

Demerit goods are goods deemed socially undesirable like cigarettes and alcohol. The government controls demerit goods by taxing, regulating, or prohibiting their manufacture, sale, and use.

Notes | Read to Learn

Promoting the General Welfare *(page 420)*

Problems and Solutions

How does the government use taxation to help citizens in need?

Government provides for the well-being of the public through **income redistribution,** which takes income from some people though taxation and uses it to assist those in need. The taxes subsidize social-insurance programs and public-assistance programs.

Social-insurance programs pay benefits to retired and disabled workers, their families, and the unemployed. **Social Security** provides *supplemental* income, or a safety net, to retirees and minimal support to people who are unable to work. Medicare provides low-cost health care for retirees. **Workers' compensation** is a state program that pays for medical care for workers who cannot work because of injury on the job. *Unemployment insurance* temporarily provides income to people who have lost their jobs through no fault of their own.

Making Inferences

Why might retired persons need the Medicare program?

Often called **welfare, public-assistance programs** make payments based on need. Payments are modest and intended to help those in need pay for food, clothing, and shelter. **Supplemental Security Income,** for example, is a federal program and makes payments to the aged, the blind, and the disabled. **Temporary Assistance for Needy Families** is a state-run program that gives help and work opportunities to needy families with young children. **Medicaid** is a state and federal program that helps pay health care costs for low-income and disabled persons. The funds do not go directly to individuals but go to the health services provider.

Regulation and Economic Stability *(page 422)*

Drawing Conclusions

As you read, underline the facts that support the following conclusion.

The main role of government in economic regulation and stability is to protect citizens in a free market.

The government intervenes in four ways to *regulate economic activity.* It protects consumers, supervises labor and management relations, promotes competition, and regulates **externalities**—economic side effects or by-products that can affect uninvolved third parties. Negative externalities include pollution, depletion of natural resources, or bankruptcy. The government also tries to e*nsure economic stability.* It intervenes to protect people from the harmful economic effects of the ups and downs of business, such as unemployment and recessions.

Critics of government involvement believe that taxpayers should not pay for merit goods. People would then have more disposable income to pay for such goods. They also believe that redistribution discourages personal initiative and self-development and that most regulations raise the prices of goods and services. They believe the market can solve its own problems without government intervention.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the difference between merit goods and demerit goods?

2. Which social-insurance and public assistance programs help people who are unable to work?

Persuasive Writing

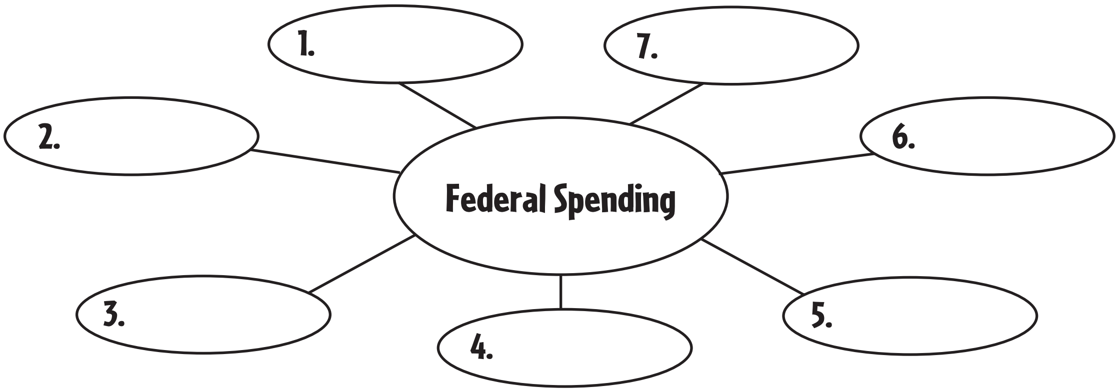
Write a speech that argues for less government involvement in the economy. Support your argument with facts you know about our free-market economy and what is shown by the production possibilities curve.

Chapter 16, Section 3 (Pages 425–429)

The Federal Budget and the National Debt

Big Idea

As you read pages 425–429 in your textbook, complete this graphic organizer by filling in the seven largest expenses for the federal government.



Notes

Read to Learn

The Budget-Making Process *(page 426)*

Drawing Conclusions

As you read, underline the facts that support the following conclusion.

Although Congress must approve the federal budget, it does not actually spend the funds.

The federal budget is based on tax receipts and expenses. The major receipts are individual income taxes, social-insurance taxes and contributions, and corporate income taxes. The largest expenses are national defense, income security, Social Security, and Medicare, and health and net interest.

The government determines a budget for each **fiscal year,** from October 1 through September 30. About 18 months before October 1, executive branch agencies submit requests for funds to the Office of Management and Budget (OMB). The president and the OMB review the requests, make a budget, and send it to Congress. The House and Senate budget committees review the budget and prepare a resolution for Congress to debate. The budget should be finalized, along with two binding budget resolutions, and passed into law before September 25 of the preceding fiscal year. When the fiscal year begins on October 1, agencies apply the budget and give out funds. At the end of the fiscal year, the Government Accountability Office evaluates the fiscal-year spending.

Often the budgets do not get passed on time and agencies can keep spending based on the year before.

Notes | Read to Learn

The National Debt *(page 428)*

Synthesizing Information

As you read, complete the following sentence.

Both the government and individuals can choose to _________ or ___________.

Making Inferences

What is the financial incentive of businesses and individuals for buying U.S. savings bonds?

____

____

____

____

Identifying the Main Idea

Underline the sentence that gives the main idea of the fourth paragraph of this passage.

The goal of the federal budget-making process is to decide how to allocate scarce resources. For most fiscal years, there is a **budget deficit**—the government's expenses are greater than its receipts. Just as a consumer must obtain a loan to pay the cost of things above his or her income, the government must obtain funds through borrowing. Government overspending is called **deficit financing.**

The government borrows funds by selling government securities to individuals, businesses, and foreign governments. An individual who buys U.S. savings bonds is actually lending money to the federal government. Individual federal agencies can also sell bonds. State and local governments sell bonds to pay for some of their activities, too.

In each fiscal year, the federal government creates new debt when it issues new securities for sale. Each year, however, it also satisfies old debt by paying off its securities as they come due. **National debt,** or public debt, is the total amount of outstanding debt for the federal government at any given time. The national debt can be calculated by subtracting the total yearly surpluses from the total yearly deficits.

In 1998, the federal government began to have a **budget surplus.** A budget surplus occurs when the amount of government receipts is greater than its expenses over one fiscal year. At the beginning of 2001, there was a projected 10-year budget surplus of $5.6 trillion. However, after the terrorist attacks of September 11, 2001, under President George W. Bush, the federal government began to spend huge amounts of funds on antiterrorism activities. In addition, Congress, with the president's approval, dramatically increased spending for domestic programs even though it was passing major tax cuts as well. In less than three years after President Bush took office in early 2001, the government was projecting a 10-year budget *deficit* of $4.4 trillion.

Are budget deficits good or bad for a nation's economy? The answer may seem obvious. Not all economists and government officials agree, however, that a balanced budget results in a stronger economy. They do agree that a nation's debt can eventually grow too large and destabilize the economy.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the main role of the OMB in the federal budget-making process?

2. Write an equation for calculating the national debt.

Expository Writing

Just like individuals, when the government tries to balance the federal budget, it must make trade-offs and weigh the opportunity cost of each economic decision. Look at the circle graphs on page 426 of your textbook and recommend which expenses might be decreased and/or which taxes might be increased to balance the federal budget. Describe the trade-offs of each of your recommendations.

Chapter 16, Section 4 (Pages 430–433)

Taxation

Big Idea

As you read pages 430–433 in your textbook, complete the graphic organizer below by filling in the definitions of the two main principles of taxation and examples for each.

Principles of Taxation		
Principle	**Definition**	**Example**
Benefits-received principle		
Ability-to-pay principle		

Notes

Read to Learn

Principles of Taxation *(page 431)*

Making Generalizations

Under which principle of taxation are local police and firefighting services paid?

Underline the facts in the passage that support your answer.

One of two major principles the government uses to justify taxes is the **benefits-received principle.** It states that the people who use a particular government service should support it by paying taxes in proportion to the benefit they receive. Under this principle, those who do not use the service do not pay for it. Toll bridges, roads, and tunnels are examples of a tax that pays for their upkeep and repair. Drivers who pay the most tolls benefit the most from them.

Taxes based on the benefits-received principle work when funds are needed to pay for a service only certain people use. However, many government services benefit everyone equally, such as the federal court system. In addition, people who are most in need of government services, such as the elderly, the ill, and the poor, are the ones who are most likely to be unable to pay taxes. The **ability-to-pay principle** states that those with higher incomes pay more taxes than those with lower incomes, regardless of the number of services they use. For example, people with higher incomes pay more in personal income taxes, even though they are less likely to need help through government programs.

Notes | Read to Learn

Forms of Taxation *(page 432)*

Formulating Questions

Before you read, think of two questions about the forms of taxes you think the passage will answer.

1. ____________________

____

2. ____________________

____

Determining Cause and Effect

What is the compound effect of a progressive tax on income as that income level rises?

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Analyzing Information

For each type of tax, name its classification and type.

1. Gas tax

____

2. Real estate tax

____

3. Fur clothing tax

____

In the United States, people classify taxes based on whether the taxes are proportional, progressive, or regressive. A **proportional tax** is easy to understand. It means you pay taxes based on a percentage of the amount of income you earn. As a result, when your income increases, the amount of taxes you owe also increases, but in the same proportion.

A **progressive tax** imposes a greater rate of taxation on higher incomes than on lower incomes. In other words, as a taxpayer's money income rises, he or she pays a higher percentage of that income in taxes. Federal individual income taxes are an example of a progressive tax. The ability-to-pay principle is what justifies progressive taxes.

The opposite of a progressive tax is a **regressive tax.** In this case, the proportion of money income paid in taxes decreases as money income increases. Sales taxes on necessities like food are one example of a regressive tax. Everyone must buy food, and the amount of food each person buys does not change much from person to person. Thus, a low-income person will pay a higher proportion of his or her income in sales taxes on food than a person with a higher income.

Following are some examples of major taxes (and their classes) in the United States. The *personal income tax* (usually progressive) is a percentage of income and a major source of receipts for the federal government and some states. The Federal Insurance Contributions Act (FICA) covers *social-insurance taxes* (proportional up to a certain income level, and regressive above that) and are the second-largest source of federal receipts. The federal government and some states collect *corporate income taxes* (progressive up to a certain amount on the federal level, and proportional above that) and are a percentage of corporate profits. A consumer pays an **excise tax** (may be regressive) based on the manufacture, use, and consumption of certain goods and services. The federal government and some states collect an *estate tax* (progressive) on the property of someone who has passed away. People who inherit property from a deceased's estate pay an *inheritance tax* (classification varies by state) to their state. Someone who gives a large gift during his or her lifetime pays a gift tax (progressive) to the federal government. Almost all states, and many localities, have *sales taxes* (may be regressive) whose rates and types differ from place to place. State and local governments impose *property taxes* (proportional) that they base on the value of real and personal property. Importers pay *customs duties* (proportional) which are taxes on imported goods.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How is a cigarette tax issued by a state government to fund the health-care costs resulting from tobacco-related diseases justified?

2. Why do some localities only charge sales tax on purchases over $100?

Informative Writing

Think about which taxes you will pay as a young adult living on your own. You will probably have a full-time job, rent an apartment, and drive a car. Remember that taxes also depend on where you live. Describe what your life may be like and the forms and types of taxes you will most likely pay.

Chapter 17, Section 1 (Pages 441–445)

Unemployment and Inflation

Big Idea

As you read pages 441–445 in your textbook, complete a cause-and-effect diagram like the one below by listing the main causes of demand-pull and cost-push inflation.

Causes of Inflation

1. 2. 3. 4. 5.	1. 2. 3.
↓ Demand-pull inflation	↓ Cost-push inflation

Notes | **Read to Learn**

Measuring Unemployment *(page 442)*

Evaluating Information

Why is the unemployment rate an important indicator of the health of the economy?

____

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High unemployment and inflation are two of the biggest threats to America's economic stability. To keep the economy healthy, the federal government uses monetary and fiscal policies called **stabilization policies.**

Expert economists advise government officials about the causes and cures of economic problems. One statistic they consider is the **unemployment rate.** This is the percentage of the civilian labor force without jobs but actively looking for work. High unemployment indicates the economy is not doing well and human resources are being wasted. Therefore, low unemployment is a major goal in stabilizing the economy.

There are many types of unemployment, including cyclical, structural, seasonal, and frictional. Moreover, not all unemployment can or should be eliminated. Although economists disagree on the level of **full employment,** most consider it to be when the unemployment rate is around 5 percent.

Unemployment is difficult to measure, and the rate is only an estimate. Survey results are imperfect, in part because of the **underground economy.** People in this economy do not follow state and federal laws in reporting earnings.

Notes

Read to Learn

Inflation *(page 444)*

Problems and Solutions

Describe ways in which consumers who are part of the labor force can adapt to inflation.

Comparing and Contrasting

Think about demand-pull inflation and cost-push inflation. How are they alike and how are they different?

Inflation is another major problem that economists watch carefully. While the economy can usually adapt to gradually rising prices, unpredictable inflation has a destabilizing effect on it. Inflation may affect consumers' standard of living, but it usually becomes a serious problem only for people who are on fixed incomes. For example, consumers who are part of the labor force might receive pay increases that help offset inflation. They may spend less on luxury items, such as vacations. During inflationary periods, people on fixed incomes may have difficulty purchasing necessary goods and services. People with medical problems may have to choose between buying food and necessary medication.

Economists do not agree on one explanation of why inflation exists. Two competing theories have developed: the demand-pull theory and the cost-push theory. The **demand-pull inflation** theory means that prices rise as a result of excessive business and consumer demand. If the economy-wide demand increases faster than total supply, the shortage leads to rising prices. There are several reasons why this may happen. One reason is that the money supply grows too rapidly, and consumers will spend additional money on limited goods and services. If taxes are reduced or consumers begin saving less, this can lead to a higher aggregate demand, or an increase in total planned purchases of the whole economy. In addition, increases in business investment and government spending increase overall demand.

The demand-pull theory assumes that a rise in demand means output will rise and unemployment will decline. Experience indicates, however, that rising prices and unemployment can occur at the same time. This low economic activity combined with inflation is called **stagflation.**

In some economists' opinions, stagflation is the result of **cost-push inflation.** The cost-push inflation theory states that wage demands of labor unions push up prices. When businesses have to pay higher wages, their costs increase. As a result, they must raise the prices of goods and services produced to maintain the same level of profits. Unemployment during cost-push inflation can remain high because wages and profits affect prices, rather than aggregate demand. Without an increase in aggregate demand, businesses do not have a reason to increase their output by hiring new workers.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How do high unemployment and inflation threaten economic stability?

2. Explain why stagflation is the result of cost-push inflation and not demand-pull inflation.

Expository Writing

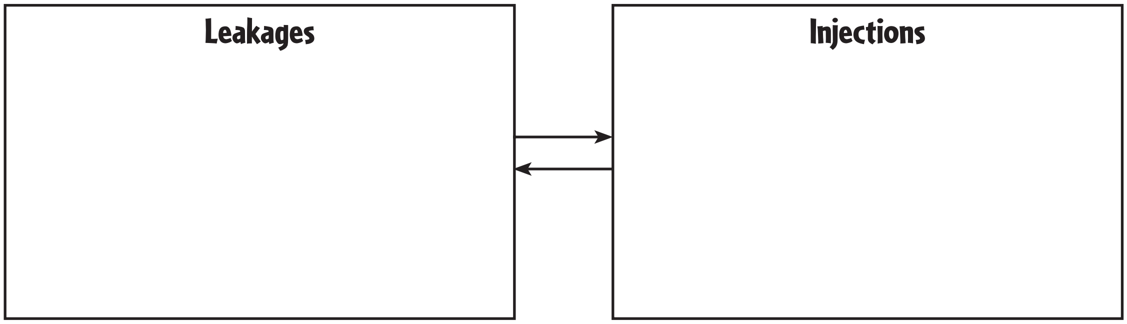
Write a cause-and-effect essay that predicts what would happen if the minimum wage was greatly increased nationwide.

Chapter 17, Section 2 (Pages 447–451)

The Fiscal Policy Approach to Stabilization

Big Idea

As you read pages 447–451 in your textbook, complete the diagram below to show how money moves around outside the circular flow of income.



Notes

Read to Learn

The Circular Flow of Income and Output *(page 448)*

Drawing Conclusions

As you read, underline the facts that support the following conclusion.

If more leakages occur than injections, the economy will not be in a state of equilibrium.

The **circular flow of income and output** shows that income flows between businesses and consumers. Money income moves from businesses to households as wages, rents, interest, and profits. Income goes from households to businesses as payments for consumer goods and services.

Consumer saving and government taxation remove some income from the circular flow, called leakage. The injection of money income occurs through business investment and government spending. Injection offsets leakage. Ideally, injections and leakages create a state of equilibrium in an economy.

Fiscal policy is the federal government's use of taxation and spending policies to affect overall business activity. During the Great Depression, John Maynard Keynes developed fiscal policy theories. His ideas about fiscal policy are now called Keynesian theory. The circular flow of income and output helps us understand Keynesian theory. Keynes believed that in a serious recession, the forces of aggregate supply and demand operate too slowly. He believed that government should stimulate aggregate demand by spending more.

Notes

Read to Learn

Fiscal Policy and Supply-Side Effects *(page 450)*

Determining Cause and Effect

If the tax rate applied to dividends drops from 39.9 percent to 15 percent, will a shareholder owe more or less in taxes?

Evaluating Information

Label the following fiscal policies as decreasing leaks or increasing injections.

1. ***Tax cuts for businesses***
2. ***Job programs***
3. ***Tax cuts for investors***
4. ***Social-insurance programs***

During the Great Depression, the government had to act to decrease unemployment. Consequently, President Franklin Roosevelt created the Works Progress Administration (WPA). The WPA created jobs by building roads, bridges, parks, and airports across the country.

Supply-side economists would disagree with Roosevelt's Keynesian program. They believe that less federal involvement in the form of strategically cutting taxes is a better way to use fiscal policy to stimulate the economy. Supply-side economists argue that tax credits to businesses result in more work, more savings, and more investment. These are called supply-side effects.

When businesses receive tax credits on capital investments, they can deduct a portion of the costs of new capital equipment from their taxes. This provides an incentive for businesses to expand. Expansion requires businesses to hire more workers and buy more materials. This is why supply-side economists believe that tax cuts fight unemployment and speed up economic activity.

One example of supply-side economics is the Jobs and Growth Act of 2003. President Bush and other supply-side supporters expected the law to increase economic growth. Tax cuts that were originally intended to be phased in over several years instead became effective in 2003. The highest tax rate fell from 39.6 percent to 35 percent.

Investors in particular received many tax cuts from the Jobs and Growth Act of 2003. For instance, dividends—income payments to shareholders of corporations—got a tax decrease. The tax rate applied to dividends fell from as high as 39.9 percent to 15 percent. In addition, the tax rate on long-term capital gains dropped from 20 percent to 15 percent. For certain low-income earners, this rate dropped to 5 percent.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Explain how money income is both leaked and injected into the circular flow of income and output.

2. How does Keynesian theory differ from supply-side economics?

Persuasive Writing

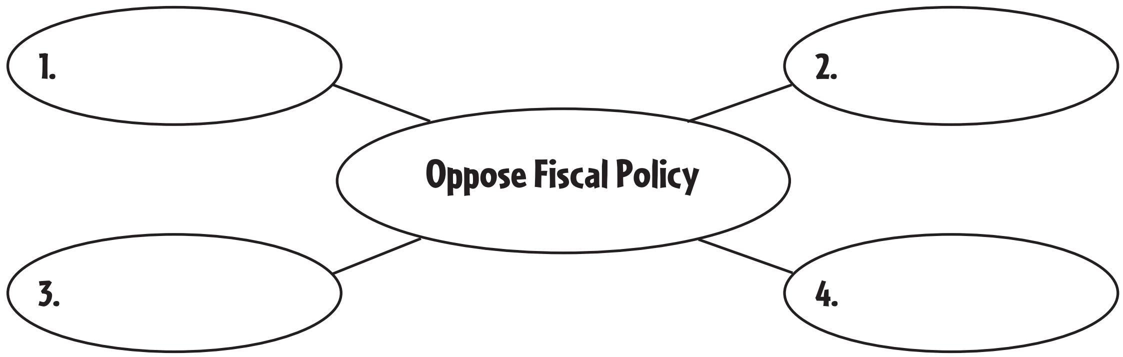
Suppose you are running for president of the United States and you are a big supporter of Keynesian economics. Write a speech that outlines why the Jobs and Growth Act of 2003 should be reversed, and describe your own Keynesian economic plan that you will implement as president.

Chapter 17, Section 3 (Pages 452–457)

Monetarism and the Economy

Big Idea

As you read pages 452–457 in your textbook, complete the web diagram below by listing the reasons why monetarists oppose using fiscal policy to slow or to stimulate the economy.



Notes | Read to Learn

The Theory of Monetarism *(page 453)*

Distinguishing Fact from Opinion

Is the statement "The Federal Reserve monetary policy is the best means to maintain economic stability" a fact or an opinion? Explain.

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Some economists—**monetarists**—believe that fiscal policy does not play a big role in stabilizing the economy. Monetarists believe instead that Federal Reserve monetary policy is the best means to maintain economic stability. **Monetarism** is the theory that deals with the relationships between the amount of money that the Federal Reserve places in circulation and the level of activity in the national economy.

Monetarists argue that the Fed should change the money supply at a smooth, given percent every year. If the Fed increases the amount of money in circulation too quickly, then people borrow more and spend more. This situation could lead to inflation.

Monetarists maintain that when the economy is operating below capacity, demand increases. The increased demand will lead, in turn, to a rise in output. Businesses will have to hire more workers to produce more. Increased hiring means decreased unemployment.

Monetarists warn, however, that if the economy is already operating at full employment, then the increased aggregate demand will lead to a rise in prices—inflation

Notes | Read to Learn

Government Policy According to Monetarists *(page 454)*

Drawing Conclusions

As you read, complete the sentence below.

Fiscal policies, such as tax credits for businesses, can increase the ______________ because they ____________ tax receipts.

Monetarists oppose using fiscal policy to stimulate or to slow the economy. They do not believe that the government should operate with budget deficits each year in an attempt to stimulate the economy. Operating with budget deficits causes government to compete with private business for funds in the credit market. Balancing the budget, however, prevents government from competing with businesses. Monetarists want the government to balance the federal budget.

In addition, monetarists believe that a steady growth in the money supply within strict guidelines, or targets, would prevent rapid inflation or high unemployment. Monetarists argue that the Fed should follow a **monetary rule,** or allow the money supply to grow smoothly at a rate of 3 to 5 percent every year.

Ben S. Bernanke is the current chair of the Federal Reserve System. He has said that the United States should use **inflation targeting,** or steering the inflation rate toward a specific target, such as 2 percent per year. The Fed can steer inflation toward the target rate by changing interest rates and by other monetary tools.

Monetarists' Criticism of Fiscal Policy *(page 456)*

Synthesizing Information

Which branch of government has the most influence over fiscal policy? Explain.

____

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Monetarists believe that fiscal policy rarely matches the real economic climate. One reason is that no single government body designs and implements fiscal policy. Another reason is **time lags,** or periods between the time fiscal policy is enacted and the time it becomes effective.

Fiscal policy begins when the president and several advisers design the desired mix of taxes and government expenditures, which the president then recommends to Congress. Congress enacts the fiscal policy with the help of many committees.

Monetarists do not like the fact that the political process influences the creation of fiscal policy. For example, members of Congress disagree about proper fiscal policy. At times, Congress disagrees with the president. Furthermore, politicians sometimes take steps that will help them get elected but might hurt the economy in the long run.

Time lags always occur between the point that the fiscal policy is enacted and the time when it actually affects the economy. A policy designed to combat a recession might not become effective until the economy swings back into inflation. Also, fiscal policy stimuli can take years to raise employment.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. According to monetarists, what might happen if the Fed increases the amount of money in circulation too quickly?

2. What is a monetarist's point of view about the political process and the creation of fiscal policy? Explain your answer.

Expository Writing

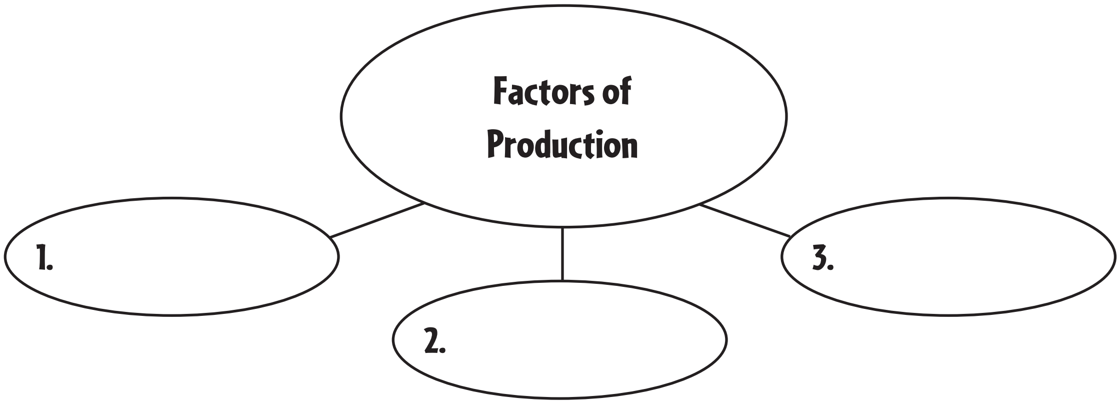
Imagine that you are a monetarist who has been invited to lecture to a high-school economics class. Prepare a lecture in which you must explain monetarism and monetarists. Remember to define unfamiliar terms and ideas in a way that the students can understand. Refer to the completed graphic organizer to help you.

Chapter 18, Section 1 (Pages 465–469)

The Benefits of World Trade

Big Idea

As you read pages 465–469 in your textbook, complete this web diagram by listing the different factors of production that make it necessary for nations to trade with one another.



Notes | **Read to Learn**

Benefits of Trade *(page 466)*

Synthesizing Information

When a country cannot make goods and services efficiently, they must ______ them at a ______ price.

Nations have varying types and amounts of natural resources, labor, and capital, or factors of production. For example, some countries have more oil, while others have more technology, and still others may have a better-educated labor force. Nations trade to obtain goods or services that they don't have or cannot produce efficiently themselves. Goods or services purchased from other nations are called **imports,** and goods or services sold to other nations are called **exports.**

Since the United States has a diverse climate, many natural resources, and a large and diverse labor force, it can produce many things that the country wants and needs. Even so, the United States imports many goods and services. For example, Miami, Florida, is the hub of imported fresh-cut flowers. In fact, members of the floral industry nationwide import a majority of their goods. The United States exports many goods and services as well, including produce to New Zealand, fertilizer and pesticides to China, and machinery to India. Countries benefit from trade with one another when each concentrates on the goods and services it can produce most efficiently.

Notes | Read to Learn

Absolute and Comparative Advantage *(page 467)*

Drawing Conclusions

As you read, complete the sentence below.

Countries always benefit from trade because there are always products that other countries can produce ______________.

Analyzing Information

Why does the nation Alpha have an absolute advantage over Beta regarding tuna and shrimp?

____

____

____

Making Inferences

Why might it be hard for nations to measure the opportunity costs of their trade decisions?

____

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When one country can produce more outputs (goods or services) with the same quantity of inputs (factors of production) than another country, it has an **absolute advantage.** Climate and geography are factors that greatly affect which agricultural products a country can produce. Colombia has an absolute advantage over Canada when it comes to producing coffee beans; Canada has absolute advantage over Columbia when it comes to producing maple syrup.

Trade promotes the efficient use of the world's resources by encouraging **specialization.** A nation's factors of production influence how efficiently or cheaply it is able to produce different goods. It is more profitable for nations to export goods that they produce more efficiently because they can sell more of them at a lower price. Even if one country could produce every item more cheaply than another country, it will still benefit from trade when it considers the opportunity cost of production.

A nation has a **comparative advantage** over another nation when it chooses to only produce the goods that have a lower opportunity cost as compared to other nations. For example, suppose there are two island nations named Alpha and Beta. Both nations have plentiful supplies of tuna and shrimp. One year, both nations decide to fish only for tuna. During that year, Alpha produces 500 tons of tuna while Beta produces 450 tons. The following year, both nations decide to fish only for shrimp. Alpha produces 250 tons while Beta produces 100 tons. Alpha has the absolute advantage over Beta regarding both tuna and shrimp. Nonetheless, Alpha would benefit from trading shrimp for tuna with Beta. This is because Alpha produces considerably more shrimp than Beta. Therefore, producing shrimp has the lowest opportunity cost—what it gives up to get something else—and gives Alpha a comparative advantage. Consider how Alpha uses its labor, natural resources, and equipment most efficiently in shrimp fishing compared with tuna fishing. Beta also benefits from trading tuna for shrimp with Alpha. Beta's ability to produce tuna efficiently is not much less than Alpha's. Whereas Beta's ability to produce shrimp efficiently is significantly less than Alpha's. When each country specializes in producing and exporting only those products in which they have a comparative advantage, both nations maximize their resources to produce the greatest possible output.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How does a nation's factors of production determine which items they import or export?

2. Which is most desirable, an absolute advantage or comparative advantage? Explain.

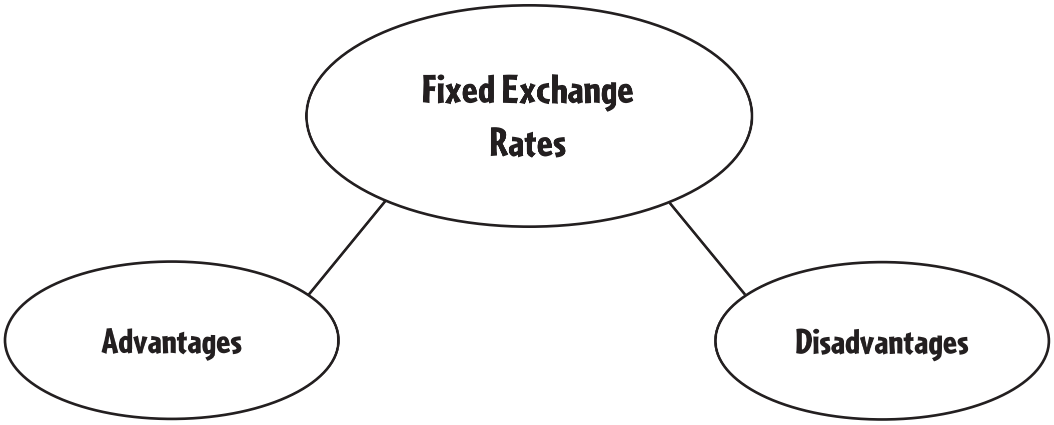
Persuasive Writing

One of your senators opposes a bill that would increase trade with India. He is concerned that the United States would lose jobs if it became easier for businesses to move part of their manufacturing overseas. Write an editorial for your local paper explaining how the United States economy benefits from trade.

Financing World Trade

Big Idea

As you read pages 471–476 in your textbook, complete this web diagram by listing the advantages and the disadvantages of a fixed exchange rate.



Notes | **Read to Learn**

Fixed Exchange Rates *(page 472)*

Drawing Conclusions

Under a fixed exchange rate, how might a government boost exports when demand for its goods fall due to inflation?

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Exchange rates solve basic problems between producers and consumers of different nations, including how to compare prices and make transactions. An **exchange rate** is the price of one nation's currency in relation to another nation's currency. People who work in the **foreign exchange markets** buy and sell currencies for businesses that import goods. Businesses can also convert currencies through banks.

From 1945 to the early 1970s, currencies traded through the foreign exchange market had a **fixed rate of exchange.** The **International Monetary Fund (IMF)** and its member countries supported this system. Governments set the value of their currency in relation to a single standard. Because businesses knew exactly how much of a foreign currency they could purchase, they could predict the quantity of goods to import. This proved to be an advantage. A disadvantage of the system, however, was that a nation's currency could be **devalued,** or lowered relative to other currencies by a government order.

Eventually a fixed exchange rate system proved too impractical. As various nations' economies fluctuated, trade imbalances occurred.

Notes | # Read to Learn

Flexible Exchange Rates *(page 474)*

Synthesizing Information

As you read, complete the sentence below.

It is desirable for nations to create international demand for their goods to prevent ________________.

Most nations today follow a system of **flexible exchange rates,** in which the market forces of supply and demand determine the price or exchange rates of various currencies. Under such a system, exchange rates can "float," or go up or down, according to changes in the market.

How do the forces of supply and demand operate in a competitive trade market? Demand for foreign goods drives demand for foreign currencies. For instance, suppose that rising demand for Japanese consumer electronics in the United States is greater than Japanese demand for American products. This causes the Japanese yen to increase in value in relation to the dollar. When this happens, Japanese goods become more expensive. If we decided to import electronics from China instead of Japan, our demand for Japanese products would decrease, as would the demand for the yen. This causes the yen to **depreciate,** or decrease in value, making Japanese products less expensive.

Political or economic instability also increases demand for stable currencies. In countries experiencing rapid inflation or political upheaval, people might seek to exchange their currency for one that is more stable, often the U.S. dollar. This would cause the country's currency to depreciate against the more-desirable currency.

Balance of Trade *(page 475)*

Making Inferences

What are two other positive effects of foreign investment not mentioned in the passage?

1. ____________________

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2. ____________________

____

A nation's **balance of trade** is the difference between the value of its exports and imports. A nation that exports more than it imports has a positive balance of trade, or a trade surplus. A nation that imports more than it exports has a negative balance of trade, or a trade *deficit*. The exchange rate of a currency affects the balance of trade. When a nation's currency depreciates, or decreases in value, that nation's exports may increase because its products are cheaper for other nations to buy. When a nation's currency increases in value, however, its exports may decrease.

The United States has a trade deficit. The trade deficit has been growing since the early 1970s, and foreign investment in the United States economy has increased. Foreign investment has many effects, including creating jobs. Therefore, a negative balance of trade is not necessarily an economic problem that needs to be fixed.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What drives demand for a particular currency?

2. How would the market react to a trade deficit under a system of flexible exchange rates?

Expository Writing

Suppose you are interested in opening a business importing exotic fruits and vegetables. Write a description of all the potential problems you may encounter doing business overseas. Also include any solutions to the problems discussed in your textbook.

Chapter 18, Section 3 (Pages 477–481)

Restrictions on World Trade

Big Idea

As you read pages 477–481 in your textbook, complete the table below by listing arguments for and against free trade.

Arguments for Free Trade	Arguments Against Free Trade

Notes

Read to Learn

Three Ways to Restrict Imports *(page 478)*

Synthesizing Information

As you read, complete the sentence below.

A protective tariff increases the ______ of imports, while a quota restricts the ______ of imports.

Governments restrict imports through tariffs, quotas, and embargoes. There are two types of **tariffs,** or taxes, which governments add to the price of an import. The purpose of a **revenue tariff** is to gather revenue for the federal government without greatly affecting the price of the imports. The purpose of a **protective tariff** is to make an imported good very expensive compared with a similar domestic good.

Import quotas give governments more control over specific products or industries. An import quota restricts the number of units of a specific good allowed to be brought into the country. This method controls the supply of foreign products.

A government enacts an embargo as a political tool to create economic pressure. An **embargo** is a complete restriction on imports or exports of a particular good or goods.

Free-trade supporters argue that unrestricted trade results in increased competition, leading to improved products, a stronger export industry, and specialization and comparative advantage. **Protectionists** argue that restrictions are needed to protect jobs, key industries, and young industries.

Notes | Read to Learn

International Trade Agreements *(page 480)*

Making Inferences

The WTO is not a political organization, but by promoting trade between nations, it is also promoting ______________.

Determining Cause and Effect

What effect would you expect CAFTA to have on a U.S. trade deficit with the region?

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Predicting

How will the growth of the EU market affect United States businesses?

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Various organizations and countries are continually working to encourage and facilitate trade. The **World Trade Organization (WTO)** negotiates trade agreements between over 140 member nations. The organization's goal is to promote free trade by reducing trade barriers. Other functions of the WTO include setting and enforcing international trade policies, handling trade disputes, and helping developing countries benefit from trade.

Agricultural trade barriers are one problem the WTO is working to solve. The United States and Europe protect their agricultural industries by providing financial support in various forms. Consequently, the price of U.S. and European agricultural goods are much lower than other nations' agricultural goods. This gives these producers an unfair advantage, and it is particularly harmful to agricultural producers in developing countries. The WTO believes that such actions ultimately hurt consumers worldwide by raising the price of food or increasing taxes to support agricultural businesses.

Countries have reached regional trade agreements to increase free trade. A few examples include the **North American Free Trade Agreement (NAFTA), the Central American Free Trade Agreement (CAFTA),** and the **European Union (EU).** The U.S. Congress approved NAFTA in 1993. It is a trade agreement between the United States, Canada, and Mexico. The agreement gradually reduced tariff barriers in order to improve trade between the three partners.

Similarly, CAFTA was enacted in 2005 as a trade agreement between Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic, and the United States. CAFTA successfully eliminated tariffs on more than 80 percent of U.S. exports to the region.

To encourage free trade among nations, European leaders created the European Union (EU). Today, the EU consists of 25 European nations, many of which have adopted a common currency, called the euro. The EU has also worked to gradually eliminate trade restrictions between member countries since 1993. The number of member countries continues to grow, along with the number of countries that have adopted the euro. Eventually, the market size of the EU will rival that of the United States.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How do trade embargoes create economic pressure?

2. What do NAFTA, CAFTA, and the EU have in common?

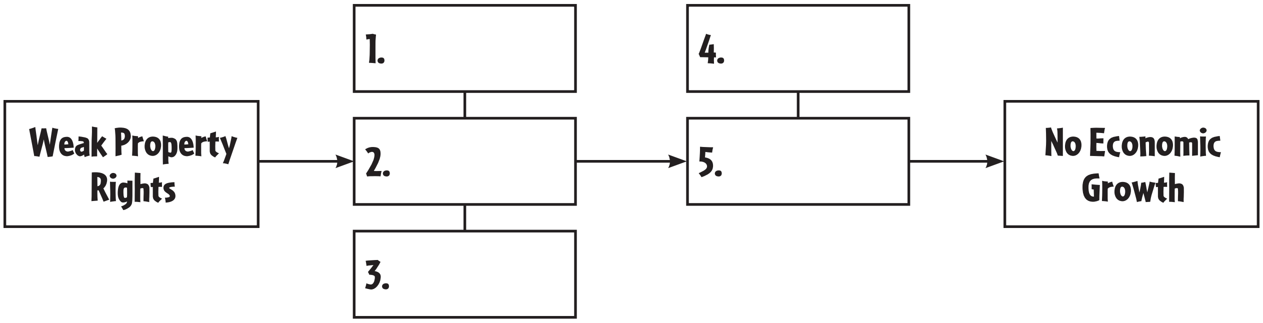
Descriptive Writing

Write a short story in which a soybean farmer from a developing country, such as Brazil, meets a soybean farmer from the United States at a farm equipment convention. Include details and dialogue that illustrate both characters' opinions on free trade.

Characteristics of Developing Nations

Big Idea

As you read pages 489–493 in your textbook, complete this diagram to explain why poorly defined property rights are a major cause of poverty in developing nations.



Notes

Read to Learn

Developed and Developing Nations *(page 490)*

Determining Cause and Effect

How can religion affect a nation's economic growth?

Developed nations have relatively high standards of living, and their economies are based more on industry than on agriculture. About 35 nations are considered to be developed nations, including the United States, Canada, all European countries, Japan, Australia, and New Zealand.

The remaining 155 nations are **developing nations.** They have little industrial development and relatively low standards of living. Developing nations share some economic characteristics and differ in others. The average per capita income can be much greater in some developing nations than in others. Some developing nations have valuable natural resources, such as oil, while some do not.

Religion has influenced economic policy during different periods of history and in different parts of the world. This is true of the economies of the United States during colonial times and of Europe during the Middle Ages. Religion continues to influence the economies of some developing countries. For example, some countries do not allow businesses or financial institutions to lend money with interest.

Notes

Read to Learn

Economic Characteristics *(page 491)*

Making Inferences

If some developing nations have a labor force and natural resources, why can't they just sell the raw materials to improve their economy?

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Developing nations share several economic characteristics, including a low per capita gross domestic product (GDP), agricultural economy, poor health conditions, low literacy rate, and rapid population growth. Economists compare nations' per capita GDP in order to measure their wealth. The per capita GDP of the United States is $40,000 per year. The per capita GDP of the developing nation of Pakistan is $2,200. Although developing nations may have both natural resources and a large labor force, they do not have the equipment, financing, and knowledge to use them in order to make products to sell.

Most people living in developing nations are farmers who grow just enough food to take care of their own needs. The farmers do not grow enough food to sell to others; therefore, people cannot have specialized jobs or work in industries. In other words, there is no surplus of food available to export or to feed an industrial workforce. This kind of agriculture is called **subsistence agriculture.**

Predicting

Would improving one characteristic, such as decreasing the population growth, significantly improve the economy of a developing nation?

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Another characteristic of developing nations is poor health conditions. Modern doctors, hospitals, and medicines are generally unavailable. The **infant mortality rate,** or death rate of infants who die during the first year of life, is high. Adults have a low life expectancy.

Developing nations often have a low adult literacy rate, which means that only a small percentage of people are able to read and write. Many children have to farm instead of going to school. When the adult literacy rate is low, business owners cannot easily train the workforce for technical and engineering jobs.

Rapid population growth is another problem developing nations face. Rapid population growth can lead to a shortage of food and housing. The population growth rate in many developing nations is three or four times higher than the population growth rate in the United States.

Weak Property Rights *(page 493)*

Drawing Conclusions

As you read, complete the sentence below.

Strong property rights are ______ to economic growth.

Many developing nations do not have a system of strong, well-defined private-property rights. People living in these countries do not legally own their homes or the land that they farm. Individuals without property rights cannot sell their property or borrow money against it. Therefore, it is more difficult to own factors of production. Consequently, they have little incentive to improve the value of their property. This can prevent individuals from farming on a large scale, developing new businesses, and increasing their standard of living.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How do the economies of developed nations differ from the economies of developing nations?

2. How might poor health conditions, low adult literacy, and rapid population growth be linked?

Persuasive Writing

Suppose you are running for president of a developing country. Write a political speech explaining how establishing property rights in your country will accelerate economic growth. Cite examples of how property rights affect the United States economy to support your argument.

Chapter 19, Section 2 (Pages 495–500)

The Process of Economic Development

Big Idea

As you read pages 495–500 in your textbook, complete this table by listing three types of foreign aid and a definition and example for each one.

Type of Aid	Definition	Example

Notes

Read to Learn

Financing Economic Development *(page 496)*

Analyzing Information

List two risks of investing in developing nations.

1. ____________

2. ____________

Synthesizing Information

Why do developing nations need military assistance?

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Foreign businesses and foreign aid from developed nations are the two main sources of investment capital for developing nations needed to improve their standard of living. Foreign businesses choose to invest in developing countries because of the countries' low wages, few regulations, and untapped resources.

Political instability is one risk of investing in developing countries. The threat of **confiscation,** when governments take over industries without paying for them, is another consideration. Some are critical because foreign companies have control over local resources, but without foreign companies factors of production may go unused.

Foreign aid is another source of financing for developing nations. Foreign aid is the money, goods, and services given by governments and private organizations to help other nations and their citizens. Types of foreign aid include **economic assistance, technical assistance,** and **military assistance.** Loans and outright grants of money or equipment are called economic assistance. Technical assistance is aid in the form of engineers, teachers, and technicians. Military assistance is aid given to a nation's armed forces.

Notes | Read to Learn

Who Supplies Foreign Aid? *(page 498)*

Making Inferences

Why does the United States give aid through state and international agencies?

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Many developed nations offer foreign aid to developing nations. The United States sends most of its foreign aid to developing nations in the Middle East and Southeast Asia.

When you compare dollar amounts, the United States gives more foreign aid than any other developed country. However, the United States gives a much smaller percentage of its gross national income (GNI) than many other nations. In fact, the United States uses less than .25 percent of GNI for foreign aid.

The United States gives foreign aid through the U.S. Agency for International Development (USAID) and through United Nations agencies, including the World Bank. The World Bank provides loans and services to developing nations.

In the late 1990s, foreign aid agencies became concerned that developing nations would be unable to repay their debts. The leaders of major industrial nations proposed a plan to cancel debt under certain circumstances. By 2006, 25 countries had received debt relief under the plan.

Reasons for Giving Foreign Aid *(page 500)*

Making Generalizations

As you read, complete the sentence below.

Private aid organizations are motivated to give foreign aid by ______, while governments are motivated by ______________.

Underline the facts in the passage that support the statement above.

Humanitarianism is one reason that developed nations give foreign aid. Private aid organizations are often motivated by the desire to help people suffering from poverty, human rights abuses, and disease. In addition, governments cite economic, political, and security reasons for giving aid as well.

Foreign aid encourages international trade, which is good for all nations' economies. When a developed nation helps strengthen the economies of other countries, it expands its own market for exports and provides new opportunities for private investment by its own firms.

Governments give foreign aid to form political relationships and alliances. In the recent past, the United States used foreign aid to support countries with democratic governments and oppose countries with communist governments. Today, the United States uses foreign aid to combat terrorism and the spread of nuclear weapons.

A fourth reason for giving foreign aid is to build national security. The United States may give foreign aid to developing countries in exchange for military bases and observation posts. In politically unstable countries, these alliances can be short-lived.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. What is the difference between foreign aid and foreign investment?

2. How does United States national security benefit from foreign aid?

Informative Writing

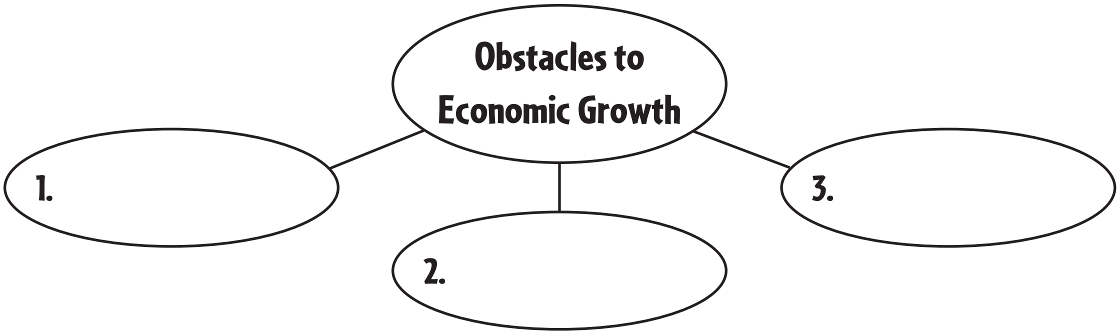
Write an article for the school newspaper encouraging students to learn about and to help developing nations. Suggest that they volunteer for a private organization or write to government leaders. Recommend specific reasons why nations and organizations provide aid as well as specific types of aid.

Chapter 19, Section 3 (Pages 501–504)

Obstacles to Growth in Developing Nations

Big Idea

As you read pages 501–504 in your textbook, complete this web diagram by listing obstacles to economic growth in Indonesia.



Notes | **Read to Learn**

Four Obstacles to Growth *(page 501)*

Analyzing Information

How do experienced bureaucracies aid economic growth?

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Evaluating Information

Why might some developing nations support trade restrictions?

____

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After World War II, Europe was able to use foreign aid to rebuild quickly. European nations had skilled labor forces, corporations and trade groups, and experienced government **bureaucracies** to make rebuilding efficient. Bureaucracies are specialized government offices and agencies. People believed other nations in need would equally benefit from foreign aid.

Four main factors hinder economic growth in developing nations. In some developing nations, people live and work in ways that reflect their traditions and culture. As a result, they may resist change even in the form of simple agricultural technology and innovation. The second factor is a high population growth rate. When the population grows faster than the economy, the per capita GDP can actually decrease. The third factor is the misuse of resources. One example is **capital flight,** the legal or illegal export of currency or money capital from a nation by that nation's leaders. The final factor is import restrictions created to protect local industries in some developing nations. Import restrictions prevent consumers from purchasing cheaper foreign substitutes.

Notes

Read to Learn

Case Study: Indonesia *(page 503)*

Synthesizing Information

How might a lack of national unity hinder economic growth?

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Comparing and Contrasting

1. ***How were President Sukarno's and General Suharto's economic policies similar?***

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2. ***How were President Sukarno's and General Suharto's economic policies different?***

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A close look at the economic development in Indonesia shows that even when natural resources and money for investment are available, economic development can be slowed by obstacles. When Indonesia won independence from the Netherlands in 1949, it seemed to have the conditions necessary for economic growth. It had natural resources, including oil reserves, farmland, and rain forests. The new President Sukarno raised over $2 billion in foreign aid during his regime. However, Indonesia was not able to use this capital to build its economy. One problem involved attitudes. The country was formed from many islands with different nationalities, religions, and politics. Indonesia did not have a sense of national unity.

Moreover, poor political and economic decisions made by Sukarno kept Indonesia from developing a stable economy. First, Sukarno was strongly against capitalism, and the United States stopped providing aid. He wasted other foreign aid on projects, such as stadiums and department stores, while more important infrastructure projects, such as railways and roads, fell into disrepair. All businesses were owned by the government, which discouraged foreign investors. Tight regulation of national businesses, growth of Indonesian bureaucracies, and corruption also contributed to the soaring inflation and national debt reached by 1965.

The next president, General Suharto, implemented new policies that helped the Indonesian economy grow quickly. He tightened the government's control of the money supply. He made alliances with some Western nations, thus foreign aid increased. He channeled resources towards agriculture and oil production. This allowed industry to grow because the country wasted fewer resources on importing food. Eventually, a system of corrupt capitalism developed in which friends and families owned and controlled businesses. The economy also relied too heavily on a few products, including oil. When the price of oil decreased as the supply increased in the early 1980s, Indonesia's economy declined. In 1997–1998, another economic crisis hurt the region of Southeast Asia. The nation's economy tumbled and General Suharto resigned.

The history of Indonesia teaches us a number of lessons about foreign aid. Foreign aid in the form of money does not always cause economic growth. Growth depends on domestic savings, foreign investment, and prudent economic government policies. Economies grow when governments do not restrict economic activity. When the economy of developing nations is tied to one or two products, economic growth may rise and fall as the value of those products changes.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why was Europe able to successfully rebuild after World War II?

2. What can developed nations learn from Indonesia's example?

Expository Writing

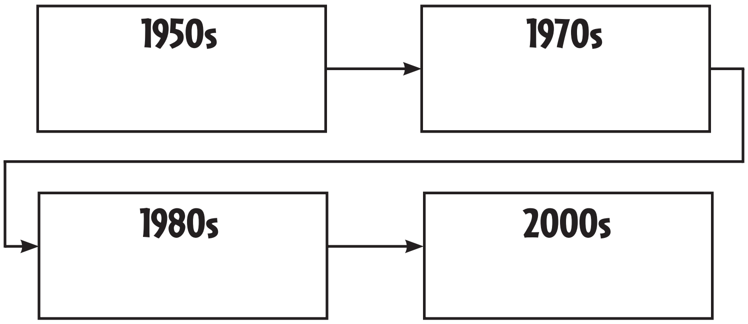
Suppose that you are President Sukarno as he leaves office. Write a letter to General Suharto with recommendations on how he can improve the Indonesian economy.

Chapter 19, Section 4 (Pages 505–509)

Economic Development in China

Big Idea

As you read pages 505–509 in your textbook, complete the time line below by identifying key events in China's economic development from its Communist takeover to the present day.



Notes

Read to Learn

Development of China's Economic System *(page 506)*

Making Generalizations

As you read, complete the sentences below.

1. ***Economic incentives motivate people to*** _______________.
2. ***Although China's economy is less centralized today, it is not a*** _______________.

After World War II, the Chinese communist government based its economy on **five-year plans,** an example of centralized economic planning. The first five-year plan did not meet its goals. In 1957, the Chinese government decided to allow local governments to make certain economic decisions. The economic reforms were not completely successful, however, because the economic plan was still not governed by the "three P's" of capitalism: prices, profit, and private property.

Chinese leaders revised the five-year plan again in 1978. This time the plan's goals included motivating citizens to work harder. The new plan allowed private individuals to rent land to farm for up to 15 years. The government provided an incentive for peasant households to produce more. The government promised that households could keep whatever they produced above a minimum amount. Over the next five years, overall farm productivity increased dramatically.

During the 2000s, several hundred million people moved to cities to work in factories and offices. Foreign investment increased, sometimes in partnership with the government.

Notes | Read to Learn

The Transition Toward a Mixed Economy *(page 507)*

Making Inferences

As you read, complete the sentence below.

Chinese government officials would be reluctant to enforce property rights because it would reduce their

_______________.

Well-defined private-property rights are an important part of pure capitalism. Although, the Chinese constitution includes private-property rights, the government still owns large parts of the economy. In urban areas, the central government owns many industries. In rural areas, farmers rent but do not own land. As a result, they have little incentive and no capital to invest in farm equipment and make long-term improvements.

Gradually, China is accepting the notion of property rights, which requires making and enforcing laws. During this period of transition, however, doing business is unpredictable. Army and government officials who control resources continue to seek bribes. The government inconsistently enforces laws relating to private property and copyright. These obstacles particularly affect foreign investors.

Another challenge the Chinese government faces as its economy grows is controlling pollution. China is the world's second-largest producer of harmful gas emissions into the atmosphere. China's air pollution affects cities in other countries as well, including Los Angeles. Government officials in China want to reduce pollution but do not want to slow overall economic growth.

Synthesizing Information

Why are environmental treaties made between nations?

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Prospects for China's Economic Future *(page 509)*

Analyzing Information

Why would some businesses and government officials in China oppose WTO membership?

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In 2000, China joined the World Trade Organization (WTO). As a result of its WTO membership, the presence of foreign products and the level of foreign investment in China greatly increased. China's large cities, such as Beijing and Shanghai, now have American fast-food restaurants and advertisements for foreign products. Another result of WTO membership is that state-owned industries in China were forced to make economic reforms. The goal of the reforms was to improve businesses' efficiency so they can better compete with foreign companies. WTO membership was an important step in China's path to economic stability and prosperity.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. How has China's economic planning changed since World War II? How has China's economy changed?

2. Why is it important to foreign investors that a country have established rules of law?

Descriptive Writing

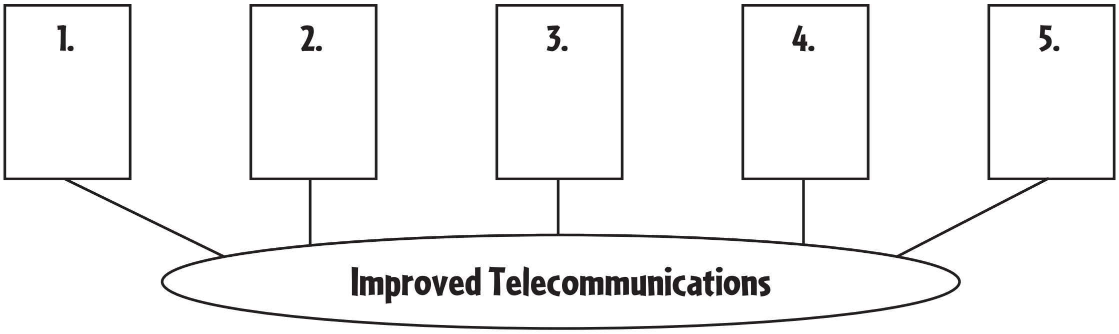
From what you have read about China, describe a typical day of someone who lives in a major Chinese city ten years in the future. Include vivid details that illustrate how the economy has grown and how Chinese industries have changed. Think about where people work, live, and shop.

Chapter 20, Section 1 (Pages 517–521)

Reasons for and Results of Global Integration

Big Idea

As you read pages 517–521 in your textbook, complete the diagram below by listing the inventions and the factors that have led to rapid improvements in worldwide communications.



Notes | Read to Learn

Improved Telecommunications *(page 518)*

Predicting

How do you think the continued use of satellite television will affect Africa and Asia?

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Interdependency among countries is known as **global integration.** This interdependency has increased rapidly over the past several decades for many reasons. A key reason is improved **telecommunications,** or long-distance communications.

The invention of the semiconductor, or computer chip, dramatically changed worldwide telecommunications. Advances in technology have led to a sharp decrease in the price of computing power. Other developments such as communications satellites, fiber-optic cables, and the Internet have also boosted global integration. In fact, satellite television has transformed the exchange of information between the Eastern hemisphere and other parts of the world. Before the 1990s, governments controlled almost all television broadcasts in Africa, Asia, Australia, and Europe. Today, people around the world receive news, sports, and other information outside of their government's control.

Increased communications has influenced people around the world who now sometimes demand products they see advertised on television. In addition, because many programs are in English, many people are learning English as a second language.

Notes

Read to Learn

The Globalization of Financial Markets *(page 520)*

Making Inferences

Why does it take longer for stock markets outside the United States to recover from a fall?

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Evaluating Information

Circle the investment below that is an example of how globalization spreads financial risk.

1. ***A mutual fund owns energy stocks in the United States***
2. ***A mutual fund owns media stocks in China, India, and Russia***

Thanks to advances in telecommunications, the world financial markets have merged into one. In the 1970s and 1980s, U.S. banks led the way by opening worldwide branch networks for loans and foreign exchange trading.

United States government securities, foreign exchange, and shares of stock are traded around the clock and around the world. U.S. government securities are bonds that the federal government sells. Foreign exchange is the buying and selling of foreign currencies. The foreign exchange became a 24-hour market in the 1970s. Other worldwide markets include commodities such as wheat, gold, and stocks.

The worldwide stock market, however, has some problems. The U.S. economy is a major part of the world economy. When the U.S. stock market falls, markets around the world also fall. For example, when the U.S. stock market fell dramatically in 1987, recovery in the U.S. stock market took two years. Worldwide stock markets, however, struggled even longer to recover. This chain reaction happened again after the terrorist attacks of September 11, 2001, when the Dow Jones industrial average fell by almost 700 points. Foreign stock markets also fell. Within two months, however, the markets began to recover.

Globalization also presents opportunities to spread financial risks. Business conditions vary from country to country. If business conditions are good within the United States, investors can put their money there. If business conditions decline in the United States but improve overseas, investors will move their funds out of the United States. Investors can also spread out their risks by investing in companies in several nations at one time.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why is global integration dependent on telecommunications?

2. Why is the U.S. stock market so important to markets around the world?

Informative Writing

Imagine that you have been asked to give a speech about global integration. The focus of your speech should be to explain how global integration has occurred. Be sure to include examples of technological developments that have made global interdependency possible.

Direct Foreign Investment—Should We Be Worried?

Big Idea

As you read pages 523–527 in your textbook, complete the table below by listing the fears that some Americans have about direct foreign investment, along with possible responses to these concerns.

Direct Foreign Investment	
Fear	**Response**

Notes

Read to Learn

Foreign Investment, Then and Now *(page 524)*

Synthesizing Information

As you read, complete the sentence below.

If more countries became politically stable, foreign investment in the United States might

____

because investors around the world would have more ways to

______________.

Direct foreign investment (DFI) is the purchase of real estate and businesses by foreigners. DFI in the United States grows as global integration of economic activity grows. Political upheaval in other parts of the world increases foreign investment in the United States because we remain politically stable.

Some worry about foreign ownership and control of American companies. Economists argue that the profit-making behavior of a corporation does not depend on its nationality. Foreign and domestic investors both want to maximize profits.

Foreigners own about 50 percent of all U.S. government securities. Even so, they probably cannot influence U.S. foreign policy. Foreigners purchase U.S. government securities only when they think the rate of return is higher than rates they can get elsewhere. Actually, the U.S. government has more control over foreign investors because they must follow U.S. government policy. Our government must keep the business climate in America friendly, or foreign corporations will invest elsewhere. U.S. corporations benefit from our government's hands-off approach toward foreign-owned businesses.

Notes | Read to Learn

Investment Here and Abroad *(page 526)*

Formulating Questions

Before you read this passage, write two questions that you think will be answered by the text.

1. ____________________

____

2. ____________________

____

Evaluating Information

Do you think people's concerns about foreign investment and U.S. direct investment in other countries is justified? Explain.

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When you buy a product, do you consider where the product was made or where the company is headquartered? Probably not. Most consumers care more about the utility and the price of a product than about which country benefits from their purchase. Some consumers who worry about losing American jobs to foreign countries buy only American products. Differentiating between foreign and domestic products is a complicated task. This is because many components of American products, such as cars, are made overseas. People should consider how foreign companies, such as Toyota, build factories and create jobs in the United States.

Some people remain concerned about foreigners "owning" the United States, although the share of foreign ownership of American industries is only about 10 percent. Americans are familiar with many foreign brands including Sony, Nokia, and BP. Even so, foreign investment in the U.S. is low compared with other nations.

Around the world, American companies have purchased foreign businesses. Boeing has factories in China. Ford is expanding to Japan. AIG provides insurance and financial services on almost every continent. The U.S. share of direct investment is more than 40 percent. Many people throughout the world fear that U.S. culture is taking over other cultures. Some people call this *economic imperialism.*

Most consumers are unaware and uninterested in who owns various companies. Labels on certain goods tell consumers where it was made, but this is not true of all goods. Some people believe that the United States should encourage DFI and debt purchases by foreigners. Foreigners would then have more incentive to want the American economy to remain strong and stable.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Should people worry about foreign control of American companies? Explain.

2. Why do some people fear economic imperialism?

Expository Writing

Imagine that you have just discovered that a big hotel in your town has recently been purchased by foreign investors. Write an e-mail to your friends describing why you do or do not support the purchase. Be sure to support your opinion by discussing economic imperialism and DFI by and in the United States.

Chapter 20, Section 3 (Pages 527–531)

The Size and Number of Multinationals

Big Idea

As you read pages 527–531 in your textbook, complete the table below by listing a definition and an example of each type of international or cross-border business.

Type of Business	Definition	Example
Multinationals		
Alliances		

Notes

Read to Learn

The Size and Number of Multinationals *(page 528)*

Making Inferences

Why do multinationals generally invest in countries nearby?

Multinationals are firms that do business and have offices or factories in many countries. There are about 60,000 multinationals in the world today, along with 620,000 branches of their firms. These branches, or **foreign affiliates,** collectively have almost $3 trillion in assets.

In the past, some critics worried that multinationals would manipulate governments. Today, multinationals play an important, but not dominant, role in the global economy. In 2006, the 500 companies with the highest revenues in the world had combined sales of $10 trillion. The top 100 multinationals, however, account for less than 20 percent of the world's productive assets.

Most multinationals invest in regions nearby. This is reflected in multinationals' patterns of direct investment. The best way to understand these patterns is to include direct domestic sales. American firms, for example, principally invest in the United States, Canada, Mexico, and South America.

Multinationals also form alliances with other firms. Alliances can help companies overcome their limitations, whether they are technological, financial, or geographical. Alliances can also help a firm catch up to its competitors.

Notes | Read to Learn

The Global Village and Tolerance *(page 530)*

Drawing Conclusions

As you read, complete the sentence below.

Americans benefit from having a multicultural society because it prepares them to work with _______________.

Determining Cause and Effect

How have improvements in telecommunications affected workers around the world?

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____

Globalization has led to increased immigration. As a result, the United States has become a truly multicultural society. In many American cities, the combined number of ethnic and racial minorities makes up the majority of the population.

The populations of many minority groups in the United States have soared in the last several decades. In the 1980s, for example, the Asian population increased more than 100 percent. In 2003, Hispanics became the largest minority group in the nation. The increase in immigration has led to increasingly diverse public schools. This diversity means that the need for open-mindedness is more important today than ever. For Americans, this includes maintaining friendships with persons of different ethnic, cultural, national, and religious backgrounds.

Globalization has also had an impact on the workforce around the world. Firms have come to realize that many types of work can be done more efficiently by workers hundreds or thousands of miles away. For example, improvements in telecommunications allow customer service calls to be handled by overseas companies. American manufacturing jobs were among the first jobs to be moved to other countries. But higher-level careers are also migrating across international borders. Many computer firms in the United States and India work together closely. American corporations are increasingly hiring overseas employees to staff their research departments.

Firms in other nations, in turn, send work to American companies. Financial firms in the United States, for example, receive a large share of their revenue from companies in other countries. This increased contact with foreigners helps Americans understand that global citizens have a lot in common.

Section Wrap-up

Answer these questions to check your understanding of the entire section.

1. Why have people's fears about multinationals manipulating governments eased?

2. What is the incentive for being tolerant of other cultures?

Descriptive Writing

Imagine it is the year 2020 and you have a job interview for your dream job. Use vivid details to describe where you are interviewing and who else is interviewing for the job. Readers should be able to infer from the story how globalization and advanced telecommunications have affected the process of getting a job.