**CHAPTER 3: ECONOMIC CHALLENGES FACING CONTEMPORARY BUSINESS**

**Chapter Overview**

This chapter introduces economic theory and the economic challenges facing individuals, businesses, and governments in the global marketplace. We begin with the microeconomic concepts of supply and demand and their effect on the prices people pay for goods and services. Next, we explain the various types of economic systems, along with tools for comparing and evaluating their performance. Then, we examine the ways in which governments seek to manage economies to create stable business environments in their countries. The final section in the chapter looks at some of the driving economic forces currently affecting people’s lives.

**Glossary of Key Terms**

**Balanced budget:** situation in which total revenues raised by taxes and fees equal total proposed government spending for the year

**Budget:** organization’s plan for how it will raise and spend money during a given period of time

**Budget deficit:** situation in which the government spends more than the amount of money it raises through taxes

**Budget surplus:** excess funding that occurs when government spends less than the amount of funds raised through taxes and fees

**Communism:** economic system in which all property would be shared equally by the people of a community under the direction of a strong central government

**Consumer Price Index (CPI):** measurement of the monthly average change in prices of goods and services

**Core inflation rate:** inflation rate of an economy after energy and food prices are removed

**Cyclical unemployment:** people who are out of work because of a cyclical contraction in the economy

**Deflation:** opposite of inflation, occurs when prices continue to fall

**Demand:** willingness and ability of buyers to purchase goods and services

**Demand curve:** graph of the amount of a product that buyers will purchase at different prices

**Economics:** social science that analyzes the choices people and governments make in allocating scarce resources

**Equilibrium price:** prevailing market price at which you can buy an item

**Expansionary monetary policy:** increases the money supply in an effort to cut the cost of borrowing, which encourages business decision makers to make new investments, in turn stimulating employment and economic growth

**Fiscal policy:** government spending and taxation decisions designed to control inflation, reduce unemployment, improve the general welfare of citizens, and encourage economic growth

**Frictional unemployment:** applies to members of the workforce who are temporarily not working but are looking for jobs

**Gross domestic product (GDP):** sum of all goods and services produced within a country’s boundaries during a specific time period, such as a year

**Hyperinflation:** economic situation characterized by soaring prices

**Inflation:** rising prices caused by a combination of excess consumer demand and increases in the costs of raw materials, component parts, human resources, and other factors of production

**Macroeconomics:** study of a nation’s overall economic issues, such as how an economy maintains and allocates resources and how a government’s policies affect the standards of living of its citizens

**Microeconomics:** study of small economic units, such as individual consumers, families, and businesses

**Mixed market economy:** economic system that draws from both types of economies, to different degrees

**Monetary policy:** government actions to increase or decrease the money supply and change banking requirements and interest rates to influence bankers’ willingness to make loans

**Monopoly:** market situation in which a single seller dominates trade in a good or service for which buyers can find no close substitutes

**Monopolistic competition:** market structure in which large numbers of buyers and sellers exchange heterogeneous products, so each participant has some control over price

**National debt:** money owed by government to individuals, businesses, and government agencies who purchase Treasury bills, Treasury notes, and Treasury bonds sold to cover expenditures

**Oligopoly:** market situation in which relatively few sellers compete and high start-up costs form barriers to keep out new competitors

**Planned economy:** government controls determine business ownership, profits, and resource allocation to accomplish government goals rather than those set by individual firms

**Privatization:** conversion of government-owned and -operated companies into privately held businesses

**Productivity:** relationship between the number of units produced and the number of human and other production inputs necessary to produce them

**Pure competition:** market structure in which large numbers of buyers and sellers exchange homogeneous products and no single participant has a significant influence on price

**Recession:** cyclical economic contraction that lasts for six months or longer

**Regulated monopoly:** local, state, or federal government grants exclusive rights in a certain market to a single firm

**Restrictive monetary policy:** reducing the money supply to curb rising prices, overexpansion, and concerns about overly rapid economic growth

**Seasonal unemployment:** joblessness of workers in a seasonal industry

**Socialism:** economic system characterized by government ownership and operation of major industries such as communications

**Structural unemployment:** people who remain unemployed for long periods of time, often with little hope of finding new jobs like their old ones

**Supply:** willingness and ability of sellers to provide goods and services

**Supply curve:** graph that shows the relationship between different prices and the quantities that sellers will offer for sale, regardless of demand

**Unemployment rate:** percentage of the total workforce actively seeking work but are currently unemployed

**Learning Objective 1: Discuss microeconomics and explain the forces of demand and supply.**

*Microeconomics is the study of economic behavior among individual consumers, families, and businesses whose collective behavior in the marketplace determines the quantity of goods and services demanded and supplied at different prices. Macroeconomics is the study of the broader economic picture and how an economic system maintains and allocates its resources; it focuses on how a government’s monetary and fiscal policies affect the overall operation of an economic system.*

*Demand is the willingness and ability of buyers to purchase goods and services at different prices. Factors that drive demand for a good or service include customer preferences, the number of buyers and their incomes, the prices of substitute goods, the prices of complementary goods, and consumer expectations about the future. Supply is the willingness and ability of businesses to offer products for sale at different prices. Supply is determined by the cost of inputs and technology resources, taxes, and the number of suppliers operating in the market.*

**Annotated Lecture Outline**

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| Opening Vignette:  Boomerang Kids Come Home to Roost Six million of today’s adults ages 25-34 are known as “Boomerang” children because of their need to move back in with parents. While these adults are often unemployed or can’t afford independent living because of student loans, the parents that support their adult children are at the same time keeping these younger adults out of job positions. Furthermore, 26 percent of these parents increase their financial debt by helping pay off their children’s loans, while 20 percent postpone major life plans like retirement. This begs the question of what triggered the rise in boomerang children and their parents’ financial support. |  |
| * 1. Economics is the social science that analyzes choices people and governments make in allocating scarce resources. | PowerPoint Slide 3 |
| * 1. Everyone’s life is affected by economic choices. |  |
| * + 1. People make choices that are global in scope (e.g., to buy a Ford or a Toyota). |  |
| * + 1. Not-for-profits and businesses make economic choices about human and natural resources, equipment, buildings, and partnerships. |  |
| * 1. Microeconomics is the study of small economic units, such as individual consumers, families, and businesses. |  |
| * 1. Macroeconomics is the study of a nation’s overall economic issues, such as how an economy maintains and allocates resources and how a government’s policies affect the standard of living. | *Lecture Enhancer: How do microeconomic issues impact macroeconomics?* |
| ***MICROECONOMICS: THE FORCES OF DEMAND  AND SUPPLY*** | PowerPoint Slide 4 |
| * 1. At the heart of every business endeavor is an exchange between a buyer who wants or needs something and a seller who provides it at a price that covers costs. |  |
| * 1. Demand is the willingness and ability of buyers to purchase goods and services at different prices. |  |
| * 1. Supply is the willingness and ability of   sellers to provide goods and services. |  |
| 1. **Factors Driving Demand** | PowerPoint Slide 5 |
| * 1. Economics is a balance between what we want and what we can afford. |  |

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| * 1. Demand is driven by consumer preferences and larger economic events. | *Class Activity:*  *Lead a discussion to obtain student examples of products which have experienced recent sharp increases and decreases and why these changes may have occurred.* |
| * 1. Demand can increase the availability of Web sites and services. |  |
| * 1. When the price of a good or service goes up, people buy less, so demand declines. |  |
| * 1. When the price goes down, consumers buy more, so the quantity demanded rises. |  |
| * 1. A demand curve is a graph of the amount of a product that buyers will buy at different prices. | PowerPoint Slide 6 |
| * + 1. Demand curves slope downward, meaning that lower prices attract larger purchases. |  |
| * + 1. Example: Lower gas prices lead to more people filling up their tanks, and higher prices lead to people driving less or carpooling. |  |
| * + 1. As the price rises, the quantity demanded decreases. | *Lecture Enhancer:* *In your opinion, which one of these factors has the most significant affect on a demand curve?* |
| * 1. Change in demand comes in two forms: change in quantity demanded and change in overall demand. |  |
| * + 1. A change in quantity demanded is simply a movement along the demand curve. |  |

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| * + 1. A change in overall demand, however, results in an entirely new demand curve. | Figure 3.1 Demand Curves for Gasoline  *Class Activity:*  *Ask students how Albert Pujols’ decision to play baseball for the Angels affected that team’s ticket sales and prices.* |
| * + 1. Businesses are constantly trying to make accurate predictions about both kinds of demand change. |  |
| * + 1. A miscalculation in these predictions can cause major problems. |  |
| * 1. Shifts in the demand curve result from: | Table 3.1 Expected Shifts in Demand Curves |
| * + 1. price | *Class Activity:*  *Discuss with the class how current economic weaknesses have affected their restaurant choices.* |
| * + 1. consumer preferences and incomes |  |
| * + 1. price of substitute goods |  |
| * + 1. changes in household income |  |
| * + 1. price of related goods and services. |  |

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| 1. **Factors Driving Supply** | PowerPoint Slide 7 |
| * 1. A supply curve shows the relationship between different prices and the quantities that sellers will offer for sale, regardless of demand. | PowerPoint Slide 8 |
| * + 1. Movement along the supply curve is opposite that of the demand curve. |  |
| * + 1. Supply curves slope upward: as price rises, the quantity that sellers are willing to supply rises. | Figure 3.2 Supply Curve for Gasoline |
| * + 1. As prices drop, the quantity supplied decreases. |  |
| * 1. The factors of production (e.g., natural resources, capital, human resources) determine the overall supply of goods and services. |  |
| * 1. A change in the cost or availability of any input shifts the supply curve. | Table 3.2 Expected Shifts in Supply Curves |
| 1. **How Demand and Supply Interact** | PowerPoint Slide 9 |
| * 1. Changes in the real world often affect both supply and demand. |  |
| * + 1. Several factors may change at the same time and keep changing. |  |
| * + 1. Sometimes, changes in multiple factors cause contradictory pressures on price and quantity. |  |
| * + 1. Other times, changes in supply and demand reflect the factor that has changed the most. | *Class Activity:*  *Discuss with students how ticket prices could fluctuate depending on which teams are playing. For example, if your favorite team is playing the Yankees, ticket prices for those games could be higher than if your favorite team were playing the Mariners.* |
| * + 1. Supply and demand can affect employment as well as products. |  |
| * 1. The law of supply and demand says that prices are set by the intersection of supply and demand curves. | Figure 3.3 Law of Supply and Demand |
| * + 1. The point where the two curves meet, *P,* identifies the equilibrium price, the prevailing market price at which you can buy a product. |  |
| * + 1. Buyers and sellers make choices that restore the equilibrium price if it differs from the actual market price. | **Hit & Miss**  **Smashburger Is, Well, a Smash Hit** |

**Notes:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Hit & Miss:**

**Smashburger Is, Well, a Smash Hit**

**Summary**

Smashburger is a Denver-based franchise that generates $54 million in annual revenue with roughly 150 U.S. locations and plans to expand internationally. CEO David Prokupek believes the successes of Smashburger lies in the company’s priority of pleasing both customers and employees. Smashburger promises custom-made burgers, shakes, and sides along with local craft beers that appeal to individual cities where the joints are located. Employees are guaranteed above minimum-wage payments, added bonuses, and rewards for skill and accuracy.

**Questions for Critical Thinking**

1. **Is Smashburger investing in the right things? What are they?**

*Smashburger is investing in the right things because the company realizes that they need to please both customers and employees in order to run a successful business. They provide customers with unique products that cater to local specialties, while employees receive recognition for excelled work and above minimum-wage payments.*

**2. Smashburger’s prices are competitive with other “fast casual” chains. Is this a sustainable strategy given its mission?**

*Smashburger has an effective sustainable strategy. Although the company invests a lot in paying their employees and using quality products for their customers, their menu items are unique, which increases the demand, and therefore profit.*

**Assessment Check Answers**

**1.1 Define microeconomics and macroeconomics.**

*Microeconomics is the study of economic behavior among individual consumers, families, and businesses whose collective behavior in the marketplace determines the quantity of goods and services demanded and supplied at different prices. Macroeconomics is the study of the broader economic picture and how an economic system maintains and allocates its resources.*

**1.2 Explain demand and supply curves.**

*A demand curve is a graph of the amount of a product that buyers will purchase at different prices. A supply curve shows the relationship between different prices and the quantities that sellers will offer for sale, regardless of demand.*

**1.3 How do factors of production influence the overall supply of goods and services?**

*A change in the cost or availability of any of the inputs considered to be factors of production can shift the entire supply curve, either increasing or decreasing the amount available at every price.*

**Learning Objective 2: Describe macroeconomics and the issues for the entire economy.**

*Four basic models characterize competition in a private enterprise system: pure competition, monopolistic competition, oligopoly, and monopoly. Pure competition is a market structure, like that in small-scale agriculture, in which large numbers of buyers and sellers exchange homogeneous products and no single participant has a significant influence on price. Monopolistic competition is a market structure, like that of retailing, in which large numbers of buyers and sellers exchange differentiated products, so each participant has some control over price. Oligopolies are market situations, like those in the steel and airline industries, in which relatively few sellers compete and high start-up costs form barriers to keep out new competitors. In a monopoly, one seller dominates trade in a good or service, for which buyers can find no close substitutes.*

*The major economic systems are private enterprise economy, planned economy (such as communism or socialism), and mixed market economy. In a private enterprise system, individuals and private businesses pursue their own interests—including investment decisions and profits—without undue governmental restriction. In a planned economy, the government exerts stronger control over business ownership, profits, and resources to accomplish governmental and societal—rather than individual—goals. Socialism, one type of planned economic system, is characterized by government ownership and operation of all major industries. Communism is an economic system without private property; goods are owned in common, and factors of production and production decisions are controlled by the state. A mixed market economy blends government ownership and private enterprise, combining characteristics of both planned and private enterprise economies.*

**Annotated Lecture Outline**

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| ***MACROECONOMICS: ISSUES FOR THE ENTIRE***  ***ECONOMY*** | PowerPoint Slide 10 |
| * 1. Policies and choices determine an economic system. | *Lecture Enhancer:* *How might a nation’s cultural practices influence its economic system?* |
| * 1. Political, social, and legal environments differ in every country. |  |
| * 1. Economies are classified in one of three categories: |  |
| * + 1. private enterprise systems |  |
| * + 1. planned economies |  |
| * + 1. mixed economies (combinations of private and planned). |  |
| 1. **Capitalism: The Private Enterprise System and Competition** | PowerPoint Slide 11 |
| 1. Industrialized nations operate economies based on the private enterprise system, also known as *capitalism* or a *market economy*. |  |
| 1. A private enterprise system rewards businesses for meeting the needs and demands of consumers. | *Lecture Enhancer: How is a business rewarded in the private enterprise system?* |
| 1. Government tends to favor a hands-off attitude toward controlling business ownership, profits, and resource allocations. |  |
| 1. Competition regulates economic life, creating opportunities and challenges. |  |
| 1. Four types of competition in a private enterprise system: pure competition, monopolistic competition, oligopoly, and monopoly. | Table 3.3 Types of Competition  PowerPoint Slide 12 |
| * 1. Pure competition is a market structure in which large numbers of buyers and sellers exchange homogeneous products and no single participant has a significant influence on price. | *Lecture Enhancer: Share a specific example of each type of competition.* |
| * + 1. It is easy to enter or leave the market because no company dominates. |  |
| * + 1. Price is set by supply and demand. |  |
| * 1. Monopolistic competition is a market structure in which large numbers of buyers and sellers exchange heterogeneous products, so each participant has some control over price. |  |
| * + 1. It is easy to begin or stop selling in a market or industry. |  |
| * + 1. Products differ on price, quality, and other features. |  |
| * + 1. Successful sellers attract new competitors. |  |
| * 1. An oligopoly is a market structure in which relatively few sellers compete and high start-up costs form barriers to keep out new competitors. |  |
| * + 1. Huge investments are required for factories, equipment, and technology. |  |
| * + 1. Products offered by competing firms may be similar or very different. |  |
| * + 1. Competing products sell for similar prices because price competition would reduce profits. |  |
| * 1. A monopoly is a market structure in which a single seller dominates trade in a good or service for which buyers can find no close substitutes. |  |
| * + 1. A pure monopoly exists when a firm’s unique traits in an industry prevent would-be competitors from entering. |  |
| * + 1. A short-term monopoly is created when a research breakthrough allows a firm to get exclusive patents on new products. |  |
| * + 1. The government prohibits most pure monopolies but permits certain monopolies in exchange for regulating their activities. |  |
| * + 1. A regulated monopoly has exclusive rights in certain markets on a local, state, or federal level, with prices and rate increases monitored by the government. |  |
| * + 1. Recently, the U.S. government has moved away from regulated monopolies toward deregulation in order to improve customer service and reduce prices for customers through increased competition. | *Lecture Enhancer: Name an industry or business that has been a target for deregulation.* |
| 1. **Planned Economies: Socialism and Communism** | PowerPoint Slide 13 |
| * 1. In a planned economy, government controls determine business ownership, profits, and resource allocation to accomplish government goals. |  |
| * 1. Socialism is an economic system characterized by government ownership and operation of major industries such as communications. |  |
| * + 1. Socialists believe that major industries are too important to a society to be left in private hands. |  |
| * + 1. Private ownership is allowed in industries less crucial to social welfare (e.g., retail shops). |  |
| * 1. Communism is a planned economy in which all property is shared equally by the people of a community under strong direction from a central government. |  |
| * + 1. In the mid-1800s, Karl Marx proposed communist theory, which would eliminate private ownership and lead to a classless society that would benefit all. |  |
| * + 1. Each individual contributes to the nation’s economic success, and resources are distributed according to each person’s needs. | *Lecture Enhancer:* *What might be a likely drawback to contributing and distributing resources according to each person’s needs and abilities?* |
| * + 1. The central government owns the means of production and everyone works for state-owned enterprises. |  |
| * + 1. The government determines what people can buy as it dictates what is produced. |  |
| * + 1. Communist nations of the 20th century gave citizens little freedom in job choice or purchases and were inefficient. |  |
| * + 1. In the former Soviet Union, bureaucracies controlled daily life; shortages and poor quality resulted as producers had no need to satisfy consumers, leading to economic and government collapse. |  |
| * + 1. Today, communism exists only in a few nations (e.g., North Korea), although some (e.g., China) have shifted toward private business and Western products. |  |
| 1. **Mixed Market Economies** | PowerPoint Slide 14 |
| * 1. A mixed market economy is an economic system that draws from both types of economies, to different degrees. | *Lecture Enhancer:* *What are the key societal benefits of a mixed market economy?*  Table 3.4 Comparison of Alternative Economic Systems |
| * + 1. In France, energy production, public transportation, and defense are run as nationalized industries, while a market economy operates other industries. | *Class Activity:*  *Discuss how important incentives are to students, and whether they might leave their homes to pursue higher incentives elsewhere.* |
| * + 1. The proportions of private and public enterprise can vary widely in mixed economies, and the mix frequently changes. |  |
| * 1. Privatization is the conversion of government-owned and -operated companies into privately held businesses. |  |
| * + 1. Governments may privatize state-owned enterprises in an effort to raise funds and improve their economies. |  |

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**Assessment Check Answers**

**2.1 What is the difference between pure competition and monopolistic competition?**

*Pure competition is a market structure in which large numbers of buyers and sellers exchange homogeneous products. Monopolistic competition is a market structure in which large numbers of buyers and sellers exchange differentiated products.*

**2.2 On which economic system is the U.S. economy based?**

*The U.S. economy is based on the private enterprise system.*

**2.3 What is privatization?**

*Privatization is the conversion of government-owned and -operated agencies into privately held businesses.*

**Learning Objective 3:**

**Identify how to evaluate economic performance.**

*The four stages are prosperity, recession, depression, and recovery. Prosperity is characterized by low unemployment and strong consumer confidence. In a recession, consumers often postpone major purchases, layoffs occur, and household savings may be depleted. A depression occurs when an economic slowdown continues in a downward spiral during a long period of time. During recovery, consumer spending begins to increase and business activity accelerates, leading to an increased number of jobs.*

*As productivity rises, so do an economy’s growth and the wealth of its citizens. In a recession, productivity stalls or possibly declines. Changes in general price levels—inflation or deflation—are important indicators of an economy’s general stability. The U.S. government measures price-level changes by the Consumer Price Index. A nation’s unemployment rate is an indicator of both overall stability and growth. The unemployment rate shows, as a percentage of the total labor force, the number of people actively seeking employment who are unable to find jobs.*

**Annotated Lecture Outline**

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| ***EVALUATING ECONOMIC PERFORMANCE*** | PowerPoint Slide 16 |
| * 1. An economic system should provide a stable business environment and sustained growth. |  |
| * 1. In a stable environment, supply and demand are aligned, with no wild fluctuations in price or availability, and there is access to a wide range of goods and services plus the money to buy them. |  |
| * 1. Growth allows expanded goods and services, more jobs, better wages, and a higher standard of living. |  |

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| 1. **Flattening the Business Cycle** |  |
| * 1. A nation’s economy tends to flow through various stages of a business cycle: prosperity, recession, depression, and recovery. | **Going Green:**  **Raleigh Hosts a Smart Grid** |
| * 1. Prosperity is a time of consumer confidence and expansion. |  |
| * + 1. Unemployment is low. |  |
| * + 1. Consumer confidence leads to more purchases. |  |
| * + 1. Businesses expand, investing in new technologies, making purchases, and creating new jobs. |  |
| * 1. Recession is a cyclical economic contraction that lasts for six months or longer. |  |
| * + 1. Consumers postpone major purchases and buy functional goods at low prices. | *Class Activity:*  *Survey the class to see how many have purchased more “store brand” items at the grocery or drugstores where they shop, as a result of softer economic conditions.* |
| * + 1. Businesses slow production, postpone expansion, reduce inventories, and cut workers. |  |
| * 1. Depression is an economic slowdown that continues into a downward spiral during an extended period of time. |  |

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| * 1. In the recovery stage*,* economic activity picks up and consumers think about spending again. | *Lecture Enhancer: How can we determine which phase of the business cycle an economy is in at a certain time?* |
| * + 1. Consumer confidence and spending increases as business activity accelerates. |  |
| ii. As business activity accelerates, unemployment begins to decline. |  |
| 1. **Productivity and the Nation’s Gross Domestic Product** | PowerPoint Slide 17 |
| * 1. Productivity is the relationship between the number of units produced and the number of human and other production inputs necessary to produce them. |  |
| * + 1. As productivity rises, so does an economy’s growth and the wealth of its citizens. |  |
| * + 1. During recessions, productivity stagnates or even falls. |  |
| * + 1. Productivity is a ratio of output to input. |  |
| * + 1. Total productivity considers all inputs needed to produce specific amounts of outputs. |  |
| * + 1. The total productivity of a nation’s businesses has become a measure of its economic strength and standard of living. |  |
| * 1. Gross domestic product (GDP) is the value of all goods and services produced within a nation’s boundaries during a specific time period, such as a year. | Figure 3.4 Nations with Highest Gross Domestic Products |
| * + 1. GDP is based on per-capita output of a country: total output divided by total citizens. |  |
| * + 1. In the United States, GDP is tracked by the Bureau of Economic Analysis (BEA), a division of the Department of Commerce. |  |
| 1. **Price-Level Changes** | PowerPoint Slide 18 |
| * 1. General level of prices is another indicator of a nation’s economic stability. |  |
| * 1. Inflation is a period of rising prices caused by a combination of excess demand and increases in the costs of factors of production. |  |
| * + 1. The core inflation rate is an economy’s inflation rate after energy and food prices are removed. |  |
| * + 1. Demand-pull inflation comes from excess consumer demand. |  |
| * + 1. Cost-push inflation comes from rises in costs of various factors of production. |  |
| * + 1. Hyperinflation is characterized by soaring prices. |  |
| * 1. Inflation devalues money as price increases reduce the goods and services people can purchase with a given amount of money. |  |
| * + 1. Inflation is hardest on those with fixed incomes. |  |
| * + 1. Inflation can be good for those with rising income or debts at fixed rates of interest. | *Lecture Enhancer: How does inflation benefit wealthier individuals?* |
| * + 1. Inflation boosts the stock market and creates millionaires. |  |
| * 1. Steady prices benefit the overall economy. |  |
| * + 1. Low inflation allows businesses to plan without worry, and low interest rates encourage investment. |  |
| * + 1. The rising cost of oil, needed to produce every product, has led to inflation as businesses cover costs. |  |
| * 1. Deflation is the opposite of inflation—a period of falling prices that weakens the economy. |  |
| 1. **Measuring Price-Level Changes** | PowerPoint Slide 19 |
| * 1. The Consumer Price Index (CPI) measures the monthly average change in the prices of basic goods and services. | Figure 3.5 Contents of the CPI Market Basket |
| * 1. The Bureau of Labor Statistics calculates the CPI monthly based on a “market basket” of common goods and services by visiting thousands of stores, service establishments, and professional offices to price items. | PowerPoint Slide 20  *Class Activity: Ask students which goods or services they think have risen and declined the most in the last few years.* |
| 1. **Employment Levels** | PowerPoint Slide 21 |
| * 1. The number of people in a nation who currently have jobs is an important indicator of how well the economy is doing. | **Hit & Miss:**  **Microloans Aid Women’s Businesses** |
| * 1. The unemployment rate usually is expressed as the percentage of total workers who are actively seeking work but are currently unemployed. |  |

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| * + 1. The total labor force includes all people who are willing and available to work at the going wage, whether they currently have jobs or are seeking work. |  |
| * + 1. The labor force includes “discouraged” workers who want to work but are not looking for jobs. |  |
| * 1. Four categories of unemployment: | *Lecture Enhancer: Think of an example of each type of unemployment.* |
| * + 1. Frictional unemployment: those temporarily not working, looking for work |  |
| * + 1. Seasonal unemployment: those not working during certain months |  |
| * + 1. Cyclical unemployment: those who have skills but are not working due to an economic slowdown and layoffs |  |
| * + 1. Structural unemployment: those not working due to lack of demand for their skills; some may need retraining for different jobs. |  |

**Notes:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Going Green:**

**Raleigh Hosts a Smart Grid**

**Summary**

Smart-grid technology uses digitally-powered electric grids to gather, distribute, and utilize information on electrical use in specific areas. This leads to research that allows people to use cleaner and cheaper modes of energy. Currently, Raleigh, North Carolina is one of the country’s largest smart-grid users. The city hosts the Future Renewable Electric Energy, Delivery, and Management (FREEDM) Center, which is working to develop a digital “smart transformer”. This project is known as one of the top 10 most important up and coming technologies. Fifty technology companies are in partnership with FREEDM and employ 3,000 people in the surrounding area. While this project will cost more than the billions already provided through governmental funding, the team is still optimistic regarding smart-grid technology that is believed to be 5 years ahead of its time.

**Questions for Critical Thinking**

**1. Do you think the government’s investment in clean energy through initiatives like FREEDM will pay off? Why or why not?**

*Answers will vary.*

**2. What are some of the benefits the FREEDM Center brings to the local Raleigh economy?**

*The FREEDM Center helps stimulate the local economy by providing jobs for roughly 3,000 employees. Also, residences with energy providers who are already using smart-grid technology are able to see where they are spending money on energy, allowing them to make knowledgeable decisions about where they can save money.*

**Hit & Miss:**

**Microloans Aid Women’s Businesses**

**Summary**

The majority of poor people in the United States are women. Having a child is one of the leading factors when a woman’s income falls below the cost of living. Single mothers are most likely to be self-employed—but also are in the greatest danger of poverty. To help women start their own businesses, Tory Burch created ACCION USA, a microlending organization modeled after those helping people in developing nations. At $500 to $50,000, ACCION USA’s loans are somewhat larger than those in developing nations, but many have the same purpose: “to economically empower women.”

**Questions for Critical Thinking**

**1. Why might having a baby cause a single mother’s income to fall?**

*Having a baby can cause a single mother’s income to fall due to the need to either spend time or money caring for the child. Once she has a child, a single mother must either reduce her working hours in order to care for her child, thus reducing her income, or she must pay for child care while she works, thus increasing her expenses.*

**2. Why do you think that the payback rate on microloans is so high?**

*Answers will vary.*

Assessment Check Answers

**3.1 Describe the four stages of the business cycle.**

*The four stages are prosperity, recession, depression, and recovery. Prosperity is characterized by low unemployment and strong consumer confidence. Recession may include consumers postponing major purchases, layoffs, and decreased household savings. A depression occurs when an economic slowdown continues in a downward spiral during a long period of time. In recovery, consumer spending increases and business activity accelerates.*

**3.2 What are some measures that economists use to determine the health of an economy?**

*Gross domestic product (GDP), general level of prices, core inflation rate, the Consumer Price Index, and the unemployment rate are all measures used to determine the health of an economy.*

**Learning Objective 4:**

**Discuss managing the economy’s performance.**

*Monetary policy encompasses a government’s efforts to control the size of the nation’s money supply. Various methods of increasing or decreasing the overall money supply affect interest rates and therefore affect borrowing and investment decisions. By changing the size of the money supply, government can encourage growth or control inflation. Fiscal policy involves decisions regarding government revenues and expenditures. Changes in government spending affect economic growth and employment levels in the private sector. However, a government also must raise money, through taxes or borrowing, to finance its expenditures. Because tax payments represent funds that might otherwise have been spent by individuals and businesses, any taxation changes also affect the overall economy.*

**Annotated Lecture Outline**

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| ***MANAGING THE ECONOMY’S PERFORMANCE*** | PowerPoint Slide 22 |
| * 1. A government uses monetary and fiscal policy to fight unemployment, increase spending, and reduce recessions. |  |
| * 1. The Federal Reserve System can increase or reduce interest rates, and the government can enact tax cuts or other reforms. |  |
| 1. **Monetary Policy** |  |
| * 1. Monetary policy refers to government actions to increase or decrease the money supply and change banking requirements and interest rates to influence spending. |  |
| * 1. An expansionary monetary policy increases the money supply to cut the costs of borrowing. |  |
| * + 1. This encourages new investments, which stimulates the economy with more jobs and growth. |  |
| * 1. A restrictive monetary policy slows the growth rate in the money supply to curb rising prices, overexpansion, and concerns about overly rapid economic growth. |  |
| * 1. The Federal Reserve (the “Fed”)is responsible for formulating and implementing monetary policy in the United States. |  |
| * + 1. The president nominates its chairman and board of governors. |  |
| * + 1. All national banks must be members and must keep a percentage of their funds on deposit at the Fed. |  |
| * + 1. It can change the percentage required of banks to deposit in the Fed to expand or shrink funds available to lend. |  |
| * + 1. It can change interest rates charged to commercial banks, affecting the rates charged to borrowers. |  |
| 1. **Fiscal Policy** | PowerPoint Slide 23 |
| * 1. Fiscal policy concerns government spending and taxation decisions. | *Lecture Enhancer: Provide an example of a U.S. spending decision intended to encourage economic growth.* |
| * 1. Fiscal policy: |  |
| * + 1. controls inflation |  |
| * + 1. reduces unemployment |  |
| * + 1. improves the standard of living |  |
| * + 1. encourages economic growth. |  |
| * 1. On some occasions, the U.S. federal government has issued tax rebates in an effort to stimulate investment and spending. | **Solving an Ethical Controversy:**  **Student Loans: Forgive and Forget?** |
| 1. **International Fiscal Policy** |  |
| * 1. Countries in the industrial world struggle to help developing nations modernize their economies. |  |
| * 1. One proposal is to “forgive” the debts of these countries. |  |
| * 1. Countries should allow citizens to own property, lower tax rates, avoid devaluing currency, reduce trade barriers, and allow businesses to start up. |  |
| 1. **The Federal Budget** |  |
| * 1. A budget is a plan for how a government, person, or organization will raise and spend money during a given period of time. |  |
| * 1. A federal budget undergoes months of deliberation and modifications before approval. |  |
| * + 1. It has many categories for spending, including defense, Social Security, the national debt, and others. |  |
| * + 1. During recessions, the government focuses spending on needed services or job creation; during prosperity, it expands spending to areas like scientific research. | *Lecture Enhancer: Why must government spending policies be flexible and modifiable?* |
| * 1. Primary sources of federal funds are taxes, fees, and borrowing. |  |
| * + 1. Taxes on sales and income raise funds, but people have less money to spend. |  |
| * + 1. Higher taxes reduce inflation but slow growth. |  |
| * 1. A budget deficit occurs when the government spends more than the money raised through taxes. |  |
| * 1. The national debt is created as the government borrows money to cover the deficit, through selling Treasury bills, notes, and bonds. |  |
| * 1. A budget surplus occurs if the government takes in more than it spends. |  |
| * 1. A balanced budget means that total revenues raised by taxes are equal to the total proposed spending for the year. |  |
| * + 1. Achieving a balanced budget does not erase the national debt. |  |
| * + 1. When the United States sells Treasury bills, it offers safe investments worldwide; without them, investors may turn to other countries, thus reducing flow of money into the United States. |  |
| * + 1. Borrowing funds public services, education, and research; because society needs these services, debt reduction may not be the best use of government funds. |  |

**Notes:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Solving an Ethical Controversy:**

**Student Loans: Forgive and Forget?**

**Summary**

The U.S. government has been debating whether to establish a plan that limits monthly payments for student loans and forgives educational debt after 20 years. Only a fraction of former students in debt would qualify, leaving people to argue that these regulations, if established, should pertain to all borrowers of educational loans. This generates both pros and cons. While this would provide millions of dollars to consumers and allow students to pursue higher formers of education without the concern of further financial burden, those in opposition point out that college graduates already have a better quality of life since they’re promised better jobs and that making smaller cash transfers to those below the poverty level would be a more effective way to stimulate the economy.

**Questions for** **Critical Thinking**

**1. How does the idea of forgiving student loans demonstrate the government’s implementation of fiscal policy?**

*A government’s implementation of fiscal policy uses spending and taxation policies to control inflation, reduce unemployment, improve the general welfare of citizens, and encourage economic growth. Forgiving student loans could increase the amount of disposable income students with loan debts might not have had before. Also, it could boost employment because these students would be more willing to pursue higher forms of education for better-paying careers.*

**2. In your opinion, do you think lowering monthly student loan payments and forgiving loan debt after 20 years would be an effective method for stimulating the economy? Why or why not?**

*Answers will vary.*

**Assessment Check Answers**

**4.1 What is the difference between an expansionary monetary policy and a restrictive monetary policy?**

*An expansionary monetary policy increases the money supply in an effort to cut the cost of borrowing. A restrictive monetary policy reduces the money supply to curb rising prices, overexpansion, and concerns about overly rapid economic growth.*

**4.2 What are the three primary sources of government funds?**

*The U.S. government acquires funds through taxes, fees, and borrowing.*

**4.3 Does a balanced budget erase the federal debt?**

*No, a balanced budget does not erase the national debt; it just does not increase it.*

**Learning Objective 5:**

**Describe the global economic challenges of the 21st century.**

*Businesses face five key challenges in the 21st century: (1) the threat of international terrorism; (2) the shift to a global information economy; (3) the aging of the world’s population; (4) the growth of India and China, which compete for resources; and (5) efforts to enhance the competitiveness of every country’s workforce.*

**Annotated Lecture Outline**

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| --- | --- |
| ***GLOBAL ECONOMIC CHALLENGES OF THE 21st CENTURY*** | PowerPoint Slide 24 |
| 1. Five key challenges: |  |
| * 1. international terrorism |  |
| * 1. shift to a global information economy |  |
| * 1. aging of the world’s population |  |
| * 1. growth of China and India |  |
| * 1. enhancing competitiveness of every country’s workforce. |  |
| 1. Creating a long-term global strategy. |  |
| * 1. No country is an economic island in today’s global economy. | **Business Etiquette:**  **Dealing with the Global Workforce** |
| * + 1. Many businesses have become multinational firms, operating facilities around the world. |  |
| * + 1. Events in one nation affect others around the world. | *Lecture Enhancer: What are some drawbacks to this type of worldwide economic interdependency?* |
| * 1. Global expansion offer U.S. firms opportunities. |  |
| * + 1. Because U.S. residents account for just over 1 in every 22 of the world’s population of nearly 7 billion, U.S. firms cannot afford to ignore the world market. |  |
| * + 1. Foreign labor and production costs are lower, but firms need to monitor their suppliers (e.g., toys from China containing toxic elements). |  |

**Notes:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

Assessment Check Answers

**5.1 Why is virtually no country an economic island these days?**

*No business or country is an economic island because many goods and services travel across national borders. Companies now are becoming multinational firms.*

**5.2 Describe two ways in which global expansion can benefit a U.S. firm.**

*A firm can benefit from global expansion by attracting more customers and using less expensive labor and production to produce goods and services.*

**Answers to Review Questions**

**1. How does microeconomics affect business? How does macroeconomics affect business? Why is it important for businesspeople to understand the fundamentals of each?**

*Macroeconomics is the study of a country’s overall economic picture and how its broad decisions, resource use, policies, and standard of living shape the everyday choices made by its citizens as well as the global economy. Microeconomics is the more focused study of economic behavior among individual consumers, families, and businesses and how these decisions determine the quantity of goods and services demanded and supplied at different prices. Businesspeople must understand the fundamentals of each so that they can make informed decisions in response to both economic forces.*

1. **Draw supply and demand graphs that estimate what will happen to demand, supply, and the equilibrium price of coffee if these events occur:**

a. Widely reported medical studies suggest that coffee drinkers are less likely to develop certain diseases.

b. The cost of manufacturing paper cups increases.

c. The state imposes a new tax on takeout beverages.

d. The biggest coffee chain leaves the area.

*Students’ graphs should show the relationship among the event that has changed the price, the demand for a certain item, and the current supply.*

**3. Describe the four different types of competition in the private enterprise system. In which type of competition would each of the following businesses be likely to engage?**

**a. large drug store chain** *– oligopoly*

**b. small yoga studio** *– monopolistic competition*

**c. steel mill** *– oligopoly*

**d. large farm whose major crop is corn** *– pure competition*

**e. Microsoft** *– monopoly*

*Pure competition is a market structure in which large numbers of buyers and sellers exchange homogeneous products and no single participant has a significant influence on price. Monopolistic competition is a market structure in which large numbers of buyers and sellers exchange heterogeneous products, so each participant has some control over price. An oligopoly is a market situation in which relatively few sellers compete and high start-up costs form barriers to keep out new competitors. A monopoly is a market situation in which a single seller dominates trade in a good or service for which buyers can find no close substitutes.*

**4. Distinguish between the two types of planned economies. What factors do you think keep them from flourishing in today’s economic environment?**

*Communism is a planned economy in which all property is shared equally by the people of a community under strong direction from a central government (examples: People’s Republic of China, Cuba, North Korea). Socialism is a planned economy in which the government owns and operates major industries such as health care and communications (examples: India, Sweden, Finland, some African nations). Government- owned monopolies suffer from inefficiency, which keeps them from flourishing in today’s competitive environment.*

**5. What are the four stages of the business cycle? In which stage do you believe the U.S. economy is now? Why?**

*The four stages include: prosperity, recession, depression, and recovery. Many students will feel that the U.S. economy is in a period of recession now, based on high unemployment rates and the rate of the average citizen’s income growth versus the rate of inflation.*

**6. What is the gross domestic product? What is its relationship to productivity?**

*Total productivity considers all inputs needed to produce specific amounts of outputs. As productivity rises, so does an economy’s growth and wealth of its citizens. It has become the measure of a country’s economic strength and standard of living. Economists refer to this measure as a country’s gross domestic product (GDP). GDP is the sum of all goods and services produced within its boundaries. The GDP is based on the per-capita output of a country—in other words, total national output divided by the number of citizens*.

**7. What are the effects of inflation on an economy? What are the effects of deflation? How does the Consumer Price Index work?**

*Inflation is a period of rising prices caused by excess demand along with increases in raw materials and factors of production. Inflation increases during rapid economic growth and falls during recessions. Price increases reduce the goods and services people can purchase with a given amount of money, so those with fixed incomes or stagnant salaries tend to buy less. But for anyone paying a loan with a fixed rate of interest, it can be at least temporarily beneficial.*

*Deflation refers to falling prices caused by a combination of reduced consumer demand and decreases in the costs of raw materials, component parts, human resources, and other factors of production. Although this situation may sound ideal to consumers, it can weaken the economy. For instance, industries such as housing and auto manufacturing need to maintain strong prices in order to support all the related businesses that depend on them.*

*The Consumer Price Index (CPI) measures the monthly average change in the prices of basic goods and services. The Bureau of Labor Statistics calculates the CPI based on a “market basket” of common goods and services by visiting thousands of businesses, then publishing the results. In this way, the public is informed about the rise or fall of prices.*

**8. What does a nation’s unemployment rate indicate? Describe what type of unemployment you think each of the following illustrates:**

**a. discharged armed forces veteran** *– frictional unemployment*

**b. bus driver who has been laid off due to cuts in his or her city’s transit budget** *– cyclical unemployment*

**c. worker who was injured on the job and must start a new career** *– structural unemployment*

**d. lifeguard** *– seasonal unemployment*

**e. dental hygienist who has quit one job and is looking for another** *– frictional unemployment*

*A nation’s unemployment rate is one indicator of that nation’s economic health.*

**9. Explain the difference between monetary policy and fiscal policy. How does the government raise funds to cover the costs of its annual budget?**

*Monetary policy concerns government action to influence economic activity, usually by impacting the growth rate of the money supply and the requirements and interest rates in banking.*

*Fiscal policy also influences the economy but involves taxing and spending decisions by the federal government in controlling inflation, reducing unemployment, improving the standard of living, and promoting economic growth.*

*The government raises funds to cover the costs of its annual budget through* *taxes, fees, and borrowing.*

**10. What is the difference between the budget deficit and the national debt? What are the benefits of paying down the national debt? What might be the negative effects?**

*A budget deficit refers to a funding shortfall in which government spends more than the amount of funds raised through taxes and fees. The national debt refers to money owed by government to individuals, businesses, and government agencies that purchase Treasury bills, Treasury notes, and Treasury bonds sold to cover expenditures.*

*Paying down the national debt is complex. The economy would benefit in that funds used for paying interest could be used for other services. Also, the debt would not be carried on to the next generation. However, the government raises money by selling Treasury bills as safe investments worldwide. Investors could turn to other countries and reduce flow of money into the United States. Also, the U.S. government debt has been used to price riskier investments, so if it issues less debt, the interest rates it commands are higher, raising overall cost of debt to private borrowers.*

**Projects and Teamwork Applications**

1. Ask students about the economic choice that they had to make, and the factors that influenced their decision. Could other factors have come into play if the situation were different? Did the factors change during the decision-making process?

2. Start by getting students to talk about the factors driving demand such as price, outside circumstances, large economic events, and consumer preference. Then talk about the factors driving supply.

3. Discuss which agencies the students chose and why they would or would not favor privatization of these agencies. What would the repercussions be if the chosen agency went private? Would citizens benefit from such a move? How?

4. Ask students to share the type of seasonal business they chose and their plans to boost sales activity during its slowdown and unemployment period. Did they come up with some creative ideas to generate off-season sales? Might any of these ideas lead to entirely new businesses or offshoots for these industries?

5. Ask students to present their findings to the class. Ask them to discuss the pros and cons of living under different economic systems. How would privatization, unemployment rates, monetary policies, and fiscal policies affect their lives?

Web Assignments

1. **Credit card regulations.** Several new federal regulations governing credit cards went into effect recently. Visit the Web site listed here and click on “New Credit Card Rules.” After reviewing these rules, prepare a brief report highlighting the most significant changes.  
   <http://federalreserve.gov/creditcard/>
2. **Unemployment.** In the United States, the Bureau of Labor Statistics (BLS) compiles and publishes data on unemployment. Go to the BLS Web site (<http://www.bls.gov>) and click on “Unemployment.” Read through the most recent report and answer the following questions:
   1. What is the current unemployment rate in the United States? How does it compare to other developed countries?
   2. Which state has the highest unemployment rate? Which state has the lowest unemployment rate?
   3. What is the so-called underemployment rate?
3. **Gross domestic product.** Visit the Web site of the Bureau of Economic Analysis (<http://www.bea.gov>) and access the most recent statistics on the U.S. GDP. Prepare a brief report. What is the current GDP? What is the difference between real and nominal GDP? What are the individual components that make up GDP?

*Note:* Internet Web addresses change frequently. If you do not find the exact sites listed, you may need to access the organization’s home page and search from there or use a search engine such as Bing or Google.

Case 3.1

**Nuclear Energy: Making a Comeback?**

**Summary**

*In the 2010 State of the Union Address, the president called for more clean-energy jobs, with expansion of nuclear power as an alternative energy source.* *The 104 currently operating plants generate nearly 20 percent of America’s electricity.* *An alloy of enriched uranium powers nuclear reactors. At current demand, the supply of uranium is expected to last approximately 70 years. There is some debate about when the demand for uranium will be greater than the supply that can be mined economically.*

**Answers to Questions for Critical Thinking**

**1. What factors do you think will affect the supply and demand curve for nuclear energy?**

*Factors that may affect the supply curve for nuclear energy include increased recycling of existing uranium and finding additional geographical sources of uranium. Factors that may affect the demand curve for nuclear energy include improved safety standards (making this form of fuel more popular than it currently is), the depletion of coal and oil supplies, and an increasing demand for clean-energy sources.*

**2. Describe what type of competition you predict will arise in the nuclear energy industry.**

*Answers will vary. Future competition in the nuclear energy industry could be based on better safety records or cheaper energy delivery methods.*

Case 3.2

**Smart Phones: Recession Proof and Growing**

The ascent of the smart phone has been one of the most revolutionary developments in electronics. Despite the recent recession, smart phones have remained wildly popular in the United States and abroad. Two influential factors in smart phone competition are coverage and applications. Predictions for the smart phone industry include greatly increased sales within the next two years, an increased share of the mobile phone market, an increase in companies selling smart phone applications, and an increase in location-based services.

**Answers to Questions for Critical Thinking**

1. **How has the rapid development of technology affected competition in the mobile-phone industry?**

*The rapid development of technology in the mobile-phone industry has increased customer expectations and enabled manufacturers to provide more capabilities to customers. Competition based on both quality and availability has increased. The rapid development of new smart phone technology has created a competitive environment in which the first product released with new technical capabilities has significant advantage over its competitors.*

1. **How does this technology affect supply and demand in the mobile-phone industry?**

*As each new product and technological capability is introduced, the demand for the new product is suddenly and dramatically increased, while the demand for existing products may similarly drop rapidly. In addition, if a new product or technological capability proves to be particularly popular, and this unexpected demand outpaces the manufacturing pace of the product, the supply of the product may decrease.*

**CHAPTER 3: COLLABORATIVE LEARNING EXERCISES**

#### 1 – Applied Economics

Learning Objectives: 1 and 2

Purpose:

To demonstrate the practical impact of key economic concepts on small businesses.

Background:

Supply, demand, price elasticity, and competitive categories can seem rather abstract to many students. This exercise is designed to make the concepts specific and concrete by applying them, through teamwork, to a hypothetical small business.

Relationship to Text:

Demand and Supply – Learning Objective 1

Types of Competition – Learning Objective 2

Estimated Class Time:

Approximately 20 minutes

Preparation/Materials:

Prepare for each student a copy of the case scenario and questions below (see the Appendix for a copy-friendly version).

Exercise:

Divide your class into teams of no more than five students and present them with the scenario and the questions outlined below. Give them about ten minutes to develop responses. Ask each team to briefly present their results to the class. Typically, the teams develop a broad range of assumptions, which create the potential for dramatically different results.

### Scenario: Your team runs a small gift shop in the main shopping district of a desert resort town outside Los Angeles. Your key source of revenue is turquoise and silver jewelry, handcrafted by a large Indian tribe in the local area. The tribe also supplies very similar pieces to many of the other shops in the business district. You and your team just heard that the tribe is planning to open a visitor’s center at one of the local natural attractions that they manage. They are sure to sell many similar pieces, at a significantly lower price than you. How should you respond, from both the supply side and the demand side? Clarify your assumptions as you answer each of the questions below.

* How do the characteristics of the town impact your business?
* Which category of competition does your gift shop compete in (monopoly, oligopoly, monopolistic competition, or pure competition)? Why?
* How will the visitor’s center affect your business? Why?
* Should you change your prices? Why? How?
* Should you take other steps to increase demand for the jewelry in your store? If so, what steps? Why?

#### 2 – Supply and Demand

Learning Objective: 1

Purpose:

To demonstrate how macroeconomic concepts are integral to our daily lives.

Background:

Often without realizing it, many students understand and apply the concepts of supply, demand, and substitute products. This quick, discussion-based exercise is designed to demonstrate that these concepts are directly relevant to their lives and completely consistent with their intuition and common sense.

Relationship to Text:

Demand and Supply – Learning Objective 1

Estimated Class Time:

5–15 minutes (depending on whether you divide the class into groups)

Preparation/Materials:

You may want to copy the scenario and the questions below for each student (see the Appendix for a copy-friendly version).

Exercise:

Ask your students how many of them drink coffee. With a little probing, you could divide them into four groups based on whether they are light (less than one cup per day), medium (one to two cups per day), heavy (more than two cups per day), or non-coffee drinkers. (If you have less time available, this exercise also works well as a full-class discussion.) Share the scenario below, write the following questions on the board, and ask each group to try to reach a general consensus regarding their response. Direct them to appoint a spokesperson and report back to the class after about five to ten minutes. Compare and contrast responses among the groups.

Scenario: The price of coffee in all of its forms (from prepared drinks at Starbucks to whole beans at the grocery store) has suddenly doubled. What will you do? How (if at all) will your coffee-drinking habits change? What factors will influence you?

When you circulate among the groups, encourage them to consider the influence of the following factors:

* Why do they drink coffee? For the taste? To socialize? For the caffeine?
* What portion of their discretionary income do they currently spend on coffee? How would that change with the price increase?
* How would their friends/families influence them?
* Are appealing substitutes (e.g., tea, soda) easily available?
* Would timing of the price increase change their responses (e.g., final exam week versus summer vacation)?

**3 – Categories of Competition**

Learning Objective: 2

Purpose:

To help students better understand the different categories of competition.

Background:

Identifying and understanding the competitive climate for a range of different businesses will help students make better decisions as future managers and entrepreneurs. This exercise is designed to facilitate that process and to sort out potential misunderstandings, especially regarding the difference between monopolistic competition and monopolies.

Relationship to Text:

The Private Enterprise System – Learning Objective 2

Estimated Class Time:

Approximately 10 minutes

Preparation/Materials:

None needed

Exercise:

Direct students to work with the one or two people sitting next to them to brainstorm—in five minutes—a list of industries that compete in each of the four categories: pure competition, monopolistic competition, oligopoly, and monopoly.

After five minutes, reconvene as a class and ask your students to call out examples by category as you list them on the board. This will give you an opening to straighten out confusion among the categories. When the lists are complete, it will be clear that monopolistic competition and oligopoly are the dominant categories.

Helpful discussion question: Does the type of competition tend to evolve? If so, how? Why?

#### 4 – Pure Competition

Learning Objective: 2

Purpose:

### To encourage students to engage in critical thinking with regard to competition.

Background:

Clearly, pure competition—using agriculture as the example—makes for a very challenging business environment. This exercise is designed to highlight agricultural producers who have broken free from these constraints, reaping additional profits through branding.

Relationship to Text:

Pure Competition – Learning Objective 2

Estimated Class Time:

### Approximately 10 minutes

Preparation/Materials:

None needed

Exercise:

Brainstorm with your students a list of agricultural producers that have established a meaningful difference in the minds of consumers … and thus a reason for higher prices. Examples include differentiated subcategories such as organic products, hormone-free milk, California cheese, plus differentiated brands such as Sunkist, Dole, and Chiquita.

Divide your class into groups of three to five students. Direct each group to choose a generic agricultural product (e.g., watermelons, or apples grown in Minnesota), and develop a strategy to differentiate that product in the minds of consumers.

Ask each group to present their strategy to the class, and ask the class to provide feedback. Bottom line: Would they pay extra for the differentiated product? Why or why not?

#### 5 – Small Businesses and Recession

Learning Objective: 3

Purpose:

To highlight the impact of recession on small businesses and to explore the range of potential responses.

Background:

Although small businesses clearly drive economic growth, they also are most vulnerable to recessions. A surprising number of students (especially at the community college level) come from families who own small businesses. Many of them have experienced the impact of recession firsthand, and they often are willing to share their stories. This exercise is designed to provide a forum for their experience, which acts as a catalyst for class discussion.

Relationship to Text:

Flattening the Business Cycle – Learning Objective 3

Estimated Class Time:

3–5 minutes per volunteer plus approximately 5 minutes for discussion

Preparation/Materials:

You will need to solicit volunteers beforehand to discuss how their family businesses have weathered recession (or several recessions as the case may be). Try to choose students from a range of businesses and personal backgrounds. If you have international students, you may find riveting stories about the impact of broad regional issues (e.g., SARs, mad cow disease, terrorism) on specific businesses. Three to five presenters typically work well.

Exercise:

Invite your volunteers to briefly describe their family business and the impact of recession. These mini-presentations typically trigger interesting discussion, but you may want to follow up with broader questions: How can a small business best protect itself from recession? When a recession hits, how can a small business keep customers? Although cutting prices is an obvious answer, it can dramatically undermine image. What are other options? Encourage them to use examples of specific businesses to support their ideas.