INSTRUCTIONS

Welcome to your Continental Academy course “Introductory Economics”. It is made up of 7 individual lessons, as listed in the Table of Contents. Each lesson includes practice questions with answers. You will progress through this course one lesson at a time, at your own pace.

First, study the lesson thoroughly. Then, complete the lesson reviews at the end of the lesson and carefully check your answers. Sometimes, those answers will contain information that you will need on the graded lesson assignments. When you are ready, complete the 10-question, multiple choice lesson assignment. At the end of each lesson, you will find notes to help you prepare for the online assignments.

All lesson assignments are open-book. Continue working on the lessons at your own pace until you have finished all lesson assignments for this course.

When you have completed and passed all lesson assignments for this course, complete the End of Course Examination.

If you need help understanding any part of the lesson, practice questions, or this procedure:

- Click on the “Send a Message” link on the left side of the home page
- Select “Academic Guidance” in the “To” field
- Type your question in the field provided
- Then, click on the “Send” button
- You will receive a response within ONE BUSINESS DAY
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Various types of economic systems and decisions, economic indicators and cycles are explained. Personal economic decision-making concepts like credit and interest rates are explained. Financial and governmental institutions workings are detailed. Decisions of presidents and other world leaders are also studied. Study questions aid students at the end of each introductory section.

- Student will understand scarcity
- Student will understand the allocation of goods and services
- Student will understand price and quantity determination
- Student will understand the macro economy
- Student will understand the role of price in the market system
- Student will understand unemployment and inflation
- Student will understand monetary and fiscal policy
- Student will understand the development of the Industrial United States
- Student will know what is civic life, politics, and government
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LESSON 1: SOCIETY AND ITS ECONOMIC PROBLEMS

Lesson 1.1: Why Study Economics?
Lesson 1.2: Understanding Economic Factors and Scarcity

Introduction:

People’s wants are almost unlimited. Everyone wants a new car every year, new furniture, or a better house. However, resources are limited. Therefore, not everyone can have all the items from the economy that they may want. In this lesson, you will understand basic economic problems. You will gain an understanding of how an economy works.

LESSON 1.1: WHY STUDY ECONOMICS?

Economics is the social science that studies how a society chooses to use its resources. Many problems arise when trying to use limited resources in the best way. To help us understand economics, we need to explain some terms to get started. “Scarcity”, for example, is an important term in economics. Scarcity means that goods and services are limited. Since goods and services are limited, a society must find a best way to allocate them.

Feudalism was once the primary system of economic allocation. Feudalism was the system used long before America was even discovered. A king or landlord would provide protection to those who used his land. The king would also direct all international affairs (including wars). The king also directed all policies regarding money. Exchanging goods was accomplished through barter. Bartering was the way you obtained goods
and services you needed. Most often you bartered for goods you did not produce yourself. Individuals exchanged what they produced for goods they needed that were produced by another individual. One must understand how inefficient such trade was. Imagine someone who has a milk-producing cow and needs clothes. However the only person willing to trade might be a wine producer. A system using money had to be put into place as a solution. Such a system using money is called a monetary system. In a monetary system, a coin or a bill, is used to buy what you want. Coins (initially gold and silver) were able to hold their own value. Their value was as a scarce metal. Again, think of gold. The value of the coin could vary depending on its weight.

Economics looks at such problems in its own special way. Since we cannot have all the goods we want, we need to decide how to handle the basic economic questions.

In present-day United States, for example, economic decisions such as those posed above are handled in a special way. In the U.S., these decisions are handled by companies, consumers, and the government all acting together. However, under communism, such decisions are made by the central government.

Let’s go back to our system in the U.S. In the U.S. the Federal Reserve System is in charge of adjusting the interest rates charged to banks. This decision affects the interest rates charged on loans by banks to consumers and businesses. These bank loans are for home loans, credit cards and auto loans, to name but a few. These are loans that affect us all. Corporations (Home Depot, for example) decide where they will build their
stores and what items to sell. So, in the U.S. the individual components all interact together.

There are two basic studies of all economic systems. **Macroeconomics** is related to the economic system as a whole (the entire nation). It uses total measures of the economy. **Microeconomics** is the study of economics related to individual units within the overall economy. Individual units can be industries, certain firms, and even people working in the household. It’s related to specific goods, services, products, and resources. These concepts dealt within microeconomics explain how prices are fixed. These concepts also tell us how individuals make their decisions.

Understanding economics is important to us as students. Many political problems today are directly related to economic issues. Economic approaches used in one country can have a vastly different outcome in another country. Not all economies will react to an approach in the same way. People need to know whether a tax cut or a tax increase is good for them. People need to know how such things will affect them. Questions such as: Why does an economic power like the United States have trade deficits with other countries? What caused this and how do we remedy such an imbalance of trade? Unemployment, inflation, taxes and other economic issues are therefore discussed widely in political campaigns. Such issues are important to you the student, as they can directly affect you.
Business decisions are financially and economically related. Decisions such as whether or not to employ one more person are both types. Decisions to use more money in marketing campaigns are also financial and economic in nature. Such financial/economic decisions can determine the growth or failure of a company. For this reason, many multi-national corporations have their own economists working for them. For example, will a new Ford factory in Mexico increase revenue and profits? Should the company introduce a product to the market, and which way will the company benefit the most?

Economics can help one make better decisions when buying or selling products. Think about some of the possibilities related to your consideration to buy a house. Will prices go up or down soon if I decide to wait to buy? What are rates now on the mortgage for the house? Will they go up or down, if I wait? These are just a few of the questions related to buying a new home. An understanding of economics can help you with important decisions you will have to make someday.
Lesson 1.1 Practice Exercises
(Pick the best answer to the question)

1) What is economics in general?
   a) A physical science that focuses on studying the different economic systems
   b) A social science that studies the efficient use of scarce resources
   c) Merely the study of scarcity
   d) The study of chemistry

2) What is/are the basic economic questions?
   a) What and how much to produce?
   b) For whom to produce?
   c) How to produce it?
   d) All of the above

3) Why is it important to study economics?
   a) It helps you make more informed decisions
   b) You need to learn only about Ford Motor Company
   c) You don’t need to make good financial decisions
   d) It helps you to understand whether a real estate agent can sell you a house for twice its value

4) Scarcity means:
   a) Resources are unlimited
   b) People never want things
   c) Resources are limited
   d) People’s wants are limited
5) How did we exchange goods before the monetary system?
   a) We used coins.
   b) We bartered.
   c) We used communism.
   d) There has always been a monetary system.

LESSON 1.2: UNDERSTANDING ECONOMIC FACTORS AND SCARCITY

At the center of economics is the idea that “nothing is free.” Burger King may offer a "free" Coke with your burger and fries. However, you must realize the Coke is not really “free”. The restaurant has set a price for the food that covers the cost of the Coke also. The restaurant must make a profit on what it sells. Otherwise, the restaurant will quickly go out of business. Taxes are the money the state gets to provide public services. These public services include such items as police protection and roads. These expenses are not free.

To understand profit, we must understand revenue at the same time. Revenue is the total amount received by a company for the sale of an item. If the burger and fries are sold for $5.50, that whole amount is revenue. A company’s total sales for this year may be $1,000,000. That $1 million is the total revenue for the company. Profit is the amount of money left from revenue. The amount is determined after all the company’s costs for the product are removed. Technically, profit is the difference between a firm’s total revenues and its total costs. A company must make a financial profit or it will go out of business.
Introductory Economics

A simple example will help here. A Burger King sells $1,000,000 in burgers and other food items in a given year. The $1,000,000 is revenue. Let’s assume that Burger King had costs for the year related to these sales of $900,000. These costs included all the items necessary to get the products (burgers, etc.) sold. These costs then include such items as pay for the workers, electricity, and food. The amount left from revenues of $1,000,000 after we take out the costs of $900,000 is $100,000. The $100,000 then is profit!

OTHER ECONOMIC FACTORS:

There are other economic terms to be introduced to continue our study of economics.

A household is another economic term we must try to understand. Households refer to everyone living in a given economic system. In America, this would include everyone living in a house, condo, or apartment. Households act in two ways. In one way, households act as consumers. As consumers, the individuals in the household buy goods that they need or want. A consumer then is the person or company buying the product. Households are also suppliers of another economic factor called labor. A person selling a product is a supplier. So in this second way, the member of the household also acts as a supplier. The members of a household represent a supplier by providing their own labor into the market place. An economic resource is a scarce commodity used in any economic system. Therefore, it should be noted that the household is also a resource owner. As a resource owner, the household member owns the scarce resource: labor.
Companies and households both as suppliers and as consumers react in different ways. Basically their demand characteristics are different for each of these two activities. **Demand** is that amount of a good a consumer will buy at selected prices. When one demands an item, this is the point at which a consumer is willing to actually buy the item. The consumer no longer just desires the item.

Other factors related to demand are:
- **Tastes** (Desire for goods)
- **Income** (Of the consumer)
- **Availability of Similar Goods** (Other available goods that can satisfy the same purpose, and their lower or higher price).
- **Expectations** (of income, price changes, tastes changes, other gains)

When discussing demand, there is always an **opportunity cost**. The opportunity cost is the "trade-off" involved when buying a good.

Suppose you have $100 and need to buy a T.V. or new chair. You may assume they cost $100 each. Since you have only $100, you can buy only one of them. If you buy the T.V., you have made a trade-off by not buying the new chair. The chair then is the opportunity cost of the T.V.

This opportunity cost is also related to jobs. As a worker, you are acting as a supplier by providing labor. If one doesn’t work, a person can do something else the person likes better. Maybe go fishing for example. Yet,
without working, one can’t pay for the cost of living for long. Therefore, most rational individuals decide to work because it is in their best interest to do so. The opportunity cost of not working is too great. One might starve or go bankrupt without income. Notice now, as a supplier of labor, we want or demand an income, which usually comes to us in the form of money.

It is important to notice how these demand factors may or may not be financial. Income is clearly financial. Tastes are not. Different types of consumers often have different priorities when buying a certain product. A low-income worker will put more emphasis on the low price of the product. A high-income worker might be more interested in the quality of the product. Further, the high-end purchaser might want the social status that the product provides. Consider a Rolex watch versus a Timex. Companies will be inclined to consider similar options when buying materials necessary to make their product. Sometimes high quality materials will be necessary to make customers happy.

An investor is interested in the expected profit of the investment. This expected profit must be compared to the risk associated with it. The higher the risk of the project to be taken, the greater the expected return that the investor will demand. Otherwise, the investor will not undertake the project.

A person with a savings account in a bank receives a small return on his or her money. The risk of losing your money is very low on a savings account. Remember, almost all savings accounts are insured by the government. If the person put the money in the stock market, the person could risk losing all or part of the money. Sizable losses can occur if the stock market values were to decrease. The person will need a higher
expected return if he puts his/her money in the stock market. If not, what is
the sense in putting the money there at all? A saver is motivated by the
interest on the bank account. A savings account allows you to extract your
money with relative ease. But the return on the savings account is small. A
certificate of deposit (CD) gives a better return, but you must leave the
money in the bank for a fixed period of time. The stock market, as an
alternative to placing your money somewhere else, involves more of a risk.
To place your money in the stock market, you must expect a better return.

Importantly, there is no right answer when it comes to taking risks.
Everyone has a different opinion. Everyone differs on what level of risk to
take. Everyone differs on what level of expected profit to demand for a
project.
Lesson 1.2 Practice Exercises

(Pick the best answer to the question)

1) Financial profit is:
   a) the money made after all costs have been covered
   b) the same as revenue
   c) determined by the amount of risk
   d) one of the four demand determinants

2) Which of these is NOT a demand determinant?
   a) Tastes
   b) Income and expectations
   c) The hours in the workweek
   d) Availability of similar goods

3) A consumer is:
   a) The seller of goods and services
   b) The buyer of goods and services
   c) Making a revenue when buying goods
   d) Making a profit when buying goods and services

4) People who do not like risks will:
   a) Usually settle for a low expected profit in order to keep risk at a minimum
   b) Try to make the most money possible by getting the riskiest choice
   c) Pick the option with the highest expected return
   d) Have lots of stocks in the market
5) In economics, we assume that:
   a) Consumers will always sell goods cheaper
   b) Consumers and suppliers act rationally and with self-interest
   c) A supplier will always sell at the highest price possible
   d) Some things might actually be free

ANSWERS TO PRACTICE EXERCISES

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LESSON 1 THINGS TO REMEMBER

- Economists define scarcity as limited quantities to meet unlimited wants.
- The most desirable opportunity given up as the result of an economic decision or action is called opportunity cost.
- Economics is the study of how people seek to satisfy their individual needs and wants when making choices.
- The financial gain made in an economic transaction is called profit.
- The direct exchange of one kind of good or service for another, as opposed to the use of money to make the exchange is called barter.
- Macroeconomics deals with the economy as a whole and involves itself in understanding the “big picture.”
- The basic unit of the consumer sector which consists of all the people who occupy a house, apartment, a condominium, or separate living quarters is called household.
- Demand is the combination of the desire, ability, and willingness to actually go ahead and buy a product.
- The organized way a society provides for the economic wants and needs of its citizens is called economic system.
- Some examples of services, as opposed to a good produced are: haircuts, repairs on your car, having someone mow your lawn and having your house painted.
LESSON 2: ECONOMIC SYSTEMS

Lesson 2.1: Command Economy
Lesson 2.2: Market Economy

Introduction:

Different economic systems are in place in the world today. You should already be familiar with the market economy used in the U.S. A market economy is often called capitalism. Many others are also familiar with the command economy in places like Cuba today. The command economy was also in place in the Soviet Union until the late 1980s. In this lesson you will study an overview of these systems. You will learn about their similarities and differences.

LESSON 2.1: COMMAND ECONOMY

A command economy has been, for the past century, an alternative to the capitalistic system. The capitalistic system, however, has been widely preferred. A capitalistic system is often called a market economy. A command economy is usually central to a highly socialist or a communistic type of government. A command economy was used extensively in Russia, until recently. The command economy is still in use in Cuba today. We must introduce how a command economy works. To do so we must therefore examine the different types of resources available in any economic system. The difference in the systems is in the allocation of resources. The allocation of resources establishes basic differences between market and command economies.
Economic Resources and their Rewards:

- **Land**: This group is not just land itself but can include other natural resources. **Natural resources** include minerals, water deposits, and forest, even the oil deposits underneath. The **reward** for the **landowner** is the **rent** he/she derives from its use.

- **Labor**: Includes all physical and mental talents of those who work. The **reward** for providing your **labor** is the **wages** you are paid.

- **Capital**: Includes all the tools and factories used to produce more goods. Importantly, capital does not refer to money in the bank. **Money** is a means of exchange. The process of purchasing capital goods is called **investment**. The **reward** for your investment is **interest**. **Entrepreneurship** is different from labor because the entrepreneur is the person taking the initiative of production. He/she makes business policy decisions. These are the managers, organizers, and risk-takers. Entrepreneurs decide what and how much to produce. The **reward** to the entrepreneur for the risk he/she takes in deciding what to produce is **expected profit**. Expected profit is often called simply **profit**.

In a **command economy**, the government is the owner of all, or most, of the economic resources. The government owns all the property and resources available within the country’s border. Central planning committees handle all decision-making. These **planners** often operate by making five- and ten-year plans. These government-appointed central planning committees make all economic decisions about what to produce and how much. These committees make all decisions about how much of each product to produce. They also decide how much reward workers will make in
terms of pay. Their pay is determined as a part of the labor force. The
government tells workers where they must work.

The command economy has not proven to be very successful. The
central government decides where to send resources. The central
government decides to produce consumer goods and capital goods. It also
decides how much to spend on war goods. In making war goods, it might
make very few consumer goods. This command system, in effect, tells
people what they can consume regardless of their desires. Products are
often standardized. Shirts, shoes, clothes, cars, etc. look similar. Sizes are
often very limited. Wages and prices are decided by a centralized
mechanism, so there is little incentive for individuals to make any extra effort.

The command economy has been proven to be efficient only in the
early stages of development in a nation. It directs all resources to whatever
plan the government wants to implement. Everything is concentrated to
selected industries at once. The nation then is able to meet realistic
centralized goals very quickly. The problems arise when the economy
becomes more mature, and central planning is no longer able to determine
society’s true needs and wants. The economic system usually falls prey to
the desires of the government rather to the needs of the people. Planners
are then forced to set goals as dictated by those in control of the
government. Inefficiency sets in, and the system often becomes a
dictatorship. Basic freedoms are often denied and meaningful economic
growth does not continue. Entrepreneurship is out of the question in a
command economy. No one except the government is allowed to create or
control other factors of productions. Individuals are not allowed to take
economic initiatives in this system.
Communism takes the form of a socialistic economic state together with a totalitarian political government. Communism is the vision of Vladimir I. Lenin and Karl Marx. Their writings on this subject are famous. Communism is in fact a command economy.

A pure communist system does not exist today exactly as it was envisioned. Communism did not work in the old Soviet Union. It has now been replaced in Russia. The old Soviet Union has now been dismantled. Even China is not a pure communistic nation today. Instead, China is an example of a “mixed” economy. China allows for private ownership and some entrepreneurship. But China also provides for centralized economic planning through its communist party. The Chinese basically reduced the degree of central planning and allowed some free market transactions. The Chinese economy has, in the last three [3] decades, heavily relied on private planning to expand its markets and world trade.

Cuba claims to be communistic. Cuba, however, is an economic failure. North Korea also claims to be communistic. North Korea is in fact a brutal one-man dictatorship.
LESSON 2.1 Practice Exercises
(Pick the best answer to the question)

1) A command economy:
   a) Uses central planning to distribute goods and services.
   b) Is the same as a market economy.
   c) Does not use economic resources.
   d) All of the above

2) Which of these is an economic resource?
   a) Land
   b) Labor
   c) Capital
   d) All of the above

3) The reward for labor is:
   a) Rent
   b) Interest
   c) Profit
   d) A Wage

4) Who developed the idea of communism?
   a) George Washington
   b) Lenin and Marx
   c) Adam Smith
   d) None of the above
5) China has:
   a) A pure form of communism
   b) A form of communism with some private ownership (mixed economy)
   c) A free market economy
   d) A market economy

### LESSON 2.2: MARKET ECONOMY

The system that centers on private ownership of economic resources is a **market economy**. In a market economy, the allocation of resources is left to "free" market forces. Each participant in this system acts according to his or her own will and self-interest. Each individual seeks to maximize his or her own rewards. Ownership of capital is private. The movement of capital is determined through prices. This movement of capital is coordinated through the free market. Neither one person nor the government controls this movement. A **market** is a place where buyers and sellers meet to exchange goods. Goods and services are exchanged by using a common method of exchange in the form of money. Those in the market who are willing and able to buy a product determine the amount. Those same people also determine the price of the product as well as the method of distribution. These people determine these outcomes through their independent decisions. However, these decisions come together in the market place. A person or entity willing and able to start a business may do
so. The end result of this interaction between consumers and suppliers is that decision-making is widely dispersed and not centralized. The market is then in control.

Suppose you are going to produce shirts. You need to know what color of shirts people prefer. You must identify where and how to produce shirts at a low cost. You must be able to beat other sellers with a lower price. If you cannot, you must provide better quality shirts for the same price. Hopefully you will do both and be able offer better shirts for a lower price. Finally, you need to sell your shirts to buyers who will be choosing from many other producers. This system creates clear advantages to consumers, because they are able to buy what they want at a good price. If your shirts are a success, you will sell many. On the other hand, if your analysis is incorrect, you will not sell shirts. You may have to give them away. You may have to sell them at such a low price that you will have to stop production.

A market economy is also often called capitalism. Capitalism gets its name because the sources of production are privately owned. Remember, the sources of production are capital. A pure form of capitalism is called laissez-faire capitalism (“let it be”). The U.S. employs laissez-faire capitalism as its model. However, the U.S does actually use some modifications to this model. The government’s role in laissez-faire capitalism is extremely limited. In fact, in this form of capitalism the government’s role is limited to certain aspects. These aspects center on protecting private property. Another aspect centers on maintaining an appropriate environment for the market to run. Interference in the economy by the government is to be as limited as possible. That is why this system is referred to as “let-it-be”
capitalism. In such a pure system, the government does not enact laws or regulations regarding market transactions because such intervention by the government will only cause inefficiencies in the system.

Adam Smith first put forth the idea for laissez-faire capitalism in 1776. Adam Smith presented his ideas in a book entitled *The Wealth of Nations*. He is the father of economic thought related to laissez-faire capitalism. Thus, he is the father of the free-market system, which exists in such economies as in the U.S and England. In Smith’s free-market system, interactions only take place in market places between buyers and sellers. Such interactions would lead to a consistent and self-governing system. Smith believed this market system would lead to growth and prosperity. He argued that the government should not interfere with market transactions.

In practice, Laissez-faire capitalism does not mean that the government never gets involved in the market place. It does not mean that only prices control economic growth. Intervention by the government has, in fact, often been necessary under the free market system. Railroad, oil, steel, and iron companies became too powerful by the early 1900s. They abused their power by actually controlling their markets. The government then had to step in with needed reforms. In the U.S., individual working rights had to be established, like the rights of workers to form unions. These rights were established through enactment of laws. The collapse of the stock market in 1929 caused many changes. One of these changes occurred when the government became active in the economy. This government activity involved many laws and regulations. The government realized that regulating the economy was necessary to keep a steady pace on the economy. This steady pace was necessary for sustainable growth and to
prevent wild up-and-down cycles. Avoiding collapses of the economy became one of the goals of the government. These collapses caused widespread panic in the population. Since the 1930s, the U.S. economy has not only been run by the market, but also by a number of governmental agencies. They help the market, as necessary, to keep a smooth flow. Government intervention has become commonplace.

In most countries today, capitalism is combined with some degree of government interaction. The outcome is a mixed form of free market and market-government intervention. The government provides rules for economic activity, which promote growth and economic stability. The government furthermore provides essential goods that will otherwise be under-produced or not produced at all. Examples are roads, tunnels, and war material. Governments also often modify the distribution of income through the implementation of minimum wage laws. The government can also redistribute income through taxes, such as income taxes. The government, however, is not the dominant force in the free-market economy. The free-market economy is completely different from the economy in the communistic system.

The current market system in place in the U.S. has proven to be the most efficient of all. It has the ability to achieve a higher standard of living. It provides a better social life. It also provides a great amount of human rights and benefits. It is efficient and provides goods that are lower in cost and higher in quality than if the government alone guided the economy. There is considerable freedom when picking the products you want. These products offer matches to your individual characteristics and desires. Security for the market is also better established. As long as someone is willing and able to
buy a product, someone will make it. This market system allows them to make it and to sell it for a profit.

Let’s analyze in more detail what happened after the 1929 stock market crash. We want to look at the reconstruction plan that followed. This analysis will help to illustrate the power of the current system.

Historical Event Analysis

In 1929, The Great Depression took place after the stock market collapsed. Though the economy had long been showing signs of decay, the government was reluctant to intervene. Previous economic thought contradicted government intervention as a tool. The market collapse created panic in all sectors of the economy. Banks closed when people withdrew their money. People could not keep up with their creditors. Jobs were lost, and people lost trust in the system. The depression that followed caused the unemployment rate to rise from 3% to 25%, and a decrease in GDP (Gross Domestic Product: the amount of product made in the U.S. per year) of 40% in the first few years of the 1930s. Many factors contributed, but the most important was the impact in the 1920s of an extremely prosperous, exploding economy. This increased stock prices and real estate prices to a point that did not reflect financial reality. (The “market bubble” of the 1990s, with the Internet Boom, is another example). The stock market had to adjust, and it did so abruptly by almost collapsing.

Change was badly needed. Franklin Delano Roosevelt won the American presidency in 1933. He implemented a plan that called for
government intervention in which the government created jobs at its own expense. Increasing the government’s debt had the effect of “priming the pump”. Economist John Maynard Keynes called this "priming the pump" necessary. It was a necessary step to get the recovery underway.

These steps did work. Such jobs distributed money through the system, including workers, contractors, companies, etc. The expansion of the number of highways and buildings created needed development in our infrastructure. Unemployment levels declined, and jobs were created for those who needed them the most.

New laws created a better central banking system. The laws allowed for better social interaction. The new laws required better accountability for firms and their finances. The Federal Deposit Insurance Corporation (FDIC) was created to insure bank deposits. Insuring these deposits lowered the public’s panic created by bank failure. The FDIC now insures bank deposits for up to $100,000. Monopolistic firms who abuse their power can be prosecuted. This prosecution helped to level the playing field for small business. The economy was back on track by the Second World War (WWII) with the conversion of many factories to war production. During WWII, there was little or no unemployment.
LESSON 2.2 Practice Exercises

(Pick the best answer to the question)

1) The system with private ownership where allocation of resources is left to market forces is a:
   a) Command economy
   b) Feudalism
   c) Communism
   d) None of the above
   e) Market economy

2) In laissez-faire capitalism, also known as pure capitalism,
   a) The government’s role is to own all private property
   b) The government’s role is to centrally control all aspects of the market
   c) The government should never help the economy
   d) The government should help the market as little as possible

3) The founder of modern capitalist theory is:
   a) Vladimir I. Lenin
   b) George Washington
   c) George W. Bush Jr.
   d) Karl Marx
   e) Adam Smith
4) Present-day capitalism:
   a) is exactly the same as the one introduced in “The Wealth of Nations”
   b) involves some sort of government help
   c) is identical to the capitalism described by Lenin
   d) None of the above

5) The Great Depression:
   a) Began in 1929
   b) Began right after WWI
   c) Lasted from 1920 – 1928
   d) Occurred in the 1910s

ANSWERS TO PRACTICE EXERCISES

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LESSON 2 THINGS TO REMEMBER

- Land is a natural resource that is used to make goods and services. This group can include oil under the ground as well as trees harvested from the forest.
- The effort that people from households devote to a task and for which effort they expect to receive a wage is called labor.
- Capital is defined as the tools and factories used to produce other goods. This group includes human-made items that are used to create other goods.
- Money serves as a standard means of exchange.
- Command economy is a system in which a central government or a central committee makes all of decisions on production, allocation, and consumption of all economic resources.
- Communism is denoted by a centrally controlled economy with all economic and political power residing in the hands of the central government. Only one party and the leaders of that party in turn control the central government.
- Karl Marx was the father of Communism.
- An economic system in which decisions on production and consumption of goods and services are based on actions and exchanges which take place independently in the market place is known as market economy.
- Capitalism gets its name form the fact that private individuals, as opposed to the government owning the capital, own capital and the system is further noted by free enterprise.
- Laissez-faire capitalism was first explained in a book entitled The Wealth of Nations, written by Adam Smith.
In this lesson, you will learn how the basic structure of our economy works. You will also learn how prices, quantity supplied and quantity demanded are tied together. You will learn how taxes affect you and how the economy in general operates. Furthermore, you will learn how fiscal and monetary policy can help or offset each other. Also you will learn how fiscal and monetary policies affect the well being of individuals.

LESSON 3.1: MICROECONOMICS AND ECONOMIC INTER-RELATIONSHIPS

Microeconomics is the study of specific interactions of consumers and businesses. These interactions determine how demand and supply are equated. Their interaction also establishes how prices are eventually set.

We can begin with a study of the market system that exists in the U.S. In such market systems, the market determines prices. Prices are established through the natural interaction of consumers and suppliers. **Price** is the amount charged by the supplier for a good or service. **Cost** is
the amount the supplier had to pay to produce a good or service. For instance, Sears cannot charge an excessive amount of money for a shirt. It needs to know what price to charge based on what people will be willing to pay for it. But at that price Sears must be able to sell the shirt for a profit. Suppliers then use the amount of quantity demanded of a product to know the amount of quantity to supply. They use these amounts to determine the prices to be charged. Basically, the price must allow for the shirt to be sold. But the sale price must allow for a profit when the sale is completed. If not, Sears, for example, will not be able to sell to its customers profitably.

Economists use graphs to understand such transactions. The following is a typical basic Supply and Demand graph.

Suppose the product in question is called “widjets”, which is just a made-up name for a product. The Supply Line slopes upward because, at a
higher price, suppliers will be willing to produce more widjets. At a lower price, suppliers will supply fewer widjets. The Demand Line, in turn, is downward sloping because as the price goes higher, people will buy less. People will be willing to buy more widjets if the price is lower. Along the Supply line, one can see how much will be supplied at various prices. Along the Demand line, one can see how much will be demanded at various prices. We must understand also that many factors come into play to create these lines.

If you are a supplier, you will allocate your resources along the supply line. The best place to be in the graph is at a price of $9, where quantity supplied will be 4.5 units and quantity demanded will also be 4.5. You have met the demands of the market and you will make a profit.

We can also use this graph to talk about direct price determination. If one lowers the price of the product, people will buy more. If one increases the price, people will buy less. This is the idea behind store-advertised sales. If SEARS has a sale on jeans, prices will be lower. However, SEARS expects that more people will buy these jeans during the sale.

The price that can be charged by companies can also affect their distribution channels. Companies like to sell their products at higher prices in order to make higher profits. Suppose that the population in Iowa is expected to increase dramatically. Housing projects and food supplies will need to be increased. Hardware stores and food companies will begin to increase their supplies in Iowa immediately. These businesses have the expectation that sales will increase dramatically because of need. They also
know they make a profit at the current price. They hope that shortages in supply will occur. If they do, they will be able to raise their prices even more.

Price controls, such as price caps, can change prices and distribution as well. **To control price increases governments establish price controls.** These increases are controlled when they occur too rapidly. An example of price caps or controls is noted in Florida. Every time there is a hurricane threat in Florida, people try to charge more for hurricane supplies. However, it is illegal for a business to raise prices quickly during a hurricane emergency in order to maximize profits. The price caps for goods and services during hurricane threats have been by law. The price cap is always in place to protect the consumer from greedy businesses. Price controls and price caps do not, in fact, work well as a government tool. The controls too often interfere with the normal flow of supply and demand necessary to make the free market system work effectively. In reality, price control is used only in emergencies such as during times of war, natural disasters, etc. in the U.S.

Developing nations also use price controls often called "third world nations". Developing nations often use price controls to further their nation’s economic development. Developing countries usually have a limited economic base. Often they must depend on imports to meet the needs of its citizens. These nations are often desperate to make their own goods but also to increase exported goods. Often these governments use price controls that allow companies to establish themselves, build factories and start production. They are allowed special advantages. Their products can
be sold domestically at a better price than the same imported item. Thus they become a protected industry with certain economic advantages.

**THE ECONOMIC CYCLE:**

Economic inter-relationships can be seen in the following chart titled: “Circular Flow of the Market”. Notice that every part of the market system is related to each other. Each depends on the other parts directly or indirectly.

**Graph 2** Circular Flow of the Market

- Worker buys a good or service from a company.
- The company uses the money to pay for the cost of the good or service and makes a profit.
- The cost of goods and services pays workers’ incomes.
- The worker receives income, which he/she will spend.

Suppose the cycle starts with a person buying shirts in the mall. The company selling the shirts must pay for its employees and for the cost of materials or services. The primary producer then has to pay the workers for the production they have provided. The money goes back to the start of the cycle. This is because workers spend their wages on the products they need. The cycle continuously repeats itself.
KEYNESIAN ECONOMICS:

The Economic Cycle can also have its negative effects. This negative side was experienced in our economy during The Great Depression (1930’s). In the 1930’s, there was a nationwide economic crash. Companies started firing workers because they could no longer pay them. Classical economists would say that the market should have had other jobs available for those workers, so they should have taken jobs in other industries. This was not the case, unfortunately, in The Great Depression. Far too many people were out of work all at once. Unemployed workers could no longer purchase goods. Fewer goods sold means less money for the companies, so companies fired even more people. The negative cycle then repeated itself. Finally, the government was called on to help by creating incentives to return to a positive cycle. The government did this by “priming the pump” with government spending, which often results in increased public debt. This policy that calls on the help of government to “prime the pump” is often termed ”Keynesian economics”. It is named after the noted economist and author, John M Keynes.

LESSON 3.1 Practice Exercises
(Pick the best answer to the question)

1) Using Graph 1, determine the quantity demanded for $12.
   a) 6 widjets
   b) 3 widjets
   c) The price does not matter. You will buy 4.5 widjets regardless of the price
   d) None of the above
2) Price is the amount:
   a) charged by the consumer to the supplier
   b) you pay at supermarket for your groceries
   c) the supplier paid to produce the good or service
   d) All of the above

3) The Supply line is upward sloping because:
   a) The higher the price, the less the supplier wants to supply and vice-versa
   b) The lower the price, the more the supplier wants to supply and vice-versa
   c) At a lower price, the supplier will produce less, and at a higher it will supply more
   d) None of the above

4) Developing countries:
   a) Have a large capital base similar to that in the U.S.
   b) Have a very high level of income for each wage earner
   c) Don’t use price controls
   d) Have a highly skilled work force
   e) Are often called Third World Countries

5) Who establishes price controls?
   a) The government
   b) The market because it’s a market economy
   c) Only the third world nations establish them
   d) Only developed nations establish them
In reality the government is always involved, in one way or another, in the economic activities of the market place. The government uses its basic roles to accomplish its goals in the economy. These roles affect individuals, groups and business in all regions of the country. The basic roles of the government include:

- Providing a Legal Framework: Provide rules and regulations to establish a fair market,
- Maintaining Competition: Enact laws and price controls that help the development of small business,
- Redistributing Income: Establish minimum wage laws to redistribute income to the lower and middle classes. This category can also include policies that encourage or maintain full employment. Tax policies can also redistribute income,
- Moving Resources to Where They are Needed: Allocate goods and services to places where they are needed. This could be better housing in low income areas,
- Promoting Stability: Do everything possible for individuals and business to prosper. People prosper with system stability. People also prosper when prices are stable. Relative price stability means controlling inflation.
In the U.S, the government has established a legal framework for someone to start a business by creating different types of business organizations. There are three basic kinds of businesses. Each has its advantages and disadvantages.

A **sole proprietorship** is a business owned by one person. This is usually a small business with an owner-manager who is also a worker. One advantage of this type of business is that it has few barriers. It is an easy business to start. Taxes are usually lower and easier to pay. Usually there are only basic licensing requirements. One disadvantage is that the owner has complete liability, meaning that the owner is totally liable for the business’ financial situation. Thus the owner suffers all its losses. Another downside is that a sole proprietorship has little ability to grow because finances are tied to only one person, the owner. Most often, the financial resources of the owner are somewhat limited. Most businesses in the U.S. are sole proprietorships. However, the vast bulk of our production capabilities are not owned by these sole proprietorships.

A second type of business permitted in our economic system is a **partnership**. A partnership is a business owned by two or more partners. It shares the same advantages and disadvantages as a sole proprietorship. It has more potential for growth because having more partners means more money to invest. It also often allows for more managers to operate the company. One serious problem with partnerships is that sometimes partners disagree on business decisions. Often they are inclined to separate.
A **corporation** is a totally different kind of business. It is the third type of business allowed by our government. A corporation is created as an entity of its own and does not have a single owner. Instead, it has shareholders who share a percentage of the total value of the entity. It’s more expensive to start because it requires more licenses and permits. The state has more tax controls over corporations. Corporations may be subject to double-taxation. Firstly, taxes may be charged to the corporation for making a profit. Secondly, taxes may be charged to shareholders for the income paid to them as dividends. However, a great advantage is that shareholders are not directly liable for the corporation’s finances. Corporations own the vast bulk of the producing capacity in the U.S.

Frameworks for firms help the government accomplish its basic roles. These different types of firms help competition and prices. Private individuals are easily allowed to form sole proprietorships, which are not heavily regulated. They are free to run the company as they wish. Corporations allow large firms to be formed. These large corporations can gather the large amounts of capital necessary for the successful operation of many of our businesses. Think about the capital and equipment necessary to operate General Motors. Small business and partnerships help the distribution of income to the lower and middle classes who start their own businesses. Competition from all segments takes away power from big business and promotes price stability.
The following graph shows the distribution of businesses by their percentage. It also shows their respective percent of sales. This graph shows that corporations own most of the market. Yet corporations account only for 20% of the number of firms.

Graph 3


When allocating resources, the government focuses on certain goods and services, that otherwise will not be produced. There are no direct buyers for them. No one wants to buy them outright. Examples of these goods are weapons programs for our national defense. On their own merit, few firms are willing to develop or build weapons. Regular people do not buy a tank to protect their houses. Buyers for this market are scarce. In this case, the government offers private firms contracts to develop weapons according to specifications. Another example is the construction of public places. Parks, streets, highways, police and fire stations, are public goods and services. Our citizens, for example, need parks, but no one wants to buy them or to build them. So the government must provide for these public goods.
The government classifies companies and works to keep competition in the market. There are three ways that companies can be organized in their market.

- **Monopoly**: A company that controls the entire market because of its large size, power, or efficiency.

- **Oligopoly**: An organization through which the market is controlled by a small group of companies.

- **Market Competition**: The part of the market in which there are many competing companies both large and small.

A monopoly historically has been unhealthy and undesirable in the market. A monopoly has control over prices. This type company can raise or lower prices as it pleases. Further, the monopoly firm can and will obstruct other companies’ entrance into the market. In general, our government moves to break up monopolistic firms when they wield too much power. With so much power, they are able to set prices too high. They can also block others from entering their market. Standard Oil Company and Microsoft are noteworthy examples of companies our government has considered to be monopolistic. Our government then moved strongly to curb their power. It is noteworthy that our society does permit some monopolies to exist with our government’s approval. There are situations in which it has been determined that only one firm would best supply the product. Take a power company or a telephone company. It would serve no purpose to allow 5 electric companies in one city. Think of all those power poles. These permitted
monopolies are called **natural monopolies** and are usually highly regulated by our government.

Oligopolies are big companies that compete with each other. No one company, however, is allowed to “corner the market.” These large companies are often required in certain industries. These are industries in which the cost of capital is high. Usually these industries require very large production capabilities. An example of an oligopoly is the car companies. The three most powerful U.S. producers of cars are Ford, General Motors, and Daimler-Chrysler.

They own other brands:

- **Ford** owns: Ford, Lincoln-Mercury, Mazda, Volvo, Jaguar, Land Rover, Aston Martin and others.

- **General Motors** owns: Chevrolet, Pontiac, Buick, Cadillac, GMC, Oldsmobile, Saturn, Hummer, SAAB, Holden, OPEL, Vauxhall and others.

- **Daimler-Chrysler** owns: Mercedes-Benz, Dodge, Chrysler, Jeep, Fuso, Freightliner and others. (It is also a partner with Mitsubishi) Oligopolies, if left unchecked, will often attempt to control prices. They can try to restrict competition by preventing new entries by other
companies. Sometimes they try to divide up market share. There are many ways they can defeat the free market system. It is for these reasons that our government watches the activity of these firms closely.

Market competition includes all those firms, big and small, which fit into certain industries. These are industries noted by many producers or service providers. These industries are noted by intense market competition. No one company or just a few companies control these markets. Most small businesses fall in this category, as do the vast bulk of the industry groups in the U.S. They usually experience strong competition for customers from other companies. The best way to take away customers is to offer lower prices. Another way is to offer better service and/or better products. Hopefully they will do both. Competition is desirable in the marketplace, because lower prices and better products benefit consumers. The government will usually try to benefit consumers.

**LESSON 3.2 Practice Exercises**

(Pick the best answer to the question)

1) The basic roles of the government are to:
   a) Provide a legal framework
   b) Maintain Competition
   c) Redistribute Income
   d) Promote system stability
   e) All of the above
2) A sole proprietorship is:
   a) The business in which the owner has full financial liability
   b) Created as an entity of its own
   c) One business with more than one owner
   d) All of the above

3) Refer to Graph 3. Which business has most in total sales?
   a) Sole proprietorships
   b) Corporations
   c) Partnership
   d) None of the above

4) A corporation is:
   a) A business owned by one person
   b) A business owned by partners
   c) A business owned by stockholders
   d) None of the Above

5) The government provides a legal framework by:
   a) Providing rules and regulations to establish a fair market
   b) Allocating goods differently than corporations do, moving them to
      where they are needed the most
   c) Having private lawyers
   d) Having minimum wage laws
The idea that the government should take a part in economic growth came during the Great Depression. The Great Depression occurred during the 1930s. Economist John Maynard Keynes maintained that the government could control the level of economic activity. He believed the government could do so through spending and tax policy. Long before the great depression, famous economists like David Ricardo (1772-1823) and John Stuart Mill (1806-1873) believed in classical economics. Classical economics followed from the ideas of Adam Smith. Smith said that the market system would provide for all the needs of society. Further, the market system did not need any government help. So believed the classical economists. Keynes, a British economist, rejected classical economic theory in 1936. He argued that the market system often needed government in order to run more smoothly. Keynes pointed out that the free market, by itself, was not able to correct the “Great Depression.” He explained how deep depressions or recessions came about. He explained that the economy was not likely to correct itself. Keynes argued that the government should play a more active role in managing the economy.

GOVERNMENTAL POLICIES IMPLEMENTED
TO REGULATE ECONOMIC ACTIVITY:

The federal government committed itself, after World War II (WWII), to providing full employment in the economy. The Employment Act of 1946 commits the federal government to control economic cycles. Cycles are controlled through the use of monetary and fiscal policy. These controls are
in place to maintain economic stability. The Executive branch is in charge of fulfilling the requirements of the act. The act also created the Council of Economic Advisers (CEA) and the Joint Economic Committee (JEC). Both the CEA and the JEC advise the president in economic matters. The president then submits suggested policies to Congress. The president then hopes Congress will make these policies into laws. These laws would then, in turn, regulate government spending and economic activity.

Different government institutions manage monetary policy. The Federal Reserve Act of 1913, under President Woodrow Wilson, created the Federal Reserve System (the FED). The Board of Governors (BOG) of the FED is composed of 7 members appointed by the president. The Senate must approve those appointed. The FED lays a significant role in developing and in enacting monetary policy.

Many entities assist the BOG of the FED to make policy. The Federal Open Market Committee (FOMC) is the most important. It’s composed of the 7 members of the BOG and 5 members appointed by the presidents of the 12 federal banks. The 12 Federal Reserve Banks serve as the central bank of the nation. They are situated in large metropolitan cities such as Boston and New York.

The division of the American federal banking system takes place by districts. These 12 banks are commercial banks themselves. They lend money to other commercial banks and arrange for distribution of paper currency.

The following is the framework of the Federal Reserve System:
The government’s policies regarding its income and expenses include decisions governing fiscal expansion or contraction. Also these policies include decisions about tax rates. Fiscal expansion occurs when the government spends more money on projects while increasing its debt. An example is the creation of the Homeland Security apparatus after September 11, 2001. This fiscal expansion was so severe that the U.S.’s large fiscal government budget surplus evaporated almost overnight. The spending quickly created the greatest deficit in American history. This extreme swing was in part due to homeland security. It was also due to other events that followed, including the wars in Afghanistan and Iraq.

An effective way in which the government helps develop the economy is by implementing expansionary income/spending plans. These plans increase government spending, allowing more workers to be hired. Such plans increase the amount of highways, railways, public parks and facilities. Government contracts are awarded to construction companies to begin such construction. These plans have a double effect: they provide better transportation and more environmentally friendly places to live. They also
allow low and medium-income families to earn money. Almost by necessity, the lower wage earner will spend the majority of his money. He is able to save very little. It is estimated that low and medium income families spend $1 or more out of every dollar they receive in wages. The excess amount comes from money they borrow by making charges on their credit cards. Thus, government expansion is usually an effective way to increase economic performance. Expansions also add services to the system. Thus services, like social security benefits can be increased. It also increases monies used for adult education in universities (financial aid). Increasing financial aid or government transfers of money to people of low income has the double effect. Importantly, when the government does spend using a deficit, a multiplier effect takes place. Fiscal “belt-tightening” plans will have the opposite effect on the economy.

Another way the government also injects spending into the economy is by increasing the amounts of money people have. A tax reduction increases the money people have to spend on goods and services. A tax increase has exactly the opposite effect. In a tax reduction, people keep a higher part of their income. People spend this money, creating further consumption in the economy. If everyone spends $100 more than usual, think about the results. The companies will increase investment and hire workers to keep up with the increasing demand.

However, tax reductions are not as effective as government transfers in promoting fiscal expansions. Many in the high-income brackets save a lot of money. These people
spend only 80 to 90 cents of every dollar they earn. Thus when this group is given more money, not as much trickles down. Tax reductions do increase government popularity. However, this it is not a good economic way to boost the market system.

**The Federal Reserve (FED)** is primarily responsible for implementing monetary policy. The FED was created as a separate institution so that government would not have all the power in the economy of the United States. As a quasi-governmental institution, the FED has the power over interest rates and minimum deposit requirements for banks. The FED can implement expansionary monetary policy. When it does so, the FED increases the money supply by putting more money into the economy. Usually the FED will also decrease interest rates, but not always. Lower interest rates allow banks to make more loans, thus putting more money into the system.

When the FED increases the money supply, people have more money, and a “multiplier effect” comes into play. More money leads to more spending and thus an expanding economy. Monetary reduction policy does exactly the opposite by decreasing or slowing economic activity. The FED is careful in using its policies. It is careful because supplying money at too high a level usually can create higher inflation levels. Too much inflation might be very harmful.

**Inflation** is the general increase in the price level. The change in the price level is measured by the percentage change in the **Consumer Price**
Index (CPI). It stands to reason that, when prices increase, it is harder for people to be able to afford to consume. A low, or controlled, level of price increases means that banks can lend, for the long term, without fear that their payback from interest will not be out-stripped by inflated prices. The Consumer Price Index (CPI) is usually tied to the standard of living and inflation. The CPI reflects the general price of the goods over the years. If the CPI is higher than last year, it means there was some inflation. Inflation is not necessarily all bad. Some inflation is expected if the country is to grow. In the United States people believe that the future will probably be better than the present or past. Therefore, some inflation is expected. Low inflation usually shows “good” growth and development.

One of the effects of the increase in government market intervention is the increase in the U.S. debt. The U.S. debt is now increasing at a rate of $1.61 billion dollars a day. At the current numbers, each citizen of the U.S. shares about $25,500 of the debt. U.S. citizens own much of the U.S. debt. Citizens become owners of the debt when they buy U.S. bonds. With bonds, they receive interest payments. Too much debt, however, is not always a good thing.
The following chart shows how the government distributes the U.S. income tax money.

Chart Provided by (www.federalbudget.com)
The Federal Reserve and the Federal Government usually work together and take the same approach towards the economy. Each entity has the power to cancel the effect of the other. In the case of a recession, both will create activity that expands the economy. In the case of too much inflation, both will create activity that contracts the economy.

**LESSON 3.3 Practice Exercises**
(Pick the best answer to the question)

1) What act commits the government to take control over economic cycles through policy?
   a) Employment Act of 1946  
   b) The Federal Reserve Act of 1913  
   c) The FOMC Act  
   d) The JEC Act

2) The Federal Open Market Committee (FOMC) is composed of:
   a) 7 members  
   b) 12 members  
   c) 5 members  
   d) Only 1 member called the Chairman of the Federal Reserve
3) In an expansionary fiscal plan, the economy is expected to:
   a) Increase because fewer workers will be working on the labor market
   b) Increase because injecting money into the market enables spending
   c) Decrease because more workers will have money to spend
   d) Decrease because fewer workers will have money to spend on consumer goods

4) An expansionary fiscal plan:
   a) Works just like a fiscal contraction plan
   b) Works just like a tax increase
   c) Works just like a tax reduction
   d) Can only take effect if David Ricardo says “yes”

5) Inflation is:
   a) The general decrease in price level
   b) Created by fiscal contraction policy
   c) What will happen when prices decrease
   d) A general increase in price level

**ANSWERS TO PRACTICE EXERCISES**

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Microeconomics deals with behavior and decision making by the small units in the economic system such as households and individual companies.

The monetary value of a good or service as determined by the interaction of supply and demand in the market place is called price.

The amount a supplier must pay out to make a good is called cost.

The item a government puts into place to control price increases that it deems are too rapid or excessive is called price caps or price controls.

John M. Keynes was a noted economist who called for rational intervention by a government into a free market economy to justify reasonable national goals, such as full employment.

A business owned by one person only, and not run as a corporation, is called sole proprietorship.

A business organization owned by its shareholders is called a corporation.

A condition noted when one company controls an entire market is called monopoly.

Corporations are business organizations that account for the vast amount of productive capacity in the U.S.

Inflation is defined as the general increase in the price level.
In this lesson, you will learn about economic sequencing of events. You will understand the dynamic nature of regions and environmental factors that contribute to their development. You will learn how to interpret the performance of the economy and understand how economists determine growth levels. Economic indicators will inform you about economic performance levels.

**LESSON 4.1: INTERPRETATION OF EVENTS**

**Macroeconomics** is the study of the economy taken as a whole. It also takes into account events that surround the economy at a given point in time. Economic events, however, occur in a certain time frame. The event is studied, and economists arrive at a scientific conclusion. Such analysis determines the good or bad performance of implemented government policies as they occur. These measurements allow for better decision-making in the future.

**GDP (gross domestic product)** is the total market value of the final goods and services produced in a year inside the U.S. GDP is a measure of
economic growth and one of the main measures of macroeconomic activity. There are two types of GDP measurements. **Nominal GDP** is the measurement of GDP in current dollars. **Real GDP** is the same measurement adjusted for any increase in prices. The **Real GDP Per Capita** is the Real GDP divided by the amount of people in the country.

Economic growth occurs when the following happen:

1) There is an increase in Real GDP over a period of time, OR IF
2) There is an increase in Real GDP Per Capita over a period of time.

Graphs 1 and 2 presented below and on the next page illustrate the effect of **GDP** on an economy. The graphs also show its impact as a measure of the growth of an economy.

---

**Graph 1**

GDP in Trillions 1999

GDP is a good measurement of growth. It’s a good measurement because an increase in GDP usually means more factories and jobs have been created. It means there has been more investment in the country, thus creating jobs. Graphs 1 and 2 show that in the U.S. GDP grew from just over 8 trillion dollars in 1999 to almost 13 trillion dollars in 2005. That level of increase is very large. The size of GDP also establishes the level of the standard of living in a given society. Standard of Living is a measurement of how much the average individuals in the country can consume with their wages compared to those in other countries. The U.S. has one of the highest standards of living in the world. This can be seen in Graphs 1 and 2 above. Compare the U.S. GDP in 2005 of 13 trillion dollars to that of India of just barely 1 trillion dollars. Then think of how many more people live in India than the U.S. No wonder the U.S has so many cars and India has so many bicycles.
The level of unemployment is a good measurement of macroeconomic activity. The unemployment rate measures the number of people out of work at a given point in time. Unemployment is tied to many factors. There is an expected or natural level of unemployment for every country. This natural level of unemployment allows for the normal flow of workers in a society from one job to another. Any good economic system would require a matching of workers with the needs of industry. Unemployment rates must also count only people actually looking for work. People not looking for work must then be excluded from the count.

As can be seen in Graph 3, in the U.S. each year, the unemployment rate runs at 4% to 6%. France and the United Kingdom (U.K.), by comparison, often have higher levels than the U.S. Note their higher rate consistently during the 1990s. Japan, on the other hand, kept lower levels for most of the 1990s than did the U.S.
Market economies such as those in place in the U. S. are prone to booms and busts. These booms and busts are called the **business cycle**. Wars are not a good thing within themselves. Wars, however, often cause sizable booms initially. The growth comes about as the affected government spends significant sums to support its war effort. The economy of the nation at war is usually kept fully engaged. Notice our significant growth both during and after World War II. During the war, the economy grew, as we had to build up our military. After, to supply all the pent-up demand for consumer goods. The economy of the nation that loses a war can be destroyed and the nation left in shambles.

Cycles can also come about if the economy is allowed to grow too quickly. Rapid expansion can often be accompanied by wild speculation. The aftermath can often be a complete economic collapse as occurred during the Great Depression of the 1930’s. The study of these and similar events and the safeguards put into place is the study of **macroeconomics**.
LESSON 4.1 Practice Exercises
(Pick the best answer to the question)

1) Real GDP is:
   a) The same as nominal GDP
   b) The same as nominal GDP but adjusted to increase in prices
   c) The same as GDP per capita
   d) Adjusted to the level of Unemployment
   e) B and D only

2) Good measurements for the behavior of the economy are/is:
   a) The Level of Unemployment
   b) The Standard of Living
   c) Gross Domestic Product (nominal or real)
   d) All of the above
   e) A and B only

3) Using Graph 2, which country had the highest unemployment rate through the 1990s?
   a) France
   b) United Kingdom
   c) Japan
   d) Germany
   e) United States
4) Wars appear to be a good thing for the U.S. economy because:
   a) Economic data appears to sustain it
   b) Some economists say so
   c) It decreases the level of unemployment
   d) Other countries usually buy weapons from the United States
   e) C and D only

5) Using Graph 1, which of these countries had a higher GDP than Germany:
   a) Canada
   b) Brazil
   c) Japan
   d) France

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LESSON 4.2: FACTORS OF PRODUCTION AND ECONOMIC INDICATORS

Different regions of the world are better suited to produce different kinds of goods. Different regions simply have different resources and different resources. Most developing countries in Latin America, for example, are well suited for agricultural activities. This is due to the tropical climate and lower cost labor. Highly developed countries are often better suited for manufacturing industrial goods. This is because they require a large amount of capital. Countries with semi-cold climates are suited for certain types of crops that favor only that environment. In the Middle East, there are special resources not as readily available in other places of the
world. Oil is a high priced commodity abundant in Middle Eastern countries. Many of these countries export oil and import other goods.

It has been proven that the best way of developing a country is by specializing in goods the country produces most effectively. Specializing means producing those goods that the country is effective at producing, and buying (importing) those goods the country does not produce well. This idea is not new. Adam Smith explained it back in 1776.

The idea is quite simple. One must look simply at comparative costs. An analysis of comparative costs helps to determine which goods a country should produce and which goods the country should not produce. One country will have a comparative advantage (CA) in some product over another trading partner if it can produce that product at a lower domestic opportunity cost.
Let’s analyze the following example:

Suppose the U.S. and Mexico are competing over the production of avocados and oranges.

Suppose each country can produce avocados or oranges. Below is the production they will have of each, if the other one is not produced.

<table>
<thead>
<tr>
<th>Production in tons</th>
<th>Avocados</th>
<th>Oranges</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Mexico</td>
<td>4</td>
<td>1</td>
</tr>
</tbody>
</table>

U.S. Avocados = 2/1
Oranges = 1/2 → U.S. comparative advantage (CA) in oranges

Mexico Avocados = 4/1 → Mexico comparative advantage (CA) in avocados
Oranges = 1/4

In this example, the production of avocados to oranges is:

(U.S. = 2/1 which is less than Mexico’s = 4/1) → Mexico has the comparative advantage in avocados

In this example, the production of oranges to avocados is:

(U.S. = ½ which is higher than Mexico = ¼) → U.S. has the comparative advantage in oranges.

Notice that comparative advantage only means that the country produces one good more effectively. It does not mean that the ineffective good cannot be produced at all.

Therefore, production is not everything. Social, cultural, and environmental factors can play a role. These non-economic factors can
influence how much production occurs in a country and at what cost. One reason it is so effective to produce oil in Middle Eastern countries is that their society is not as worried with the environment. Compliance with environmental laws, on the other hand, cost companies in the U.S. a great deal of money. Labor costs are significantly higher in the U.S. Furthermore, governments in the Middle East are directly associated with the production of this commodity. These Middle Eastern governments have the power to make laws in their favor. These laws are enacted through membership in the oil price-setting cartel, the Organization for Petroleum Exporting Countries [OPEC]. Such price setting would be illegal in the U.S. As an example, Japan excels in technology. Thus, Japan produces enormous amounts of products encompassing sophisticated amounts of technology.

The difference between many countries is the way they employ their own factors of production. Labor-intensive countries often have access to land they can cultivate and exploit. Countries with access to more money are usually less labor-intensive. These countries with greater capital can use more mechanized forms of production. The ways that factors of production are used also depend on the government structure used in the country. In market economies, consumers usually decide what should be produced. In other economies, such decisions might not be answered in the same way.
LESSON 4.2 Practice Exercises

(Pick the best answer to the question)

1) The idea of specialization is not new; it was already explained by_______ in 1776.
   a) Carl Marx
   b) Lenin
   c) Adam Smith
   d) George W. Bush Jr.
   e) The statement is false; it is a new idea

2) Many Latin American countries appear to be well suited for:
   a) Agricultural industries
   b) Industrial production
   c) The extraction of oil
   d) All of the above

3) Exporting means:
   a) To buy and ship in products from another country
   b) That a country has a comparative advantage in the importation of goods
   c) The country has a comparative advantage in the exportation of goods
   d) The country has specialized
   e) None of the Above
4) The U.S. has a highly specialized and trained labor force as well as access to sound financial institutions; this creates a good environment for:
   a) The production of agricultural goods
   b) The production of industrial and specialized goods
   c) An economic depression
   d) The development of a command economy
   e) Having terrible financial profits

5) Based on the comparative advantage chart, which is true?
   a) The U.S. has a comparative advantage on oranges
   b) The U.S. has no advantage
   c) Mexico has a comparative advantage in avocados
   d) Mexico has a comparative advantage in both oranges and avocados, because Mexico has a better climate than the U.S.
   e) Both A and C

ANSWERS TO PRACTICE EXERCISES

<table>
<thead>
<tr>
<th>Lesson 4.1</th>
<th>Lesson 4.2</th>
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<tr>
<td>2. D</td>
<td>2. A</td>
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<td>3. A</td>
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<td>4. E</td>
<td>4. B</td>
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<tr>
<td>5. C</td>
<td>5. E</td>
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</tbody>
</table>
**LESSON 4 THINGS TO REMEMBER**

- The total value of all goods and services produced in an economic society is called gross domestic product (GDP).

- A period of macroeconomic expansion followed by a period of economic contraction, with the cycle repeated all over again, is called a business cycle.

- The ability a society has to produce a product more efficiently, with its given resources, than it could produce all other products it might consider as alternatives is called comparative advantage.

- One country exports goods that it can produce better than other countries do. This country must import goods that it cannot produce as efficiently as other countries do. This economic situation is called specializing.

- Imports are goods that are brought in from another country.

- A good that is sent to another country to sell in the foreign country is an export.

- Gross Domestic Product is a good measure of economic growth in a society. The U.S. is the largest producer of goods and services in the world today.

- On a relative basis, Standard of Living measures how the average citizen in a country is living.

- The number of people out of work is measured by the unemployment rate.
In this lesson, you will learn about
the Industrial Revolution. The Industrial
Revolution created the first true industries
in the world. It increased production of
manufactured goods to high levels. It
started the mechanization movements of
all sectors of the economy. The Industrial
Revolution was a decisive factor in the
level of inter-dependence that exists in
the world today. It began in Britain and quickly expanded worldwide.

LESSON 5.1: INDUSTRIAL REVOLUTION OF THE 1800S

In the period 1750 to 1850, Britain and the world underwent a great
deal of growth and development called The Industrial Revolution. Population
was rising rapidly. England, however, was able to feed its people while
changing from an agricultural nation to an industrial nation. The cotton
textile industry was one of the first major industries that developed in this
period. Iron and steel came next. They fed the huge expansion of newly
developed steam engines and railroads. Steam-powered boats were now
able to travel across the Atlantic in a matter of days. Previously it took
weeks, if not months. This increased the speed of communication and travel and further encouraged world trade.

As the population grew, agricultural resources became scarce in England. There was the need to innovate to feed a growing population with limited food. Engineers and inventors came up with better ways of planting and growing food. Better plows and farming techniques were developed. These better techniques allowed agricultural labor to move out of the farmlands and into cities. Land was enclosed and developed. The enclosed land allowed for even better use of farm areas. New technologies, such as better irrigation and drainage, further increased agricultural production. Better land use techniques increased the re-using and re-cycling of good land. As farmers increased the productivity of their lands, a population shift took place. Less fortunate people moved into urban areas looking for industrial jobs.

**HISTORICAL EXAMPLE:**

Cotton textile was one of the first industries to develop. Eli Whitney invented the cotton gin in the United States in 1792. Farmers in the southern United States produced a lot of cotton. They had a hard time separating the seed from the balls of cotton they picked up from the harvest. The cotton gin was invented to separate the seed from the cotton
ball. It did so quickly and efficiently. There were few processing plants in the U.S. to make cotton into yarn. Clean, raw cotton then was exported to England. Cotton clothes are more desirable because they are soft and durable. Cotton clothes do not itch like wool does. Cotton is also a cloth that insects do not like to eat. The textile industry in England boomed. Cotton clothes were a fantastic seller. Though England did not harvest cotton, it did produce clothes. England imported the cotton from the United States. England then sold the finished product all over the world. It was one of the first times production was done on a global scale.

England developed economically as a result of its ability to mechanize. This mechanization helped England produce on a grand scale. Free-trade theories spread throughout the world. The thinking of Adam Smith fostered them. Further, they were encouraged by the concept of comparative advantage. The world changed markedly. Living standards in England improved. Unemployment in England was low. Gross Domestic Product (GDP) in England increased dramatically. The middle class developed more quickly. At this time, healthcare and medicine became more readily available. People even lived longer. Low-priced manufactured goods were available worldwide. Low prices allowed for more consumption of these goods. Globalization took shape. It was now efficient and inexpensive to move goods around the world quickly.
Factory manufacturing became the primary way of producing goods, especially consumer goods. In a modern factory, there is a high division of labor. A person is in charge of one or only a series of tasks. This is called *specialization*. Specialization then can include the division of labor in a factory. Labor then can be divided into groups. When these groups are allowed to specialize, they become extremely efficient at the task they perform. This new way of producing also created efficient managerial work. Organization, work performance, and efficiency became very important in the factories. Before the Industrial Revolution, one person or a team would make the entire product in the shop. In the factory, this production was divided into segments. In each segment, workers focused on a particular task. Management closely watched all aspects of production.

As countries industrialized, the world shrunk. Countries used the same technology that they borrowed. This technology was easily copied from one country and transferred to the next. The United States and the countries of northwestern Europe quickly applied technology developed in England. The U. S. borrowed and developed this technology quickly and efficiently. By the late 1800s, the U.S. was the primary producer of almost every industrial good in the world. This level was achieved only 50 years after the Industrial Revolution began in England. By the 1890s, the
U.S. was the primary producer of steel, coal, iron, and oil, to name only a few goods.

All over the world, the Industrial Revolution increased the standard of living. Prices of manufactured goods were lowered, and people gained purchasing power. The concept of “economies of scale” was born. “Economies of scale” means that one can lower the price of goods and make higher or equal profits by selling on a large scale. Technology was safer and better than ever. Innovations in energy sources, such as coal and gas, set the stage for the future. Production of raw materials happened in one place, manufacturing in another, and distribution became worldwide.

**LESSON 5.1 Practice Exercises**

(Pick the best answer to the question)

1) The Industrial Revolution first took place in:
   a) The United States
   b) Britain
   c) Italy
   d) Germany
   e) A and B only

2) The inventor of the cotton gin was:
   a) Thomas Savery
   b) Adam Smith
   c) Eli Whitney
   d) None of the above
3) The Industrial Revolution was:
   a) A period of industrial decline in the United States
   b) A period of Depression in the United Kingdom
   c) In the period between 1750 and 1850 approximately
   d) A period of great growth that began in Britain
   e) C and D only

4) The concept that one can lower prices and make the same profit by selling more is known as:
   a) Economies of Scale
   b) Specialization
   c) Invented by Thomas Savery
   d) Developed by Eli Whitney
   e) A and C only

5) The cotton gin:
   a) Helped England (Britain) obtain raw cotton to turn into clothes
   b) Was insignificant and unimportant
   c) Was invented by Eli Whitney
   d) Both A and C
   e) Both B and C
LESSON 5.2: WORLD INTERDEPENDENCE

Goods were exported and imported with greater frequency due to the advances in transportation and world cooperation during the Industrial Revolution. A factor that allowed increased international trade was the successful introduction of exchange rates. An exchange rate is the rate at which a person can trade one currency for another while maintaining the same relative value.

There are three types of exchange rates.

- **Gold Standard**: Values of different currencies are measured against gold (gold standard) or silver (silver standard), as measured in ounces of gold or silver.

- **Fixed Exchange Rate**: the value of the currency is tied to the value of another currency, usually a more valuable and widely accepted currency.

- **Floating Rates**: The value of currency is adjusted every day depending on supply and demand of the currency with respect to each other’s currency.

The Gold Standard was one of the first exchange rate systems widely used and accepted. As precious metals, gold and silver have been media of exchange since the beginning of history. As a system, gold was adopted in most of continental Europe during the 1850’s. In items of trade, it provided a stable and predictable exchange across markets and participating countries. All currencies had a value with respect to gold and thus to one another.
People were more willing to use a nation’s currency when the currency was backed up by gold. The gold standard required a certain amount of international cooperation. When this cooperation started to disappear, the gold standard started to fail. Eventually, the gold standard was abandoned.

Fixed exchange rates were implemented in many countries to replace the gold standard. For example, Argentina was a country with a fixed exchange rate. Before the collapse of the Argentinean peso in late 2001, the peso was fixed in value to the U.S. dollar at a rate of $1 American to 1$ for the Argentinean peso. This meant that the peso should have the same value as the dollar. This was certainly not the case, however.

One could not take a peso and change it for a dollar in places outside Argentina. As the dollar grew in value with respect to the peso, the Argentinean central bank suffered great losses. Its central bank simply could not keep getting dollars and handing them out for an Argentinean peso. The dollar was worth way more than the peso. This banking crisis greatly reduced the selling price of exports from Argentina. Argentina was, and still is, very dependent on exports. Many people are employed in the export sectors of the economy where most economic development takes place. This involved exports to Brazil, Paraguay, Uruguay, the U.S and others. Since the financial loss by exports could not continue, the central bank of Argentina devalued the currency. A currency depreciates (devalues) with respect to another when its worth is less than before with respect to a specific currency. When the opposite happens, the currency has appreciated (gained value) over the devalued currency.
Today’s preferred way of exchanging currencies is the floating exchange rate. Here, currencies appreciate and depreciate constantly with respect to each other. This instantaneous change is due to the intricate network of computers that keeps track of currency prices all over the world. There are people who keep track of very small changes in the price of currencies. They can make money by exchanging large amounts of money from one market to another as price changes occur. Buying and selling currency is no different than buying and selling shirts. A blue shirt can be selling at a high price in N.Y. but at a low price in Los Angeles. It is then a good idea to buy that shirt in Los Angeles and bring it to New York to sell. The same is true about money in terms of worldwide exchange.

The Case of Japan and China:

Large Asian markets such as China and Japan have decided to manipulate the currency market to benefit their exports. Japan has been buying large quantities of dollars in the market while injecting its currency, the yen. This causes the yen to decrease in value with respect to the dollar. If the dollar becomes more powerful than the yen in the world market, then countries that have dollars can buy Japanese goods for a cheaper exchange rate. This will cause the amount of consumption of Japanese goods to increase because these goods are cheaper for those who pay in dollars. Exports from Japan then increase.

As in Argentina, Japan and China depend heavily on their exports. This makes them particularly interested in maintaining this kind of attitude against the dollar. This information can be easily confirmed. Common consumer goods come from Asian countries. American consumers eagerly
buy Hondas, Toyotas and other Japanese-made cars. The United States also imports many computers and general electronic equipment directly from Japan. The United States obtains clothing, plates, glasses, toys, shoes, and cheap electronic equipment assembled in China.

International trade is beneficial for both parties involved. Many, if not all, countries in the world have entered into the ever-increasing international trade market. This would be impossible without efficient transportation channels. Such channels make goods move faster from one place to another, allowing for more frequent transactions.

Another advance allowing for the growth of international trade is in the area of communications technology. Telephones, computers, the Internet, and fax-machines network all traders. This enables companies to develop all over the world. They can communicate effectively with partners in other places. A distributor in Washington can get a price quote from Japan in no time. Money and electronic transactions move at high speeds across fax, modem, and cell phone lines. Tariffs have declined through the years. A tariff is the extra cost imposed by the government of any country to importers of goods into the country. The free market has expanded across international boundary lines.
Huge companies with business all over the world are now the order of the day. These same companies control many markets in many different parts of the world. They are called **multi-national corporations (MNC)**. Multi-national corporations are also called **trans-national corporations**. These **MNCs** are big and powerful companies that own factories and places of business worldwide. There are many of these giants today involved in many business expansions.

Wal-Mart, for instance, has introduced its stores worldwide, not just in the U. S. Wal-Mart’s secret lies in its networking and communication channels. It has direct contacts with the suppliers all over the globe who contact the company as soon as merchandise levels decline. A complex network of buyers and sellers goes into play. Merchandise is rapidly distributed to the store that needs it. Wal-Mart is extremely efficient in doing this. It now dominates markets all over the world. When Wal-Mart introduced stores in Germany, its prices were very low. The prices were so low that the German government put a price floor on Wal-Mart products. This floor required products from Wal-Mart to be sold at a price no lower than German products.
The high level of commerce between the nations of the world has led to an increase in interdependence between them. It is necessary now to keep good international relations in order to maintain business. Many nations have decided to join others to establish trade blocs (groups) and agreements. In 1994, **NAFTA (North American Free Trade Agreement)** was created. This agreement removes most barriers of trade and investment between the United States, Canada, and Mexico. **MERCOSUR** is another regional agreement between Argentina, Brazil, Paraguay and Uruguay. **MERCOSUR** was formed to establish a common market for products.
LESSON 5.2 Practice Exercises
(Pick the best answer to the question)

1) An exchange rate:
   a) The same as barter
   b) The rate at which you can exchange one currency for another
   c) Creates a depression
   d) Creates inflation

2) The floating exchange rate:
   a) Ties the value of one currency to another currency
   b) Is the same as a fixed exchange rate
   c) Was first used in 1869
   d) Is adjusted everyday depending on currency demand and supply
3) What Argentina did in 2001-2002 was:
   a) A depreciation of the peso
   b) An appreciation of the peso
   c) The same thing Japan did in 1990
   d) Part of a multi-national corporation investment

4) In 1999, which of these countries had more exports (see Graph 1)?
   a) The United States
   b) Japan
   c) Germany
   d) United Kingdom

5) A good example of a multi-national corporation is:
   a) Joey’s little corner restaurant
   b) NAFTA
   c) MERCOSUR
   d) Wal-Mart

ANSWERS TO PRACTICE SECTIONS

Lesson 5.1  Lesson 5.2

2. C 2. D
3. E 3. A
4. A 4. A
5. D 5. D
LESSON 5 THINGS TO REMEMBER

- The Industrial Revolution of the 1800s centered in England's society
- Eli Whitney invented the cotton gin
- Gold Standard is the monetary exchange rate system that uses currency and coins related in value to the gold backing up the currency
- Floating Rates is a monetary exchange rate system in the currency of a nation is adjusted daily depending on the demand and supply for that nation’s currency.
- When a currency has gained in value, it has appreciated
- When a currency “depreciates”, it devalues
- The Industrial Revolution was a period of great growth that began in Britain between 1750 and 1850
- The concept that one can lower prices and make the same profit by selling more is known as Economies of Scale
- An exchange rate is the rate at which you can exchange one currency for another
- Wal-Mart is a good example of a multi-national corporation
LESSON 6: HISTORIC AND ECONOMIC DECISIONS

Lesson 6.1: Events from the Industrial Revolution to the 1950s
Lesson 6.2: Events after 1950s and the Contemporary Concept of Sustainable Economic Development

Introduction:

In this lesson, you will learn more about historic and economic events since the Industrial Revolution. You will learn how those events have changed and shaped our society. You will study how the Industrial Revolution affected America and other countries. You will discover the transformations that took place. You will also study what caused the Great Depression, and how the U.S. recovered. Finally you will be introduced to the modern concept of sustainable development and growth.

LESSON 6.1: EVENTS FROM THE INDUSTRIAL REVOLUTION TO THE 1950S

The Industrial Revolution, centering in the 1850s, was a significant worldwide event. Advances that led to today’s societies appeared and developed in this period. The Industrial Revolution spread from Britain all
through the world. Factories mechanized and workers earned wages in the form of “hard currency”. Workers exchanged this hard currency for goods and services. In prior times, workers were paid in grain or other goods and were forced to barter. There was a high degree of coordination in factories, including the division of labor and specialization. People were no longer needed in the fields, so they moved to the cities. Communication and transportation channels grew with new ways to travel and send messages. Railroads spread. The middle class sector developed and prospered. Many became literate and newspapers were born. Modern mass industrialization was growing.

England was undoubtedly the world leader in the early years of the Industrial Revolution. The English pound was the most circulated coin in the world. This lasted until the 1890s, when the U.S. and Germany began to share economic leadership in the world. The U.S. became a dominant producer by using creative innovations to make products better and cheaper than were already being made in England. Germany gained an economic advantage and prospered through the use of fine craftsmanship to make superior products. The U.S. had a further advantage as its territory was large and thus provided a greater domestic market. During this period many new immigrants had come to America. These immigrants brought many special skills. Many of these immigrants were willing to take risks as new entrepreneurs. The labor market was composed of many skilled and semi-skilled workers. The railroad infrastructure was developing very rapidly. It was also aiding the connection between the east and west coasts. The American national government developed a strong market and institutions. Americans were used to rapid change and adapted quickly.
The U.S. Civil War occurred in this period. By December 20, 1860, South Carolina had formally broken from the Union. South Carolina’s departure from the Union was followed by many other southern states. On April 13, 1861, the South attacked Union weapons warehouses in Florida and South Carolina. War was declared. The Civil War was a disaster both in terms of loss of life and the destruction of property. No other war has seen so many Americans killed or wounded. It was the first time since 1776 that this newly formed nation had such severe and different feelings about the way policy and the country should continue. The South, with better generals and officers, initially posed a huge threat to the concept of a union that must remain intact. However, with vastly more men and significantly superior producing capacity, the North eventually won and the Union stayed intact. During this war, factories in the North had begun producing weapons for the Union army. Weapons production increased productivity and the workforce grew. Soldiers had to be paid and this increased their income. The South did not grow as much in this period. However, after the Civil War, the South began to industrialize so it could be more self-sufficient. Despite the devastation caused by the Civil War, the United States shortly thereafter became economically the strongest nation in the world.

Not all was perfect in the U.S., however. The banking industry was well developed in this time period. Essentially there were many banks in the U.S. These banks were unregulated. They issued bank notes as if they were currency, but they had no backing (guarantee). Most U.S. financing really came from European nations. In 1907, there were “bank panics” and “bank runs” of unbelievable proportions. These bank runs occurred as people developed fears that their bank would not be able to pay depositors their
money when demanded. Many people and corporations went bankrupt, and many banks folded. In response, in 1913 the government created the Federal Reserve System. It was created to regulate all of the nation’s banks. Further, the System was to provide some uniformity of rules. The Federal Reserve Act of 1913 created the organization of modern-day banking in America.

The U.S. was strong. Big companies had now developed over time. Many of these large companies had a lot of power. Most people worked for wages in the cities. However, the workers were not able to get good working conditions. Furthermore, workers were not able to get wages they needed to provide for a decent living. Workers were unable to have their grievances heard as these companies had gained so much power. The workers decided to unionize to improve their wages and conditions. A union is an organization created by workers to unite and fight for better pay and working conditions.

Some of the noteworthy groups formed to fight for worker rights during this time period were the Knights of Labor and The American Federation of Labor. The Knights of Labor was created in 1929 and demanded the abolition of child labor and the establishment of a 40-hour workweek. Other demands included equal pay for men and women and insurance for workers when employers went bankrupt. The American Federation of Labor (AFL) was born in 1886. The AFL advocated for better wages and workers’ compensation. Also it promoted the abolition of child labor and minimum wage laws. Importantly, the AFL wanted the government to stop interfering on behalf of businesses. Big companies saw unions as a problem and fought to eliminate them, with limited success.
In the early 1900s, another revolution took place in the factories. In 1903, the Ford Motor Company was created. Cars were first introduced for the rich only. However, between 1910 and 1913, Henry Ford developed the idea of the assembly line to mass-produce cars. Then he would be able to provide an affordable car for “everyone”. He incorporated standardized and interchangeable parts. He developed the concepts of division of labor and a continuously moving assembly line. He used these techniques for the production of the famous Ford “Model T” automobile. These innovations allowed Ford to lower the price of its cars dramatically. Ford envisioned that the common man should be able to purchase a car. He knew that cars were the way of the future. These innovations revolutionized the whole car industry in the world. By 1918, half of the U.S. population owned a Model T. At its peak, the Ford Model T cost only $290. Many industries and companies followed the techniques developed by Henry Ford. These techniques involved the mass-production of goods, assembly lines and specialized labor.

By the 1920s, there were giant employers. The steel industry was booming. Companies began making car accessories and parts. Gas stations, car insurance, and oil industries emerged. Highways were created and motels and roadside services grew. Many places in the country were accessible by cars.
The housing construction industry increased production as workers’ wages went up. The impact of the automobile industry was great.

World War I (WWI) broke out in Europe in 1914. Initially worldwide panic set in, and some of it spread to the U.S. People became worried about the future and withdrew money from banks and the stock exchange. The financial and banking systems in the U.S turned into chaos. The New York Stock Exchange closed in November 1914 and did not even reopen until the following April. Nevertheless, the war eventually led to an economic boom for the United States. Because fighting was not on our soil and because of our large production capacity, the U.S. became a major supplier to the war effort. By mid-1915, the U.S. was in full economic gear. The industrial and agricultural output increased. The Federal Reserve even allowed our banks to make loans to European Banks. That money, in turn, was used to buy weapons from the United States, which were used to fight the war.

Eventually the U.S. entered World War I on the side of its allies. The United States government temporarily took control of key industries to convert them fully into the war effort. It was the first such central interference in history. The war ended on the eleventh day of the eleventh month in 1918 (Nov. 11, Veterans Day).

By 1920, the U.S. reached its highest level of exports. By the 1920’s, the average person in the U.S. had access to many different loan programs. Buying on credit was part of the newly found affluence that citizens enjoyed. Americans now looked at the stock market as an indicator of economic performance. More people moved into urban areas as agricultural work
became scarce due to mechanization in farming. The U.S. continued to look inward politically. By way of example, the U.S. did not join the League of Nations formed after WWI. The League was formed in the hopes of stopping all future wars. People did not care as much about problems external to our own nation.

The stock market crashed on October 24, 1929 (Black Thursday). The Great Depression was born. By November 1929, citizens had lost millions in the stock market. Many went bankrupt and could not re-pay their loans. The agricultural industry grew smaller quickly. The farming sector would never be the same again. The days of the independent farmer were markedly changed both in terms of numbers and in terms of importance. Most industries declined in output. By 1931 the depression had spread to Europe and became worldwide. Initially, in keeping with the prevailing economic doctrine of the time, the U.S. government did nothing. This doctrine said that the market would adjust itself. Europeans now could pay back their own loans that dated back to WWI. Unemployment in the U.S. surged to 33%. Thousands of banks closed. People lost money due to uninsured deposits at those failed banks. Wages and Gross Domestic Product fell.

Franklin D. Roosevelt became President in March of 1933. He had new ideas to cope with the Great Depression. He called it the “New Deal”. Roosevelt immediately lowered tariffs (import taxes) and increased Federal aid to the unemployed. He declared a bank holiday and closed all banks. The Emergency Banking Act was passed. Only safe and secure banks were allowed to re-open. Roosevelt extended the lending power of the Federal
Reserve to help these banks stay in business. He significantly increased government spending. Roosevelt devalued the dollar to increase exports and enhance production. Roosevelt was, in fact, reacting to the new economic theories put into play. These new theories were put forth by the proponents of Keynesian Economics and called for the government to “prime the pump”.

Roosevelt agreed. The **Civilian Conservation Corps (CCC)** was formed and put people to work. The **Agricultural Adjustment Act (AAA)** was formed. The AAA extended federal loans to farmers in an effort to stop many of the farm failures. The Federal Securities Act was enacted and established regulations about the workings of the stock exchange. These security regulations were aimed at eliminating excessive speculation in stocks, which occurred primarily through margin borrowing. Roosevelt also passed the Glass-Steagall Act of 1933, creating the Federal Deposit Insurance Corporation (FDIC) to limit bank failures and raise minimum deposit requirements. The FDIC was formed also to develop policies to make banks stronger. It provided federal insurance to depositors and currently now insures all deposits up to $100,000. A **Minimum Deposit Requirement (MDR)** was established which controls the amount of cash the banks keep in their vaults instead of lending it out. This MDR helps insure that banks give depositors much of their money back. In 1934, the **Reciprocal Trade Act (RTA)** was established. The RTA allowed for the U.S. to lower import taxes (tariffs) if other countries would do the same. This lowering of tariffs encouraged competition. It also provided enhanced benefits derived from comparative advantages.
These measures marked the first time government decided to intervene completely to help the economy and it worked. From this point on, the government would do so when necessary.

The United States was on its way to recovery by 1935. World War II broke out in Europe in 1939. Later the war would directly involve the U. S. as a participant when Pearl Harbor was attacked in December 1941.

Toward the end of the Great Depression and afterwards, the focus of the American people shifted. The American people began, to be concerned about finding ways to improve the life of everyone in society. Of special concern was improving the life style of the less fortunate. In response, on August 14, 1935 the government passed the Social Security Act. This act established a system for old age benefits for U.S. workers. It created benefits for victims of work accidents. The Social Security Act provided unemployment insurance. The Act provided aid for mothers, their children, and the physically handicapped. It set new standards for the government’s role in society. The government had now become responsible for social welfare. The Wagner Act followed and allowed workers to organize into unions. It established laws regarding how these unions were to operate. It also established regulations regarding unfair treatment of workers. In 1938, minimum wage laws were passed. The minimum wage was initially 25 cents an hour, but has been raised many times since.
LESSON 6.1 Practice Exercises

(Pick the best answer to the question)

1) Since the Industrial Revolution:
   a) Many countries have focused just on agricultural products
   b) Factories have become less mechanized
   c) Factories have become more mechanized and developed
   d) Britain has become a poor country
   e) None of the above

2) When did the U.S. first become a leader in the production of steel and iron?
   a) In the 1890s
   b) In the 1850s
   c) After 1920
   d) After WWI
   e) None of the Above

3) Who successfully used the moving assembly line to increase dramatically the production in his company?
   a) Samuel Gompers
   b) The Workers Union
   c) Henry Ford to make the Model T
   d) Everyone did it successfully before the 1900s
   e) Adam Smith in 1776
4) Black Thursday, the day of the stock market crash, was:
   a) October 24, 1939
   b) October 24, 1929
   c) November 1932
   d) August 14, 1935
   e) None of the above

5) Under which president was the Glass Steagall Act enacted?
   a) George W. Bush Jr.
   b) George Bush Sr.
   c) Woodrow Wilson
   d) Franklin D. Roosevelt
   e) None of the above

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LESSON 6.2: EVENTS AFTER THE 1950S AND THE CONTEMPORARY CONCEPT OF SUSTAINABLE ECONOMIC DEVELOPMENT

After WWII, the government highly influenced by Keynesian economics, took a more active role in the development of the economy. The Employment Act of 1946 declared the intention of the government to provide economic policy. The Act made the U.S. government responsible for creating employment and increasing production levels. This Act led to a government that provides for general welfare without interfering in free enterprise. The Council of Economic Advisors was formed to help the president decide on economic policy.
After WWII, the United States and other countries joined to create a series of international organizations. These organizations include the World Bank and the IMF. The **World Bank** granted loans to countries in the process of rebuilding Europe. It now serves as a bank that fosters development for many underdeveloped nations. The **International Monetary Fund (IMF)** also finances development projects around the world.

Initially, only European countries recovering from war had access to the **IMF**. Now the IMF helps countries like Argentina recover from the devaluation of its peso. It helps many Third World countries with solutions to increase growth and development.

After WWII, penalties were not imposed on the conquered nations such as Germany or Japan. Victorious countries realized that making someone pay for war expenses would only make them angrier. Penalties would only make them poor and bitter. In fact, such bitterness can lead to another war. Instead, mechanisms were put in place to help them rebuild. These rebuilding programs were highly effective. The **United Nations (UN)** was created after WWII with a mission to maintain world peace. The UN also was charged in developing good relations between countries. It was mandated to promote cooperation in dealing with problems between nations.
Most importantly, it was formed to increase respect for human rights. The UN is comprised of the many small and large countries of the world that agree to abide by its rules and cooperate with one another. The UN can raise an international armed force to enforce its decisions.

The “Cold War” was born during these same postwar years. The Cold War was a scenario of increased hostilities and an arms race between the Soviet Union and the United States. The Soviet Union had a communist form of government. The U. S. government was determined to stop the spread of communism. The Cold War created an increase in arms and missile technology implemented in both the U.S. and Russia. This increased amount of government spending meant more jobs and the creation of many governmental institutions. Technology became one method of spurring growth. In fact, to support this growth, the U.S. government formed NASA (the National Aeronautical and Space Administration). NASA is a U.S. government funded agency. It was drawn into a competition with Russia to put a man on the moon as well as to enhance overall space travel and exploration.

The Cold War period featured the Korean War (1950-53) and the Vietnam War (1959-1975). In both cases, the United States intervened directly to reduce the threat of communism spreading to other countries. Policymakers believed that if communism expanded to more countries, the Western way of life would be in danger. The Vietnam War, in particular, was a failure. The U. S. failed to achieve its goal, and in 1975 Vietnam was reunified into communist control in 1975. The war cost 58,000 American lives. It was a political disaster for the U.S., and created many international
protests, and an antiwar movement. Communism, however, provided its own undoing simply by failing to provide for its citizens adequately. The Soviet Union broke apart in the 1980s and 1990s. Communism no longer controlled the Russian government. By the turn of the 21st Century, communism no longer remained a concern as a threat to world peace. The “Cold War” also came to an end.

The 1950s and 60s were a great time of economic affluence for Americans. After the world war, soldiers returned and established families. The suburban housing industry boomed, and car production again rose. Technology that was developed during wartime entered people’s houses in the form of telephones, refrigeration, canned foods, and clothes made of new materials. By 1970, almost all Americans had electricity, refrigerators, TVs, toilets, and running water. They lived comfortably. This sparked a population boom (the postwar “baby boom”). Development and growth were expected; a new phenomenon.

Events in the last half of the 20th century led to the concept of sustainable development. **Sustainable economic development** is the idea that economic growth, population growth and increases in well-being are sustainable. Prior to this, people did not believe that sustained population growth could continue without terrible consequences. Now, most believe that the future will be better than the present. People expect to earn more. They expect to own more. People expect to live in a better place.
in the future. This concept requires that government fine-tune the economy. The government will take the appropriate steps to maintain economic growth. Industries are expected to grow and prosper, and individuals to flourish. This new development is expected to occur in every country because everyone benefits from economic growth.

The U. S. continued to grow in the 1980s and 1990s and continues to grow today. The growth has been in all economic sectors, on balance, and it has been sustained. Japan and China increased development and production considerably during this time. Western European countries seemed to have fully recovered from the devastations of the two world wars. Issues today center on oil and global pollution.

The following graph shows the U.S. real GDP between 1986-1994:

**Graph 1**

![Graph 1](image)

Source: United Nations [UN]
Compared to other countries, the United States is still a strong world power. The following United Nations graph shows a comparison of real GDP in selected countries.

Graph 2

United States Nominal GDP

Chart Info: CIA World Fact Book


Graph 3

Comparison real GDP 1994 in millions

Graph provided by United Nations Statistics
LESSON 6.2 Practice Exercises

(Pick the best answer to the question)

1) Since WWII, most government policies with respect to the market:
   a) Have been influenced by Keynesian economics
   b) Are basically the same as Adam Smith’s ideas
   c) Have been influenced by Stuart Mill’s theories
   d) Have been about increasing unemployment

2) The United Nations (UN) was created to:
   a) Make Germany and Japan pay the expenses for WWII.
   b) Make sure NASA worked the way it was supposed to work
   c) Promote peace in the world and cooperation among world’s nations
   d) Fight communism during the Cold War

3) Sustainable development is:
   a) The ideal that economic growth, raise in population and the increase in well-being are possible, desirable and sustainable.
   b) A relatively new idea
   c) An old idea, developed by Adam Smith in his book “The Wealth of Nations”
   d) A and B only
   e) A and C only
4) From 1986 to 1994, the United States real GDP:
   a) Has decreased over time
   b) Has increased over the period
   c) Shows economic growth
   d) B and C only
   e) None of the above

5) Which of these countries had the highest real GDP in 1994?
   a) Japan
   b) France
   c) Germany
   d) Mexico
   e) U.S.

ANSWERS TO PRACTICE EXERCISES

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LESSON 6 THINGS TO REMEMBER

- Henry Ford developed the concept of an assembly line and wanted a car for everyone.
- The Great Depression, which began in 1929 and continued into the 1930s, started in the U.S.
- The Civilian Conservation Corps (CCC), formed in the 1930s as a response to The Great Depression, is an example of Keynesian Economics.
- The U.S. entered into WWII as a response to Japan’s bombing of Pearl Harbor.
- Black Thursday, the day of the stock market crash, came on October 24, 1929.
- The United Nations (UN) was created to promote peace in the world and cooperation between world nations.
- The ideal that economic growth, rise in population and the increase in well-being are possible and desirable is known as sustainable development. It is a relatively new idea.
- The Glass Steagall Act enacted while Franklin D. Roosevelt was the President.
- In order to help rebuild Europe with the help of the world, countries like the U.S., U.K., France and others created the United Nations (UN), World Bank (WB) and International Monetary Fund (IMF).
- After the Great Depression and WWII, the U.S. government decided to provide economic policy because Laissez-faire ideas failed and the new ideas of Keynesian Economics had been proven to be better.
LESSON 7: PERSONAL ECONOMIC DECISIONS AND FINANCE

Lesson 7.1: The Motivation behind the Different Allocation of Resources
Lesson 7.2: The Importance of Sound Personal Credit History

Introduction:

In this lesson, we will discuss making sound economic and financial decisions. We will address the significance of having a good personal credit history. You will see how previous decisions affect future consumption opportunities. You will learn how to maintain a better credit report. You will learn the motivations behind different ways to allocate resources for families.

LESSON 7.1: THE MOTIVATION BEHIND THE DIFFERENT ALLOCATION OF RESOURCES

Personal economic practices are highly related to business financial practices. This includes loans, credit cards and other ways of managing your money. Let’s discuss how banks work. Banks receive deposits from individuals and convert them to loans. They loan money on credit based on a certain amount of the cash they receive. How much they loan out is restricted by the minimum deposit requirement established by the Fed. In this process, banks are said to “create” money since they are allowed to lend more than they have.

The money that banks lend allows consumers to receive loans. From these loans, a person can purchase items he cannot afford presently. Not
everyone has $200,000 in the bank to buy a house. In our system, there are
different ways to obtain credit. One is to have property to back up the loan
(loan on property or collateral). This type of personal loan is most
commonly made on houses and cars. The bank holds the title to the home or
car as collateral on the loan. You, the borrower, have the right to use such
property while making repayments. Later, an unrestricted title flows back to
you upon your completing the repayment of the loan.

Another important way to establish credit is to have credit cards. Credit
cards are not backed by property (loan on credit) and as such are generally
unsecured debt. A credit card is given to you based on your credit score,
and is not necessarily backed up. Notice that the interest on non-backed
loans is higher. The interest is higher because there is a greater risk of
people “defaulting” (not paying their debt). People will default more readily
on credit card debt. The bank suffers further exposure on this type of loan
due to a lack of collateral. With unsecured debt, in the event you default, the
bank has no direct collateral tied to the loan to take back to sell to pay off the
loan balance. The bank then wants a
higher return for taking the additional
risk on this type of loan. Credit card
companies do have the power to take
individuals to court to attempt to collect
on a debt.

Different individuals have different
ways of consuming. Different
individuals also have different ways of allocating resources. Some of us will
prefer to have a big house with a lot of furniture. Others might prefer an
apartment with a big screen TV and an expensive car. We have the legal right to our own preferences, and companies take that into account. Consumer goods are as varied as ever. Houses come in many shapes, forms, and sizes. So do other products that we buy. The government ensures that we have the right to consume what we want.

The government has also taken steps to assure that we all have equal access to the credit markets. Title VIII of the Civil Rights Act of 1968 (Fair Housing Act), as amended, prohibits “discrimination in the sale, rental, and financing of dwellings, and in other housing-related transactions." It prohibits discrimination based on race, color, national origin, religion, sex, and family status. It also prohibits discrimination against pregnant women, and people securing custody of children under the age of 18, as well as those with any disability. This Act sets the stage for equal lending on housing. It also sets the stage for equal lending in other areas of personal finance as well.

Our government has also enacted laws to insure that we are all treated equally in matters of employment. Anti-discrimination laws are in place to be followed by all companies. The Equal Employment Opportunity Commission (EEOC) actively enforces such laws. In today’s society, employers are not allowed to deny jobs based on race, color, origin, religion, sex or disability. These
personal, political and economic rights reinforce each other, creating a society in which all are equal under the law.

The differences in consumption patterns usually depend on the individual. Influencing factors are cultural tradition, expected gain, and risks involved. The current generation of Americans is used to handling credit on a daily basis. Most Americans are able to manage debt in a proper way. However, there are others who must file for bankruptcy when unable to pay debt when due.

Consumer preferences are often different for different societies. In Latin America, people are less willing to enter into debt. They have been taught to pay off everything in one transaction. Other societies, such as current communist countries, are not used to handling debt. In Cuba, for example, people do not pay house loans, or taxes on property, or income taxes. Few taxes, however, lead to few services being provided by the government. Additionally, the average Cuban makes only $10-$15 dollars a month.

Capitalist societies are used to handling debt. Most people enter into debt because they believe the rewards will be greater than the cost of the loan. Homebuyers know that houses usually accumulate value over time. If one buys a house, the house is usually worth more after 5 years. This value that is accumulated over and above your cost of the property is called **Equity**. Equity, then, is the difference between the current market value and your original cost. Furthermore, the house is yours, and you are able to live in it. Also, at the end of the payments, the property will be completely under
you name. The title at that time will be “free and clear”. Renters have decided that they are better off renting than owning property.

Risk is another factor in a financial decision. There are three types of people: risk adverse, risk neutral, and the risk lover. A **risk adverse** individual is the one that does not like to take any risks at all. A **risk neutral** has no risk preferences. The risk neutral person may well be willing to take risks in one situation but not in others. A **risk lover** takes risks, almost without any regard for the consequences. Buying stock is one of the ways this can be analyzed. Depending on adversity, you may be willing to buy stock or not. You will also be willing to buy stock in a volatile company if it pays off more. Or you may be willing to buy stock that pays less but is more secure. The stock market provides all types of stocks and options for you to select. These different types have different risk characteristics and patterns of return.

In the stock market, there are winners and there are losers. When someone wins big in the market, someone else loses. Be forewarned that the stock market is cyclical. When the stock market crashes, everyone loses. Major market declines occur every five years or so. The latest crash occurred in 2001, initiating a short but deep recession.
LESSON 7.1 Practice Exercises
(Pick the best answer to the question)

1) Commercial banks create money by:
   a) Printing money
   b) Getting money from the Federal Reserve
   c) Playing with the minimum reserve requirement
   d) Lending money

2) A loan on property is when:
   a) A bank lends money to you and you have property to give to the bank if you do not repay the loan
   b) A bank lends money to you and you do not have property to give to the bank if you do not repay the loan
   c) You obtain a loan on credit
   d) You apply for a credit card

3) An example of a loan on credit are/is:
   a) House loan
   b) Car loan
   c) Buying with a Credit Card
   d) A and B only
   e) None of the above
4) A “risk neutral” individual is:
   a) One who does not like to take risks
   b) One with no risk preferences
   c) One who loves to take risks
   d) The one who caused the 1929 stock market crash
   e) None of the above

5) The extra, accumulated value of your property is called:
   a) Supply
   b) Interest
   c) Price
   d) Profit
   e) Equity

LESSON 7.2: THE IMPORTANCE OF SOUND PERSONAL CREDIT HISTORY

Using credit wisely is an important skill. Using credit is entering into debt. Debt is not necessarily bad, as long as one uses it wisely. Credit allows one to buy a house or a new car. It is used when one cannot or does not want to pay for the full price of the product right away.

To use credit, one will have to pay interest on the debt. Interest is the amount or percentage charged for a loan. Interest is usually expressed in yearly rates called APR (Annual Percent Rate). To learn how much interest you will have to pay for a certain amount of money, multiply the interest rate as a decimal by the amount you want to obtain, times the time amount of
time (in years) the loan will be outstanding. This is not true, however, for all types of loans. Home loans, for example, are calculated differently.

Lending institutions use different ways to allow one to pay debt. Credit cards are usually the most expensive way to obtain credit in terms of interest. Credit card companies usually charge the highest interest. Credit cards divide the interest rate (yearly interest rate) into a daily rate. They charge this daily rate to you every day. The net effect is to charge you more interest. It is called compounding interest daily.

Long-term loans, such as a home loan, compound interest monthly. Always be aware of terms that apply to your specific loan. Loan terms can change dramatically from one company to another. Longer loans allow you to pay your debt in smaller monthly payments. But the total interest will be larger on the longer loan. If you pay your loans quicker, you will save on interest.

The best way to deal with debt is to make timely monthly payments so as not to be charged penalties. One cannot overstress the importance of a good credit history. Most companies allow some late payments, but you must notify them prior to the due date of the payment. Paying late will damage credit somewhat, but not paying can damage it permanently. Not all companies report good credit to the credit reporting companies, but all
will report bad payment histories. If you have bad credit and someone DOES lend you money, you will be charged higher interest rates. Ultimately then, with bad credit, you will spend more money on interest.

People who get in credit trouble often believe that it will not affect them in the future. They are wrong. Imagine that you have credit trouble at age 20, but by 25 you have reformed yourself and have a great job. It takes 7 to 10 years for credit problems to disappear from one’s credit history. Even though you are now a good earner and pay on time, you will often be charged a higher rate of interest. You might be turned down for a house loan or a credit card.

Having good credit is very important. Think of the alternative of having to pay for everything in cash. Paying in cash is more restrictive than you think. If you want a $1000 TV or a $25,000 car and have bad credit, then you better have it all in your bank account. Keep a good credit history by not getting more debt than you can handle. Learn how to save some money to pay for unexpected expenses. If you lose your job, unemployment compensation may help, but it will not be enough. Save money to allow for retirement. The earlier you start saving, and the more you save, the better.

Filing for bankruptcy is one option if you cannot keep up with your debt payments. This might not take away your debt. It may only put it on hold until you are able to make payments. Often, reduced payments will be required until the debt is paid off. Depending on which bankruptcy law you apply for, you may have to sell property to pay for some of the debt. Under the new bankruptcy laws put into place in 2005, one has to pass a “test” to determine whether or not one qualifies for bankruptcy. Under that law, most Americans
(medium and lower income brackets) will still qualify for bankruptcy. But often you will still be required eventually to pay off the old debt again under a reduced payment schedule.

Consult with a lawyer and be extremely informed about your options. Do not get into credit trouble. That way you do not have to learn about your bankruptcy options. Bankruptcy stays on your financial record for quite some time. It is certainly something you do not want to write on your résumé.

Work smart and hard to keep your credit clean!

**LESSON 7.2 Practice Exercises**

(Pick the best answer to the question)

1) Interest is:
   a) The extra value of your house
   b) What they charge you for buying groceries
   c) What you are charged for obtaining a loan
   d) The magic word that can take you out of debt

2) Interest is usually expressed in:
   a) A yearly rate called (APR)
   b) A monthly rate called (APR)
   c) It depends on whether it’s a credit card or not
   d) A and C only
3) Which of the following is usually the most expensive loan in terms of interest rates?
   a) House loan
   b) Car loan
   c) Buying with a Credit Card
   d) A and B only
   e) None of the above

4) If you enter into bankruptcy your credit will be cleared immediately.
   a) True    b) False

5) Your bad credit history will usually take 7-10 years to clear.
   a) True    b) False

6) Filing for bankruptcy under any law will take away all your debt problems
   a) True    b) False

ANSWERS TO PRACTICE EXERCISES

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LESSON 7 THINGS TO REMEMBER

- Property used to secure or “back” a loan from a bank is called collateral.

- Credit cards are examples of unsecured debt.

- The Civil Rights Act of 1968, also called “The Fair Housing Act”, prohibits discrimination in transactions involving housing.

- Equal Employment Opportunity Commission was put into place to prevent discrimination in the economy due to race, age, sex, etc.

- The increase in a commodity’s value over time is known as maturity. For example a home, over and above what you paid for it.

- A risk lover is one who takes business risks no matter what the consequences.

- The amount you pay on a loan for the use of the money borrowed is called interest.

- Interest is usually expressed in terms of APR.

- It is very important for individuals to keep their credit reputation “clean”, and often must work hard to keep it that way.

- A bad credit history, especially one that involves bankruptcy, can take 7 to 10 years to “clear”
Economists define scarcity as limited quantities to meet unlimited wants.
The most desirable opportunity given up as the result of an economic decision or action is called opportunity cost.
Economics is the study of how people seek to satisfy their individual needs and wants when making choices.
The financial gain made in an economic transaction is called profit.
The direct exchange of one kind of good or service for another, as opposed to the use money to make the exchange, is called barter.
Macroeconomics deals with the economy as a whole and involves itself in understanding the “big picture”.
The basic unit of the consumer sector, which consists of all the people who occupy a house, apartment, a condominium, or separate living quarters, is called household.
Demand is the combination of the desire, ability, and willingness to actually go ahead and buy a product.
The organized way a society provides for the economic wants and needs of its citizens is called economic system.
Some examples of services, as opposed to a good produced; are haircuts, repairs on your car, having someone mow your lawn and having your house painted.
Land is a natural resource that is used to make goods and services. This group can include oil under the ground as well as trees harvested from the forest.
The effort that people from households devote to a task and for which effort they expect to receive a wage is called labor.

Capital is defined as the tools and factories used to produce other goods. This group includes human-made items that are used to create other goods.

Money serves as a standard means of exchange.

Command economy is a system in which a central government or a central committee makes all of decisions on production, allocation, and consumption of all economic resources.

Communism is denoted by a centrally controlled economy with all economic and political power residing in the hands of the central government. Only one party and the leaders of that party in turn control the central government.

Karl Marx was the father of Communism.

An economic system in which decisions on production and consumption of goods and services are based on actions and exchanges which take place independently, in the market place, is known as market economy.

Capitalism gets its name from the fact that private individuals, as opposed to the government owning the capital, own capital and the system is further noted by free enterprise.

Laissez-faire capitalism was first explained in a book entitled The Wealth of Nations.

Microeconomics deals with behavior and decision making by the small units in the economic system such as households and individual companies.

The monetary value of a good or service as determined by the interaction of supply and demand in the market place is called price.
• The amount a supplier must pay out to make a good is called cost.

• The item a government puts into place to control price increases that it deems are too rapid or excessive is called price caps or price controls.

• John M. Keynes was a noted economist who called for rational intervention by a government into a free market economy to justify reasonable national goals, such as full employment.

• A business owned by one person only, and not run as a corporation, is called sole proprietorship.

• A business organization owned by its shareholders is called a corporation.

• A condition noted when one company controls an entire market is called monopoly.

• Corporations are business organizations that account for the vast amount of productive capacity in the U.S.

• Inflation is defined as the general increase in the price level.

• The total value of all goods and services produced in an economic society is called gross domestic product (GDP).

• A period of macroeconomic expansion followed by a period of economic contraction, with the cycle repeated all over again, is called a business cycle.

• The ability a society has to produce a product more efficiently, with its given resources, than it could produce all other products it might consider as alternatives, is called comparative advantage.
One country exports goods that it can produce better than other countries do. This country must import goods that it cannot produce as efficiently as other countries do. This economic situation is called specializing.

Imports are goods that are brought in from another country.

A good that is sent to another country to sell in the foreign country is an export.

Gross Domestic Product is a good measure of economic growth in a society. The U.S. is the largest producer of goods and services in the world today.

On a relative basis, Standard of Living measures how the average citizen in a country is living.

The number of people out of work is measured by the unemployment rate.

The Industrial Revolution of the 1800s centered in England’s society.

Eli Whitney invented the cotton gin.

Gold Standard is the monetary exchange rate system that uses currency and coins related in value to the gold backing up the currency.

Floating Rates is a monetary exchange rate system in the currency of a nation is adjusted daily depending on the demand and supply for that nation’s currency.

When a currency has gained in value, it has appreciated.

When a currency “depreciates”, it devalues.
The Industrial Revolution was a period of great growth that began in Britain between 1750 and 1850.

The concept that one can lower prices and make the same profit by selling more is known as Economies of Scale.

An exchange rate is the rate at which you can exchange one currency for another.

Wal-Mart is a good example of a multi-national corporation.

Henry Ford developed the concept of an assembly line and wanted a car for everyone.

The Great Depression, which began in 1929 and continued into the 1930s, started in the U.S.

The Civilian Conservation Corps (CCC), formed in the 1930s as a response to The Great Depression, is an example of Keynesian Economics.

The U.S. entered into WWII as a response to Japan’s bombing of Pearl Harbor.

Black Thursday, the day of the stock market crash, came on October 24, 1929.

The United Nations (UN) was created to promote peace in the world and cooperation between world nations.

The ideal that economic growth, rise in population and the increase in well-being are possible and desirable is known as sustainable development. It is a relatively new idea.

The Glass Steagall Act was enacted while Franklin D. Roosevelt was the President.
In order to help rebuild Europe with the help of the world, countries like the U.S., U.K., France and others created the United Nations (UN), World Bank (WB) and International Monetary Fund (IMF).

After the Great Depression and WWII, the U.S. government decided to provide economic policy because Laissez-faire ideas failed and the new ideas of Keynesian Economics had been proven to be better.

Property used to secure or “back” a loan from a bank is called collateral.

Credit cards are examples of unsecured debt.

The Civil Rights Act of 1968, also called “The Fair Housing Act”, prohibits discrimination in transactions involving housing.

Equal Employment Opportunity Commission was put into place to prevent discrimination in the economy due to race, age, sex, etc.

The increase in a commodity’s value over time is known as maturity. For example a home, over and above what you paid for it.

A risk lover is one who takes business risks no matter what the consequences.

The amount you pay on a loan for the use of the money borrowed is called interest.

Interest is usually expressed in terms of APR.

It is very important for individuals to keep their credit reputation “clean”, and often must work hard to keep it that way.

A bad credit history, especially one that involves bankruptcy, can take 7 to 10 years to “clear”.

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