



UNIT

7

# The Free Enterprise System

**Encounter Restaurant  
suspended above Los  
Angeles International  
Airport**



★ **Chapter 23** Government and the Economy

★ **Chapter 24** Money and Banking

★ **Chapter 25** Government Finances

## **Be An Active Citizen**

**CITIZENSHIP**

The free enterprise system takes a look at the economy as a whole. Talk to two or three business owners in your community. Ask about the general state of their businesses, how they feel about governmental economic policies, and their outlook. Write a summary of your findings.



# Reading Social Studies

## Making Inferences

### 1 Learn It!

Writers do not always state directly what they want to say. Often, they expect readers to make inferences or draw conclusions. Making an inference is “reading between the lines” by using clues and details the author provides to gain additional meaning from the text.

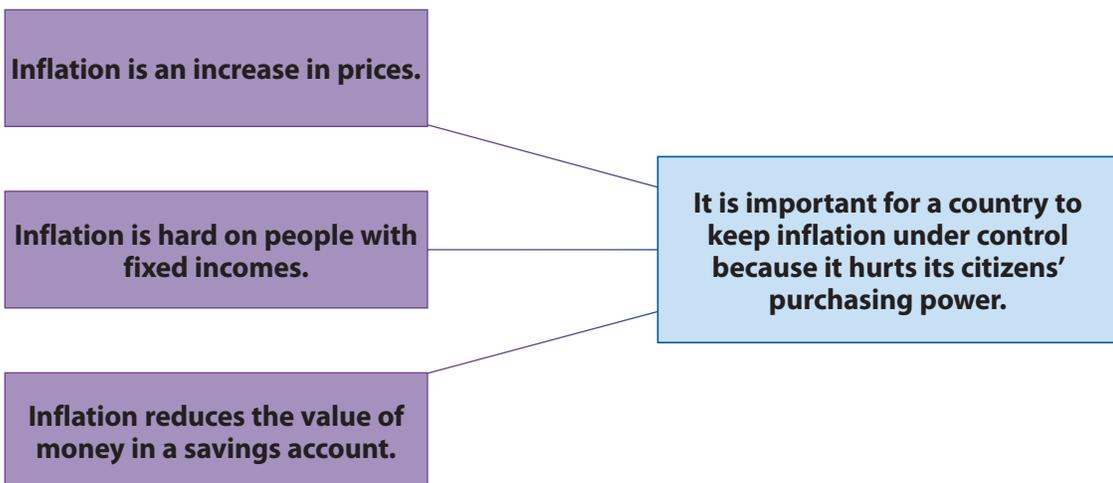
- Read the paragraph below.
- Pay attention to the facts provided by the writer.
- Read the inference that was drawn by the reader.

*A chart like the one below can help you identify information you can use to make inferences.*

Suppose that an ice-cream cone that costs you a dollar doubles in price. This price increase causes the purchasing power of your dollar to fall because you have to use twice as many dollars to buy the same item. This is why inflation is particularly hard on people who have fixed incomes. . . . Inflation also reduces the value of money in a savings account because it will buy less after inflation than before.

—from page 642

#### **Information from Text**





## 2 Practice It!

Read the following paragraph from this unit.

- Draw a chart like the one shown below.
- Write three important facts from the paragraph in the boxes on the left-hand side.
- Make an inference about the sensitivity of the stock market based upon the information from the text and write it in the box on the right.

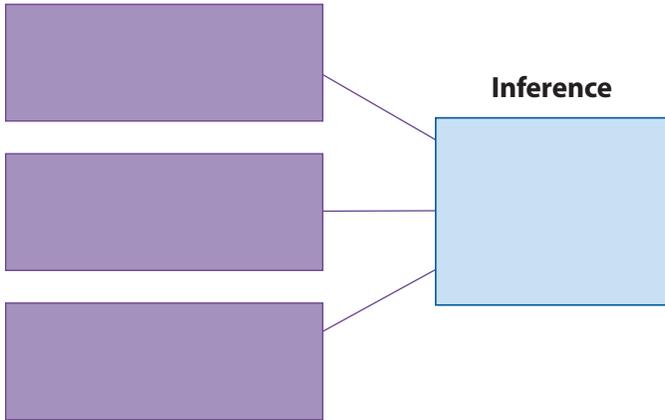
The price of a company's stock, like most other things, is determined by supply and demand. Factors such as changes in sales or profits, rumors of a possible takeover, or news of a technological breakthrough can change the demand for a company's stock and, therefore, its price.

—from page 643

### Read to Write Activity

Read the section titled *Safeguarding Our Financial System* in Chapter 24. Jot down any relevant facts. Then, write a statement in which you make an inference about how safe you feel using the banking system.

#### Information from Text



## 3 Apply It!

Choose one section from each chapter in this unit and create a chart like the one above. Read your facts to a partner and ask if your partner made a similar inference based on the facts you provided.





Chapter

23

# Government and the Economy



## Why It Matters

Promoting a stable, growing economy is a major goal of the federal government. The decisions that government makes affect our economic lives every day. As you read the chapter, list the specific ways in which the government affects you economically.



# BIG Ideas

## Section 1: The Role of Government

Free enterprise is the freedom of individuals and businesses to operate and compete with a minimum of government interference or regulation. In order to encourage competition and prevent monopolies, governments take steps to regulate economies.

## Section 2: Measuring the Economy

An economic system is the way a society organizes the production and consumption of goods and services. Our government plays a limited, but important, role in measuring and trying to balance the alternating periods of growth and decline called the business cycle.

## Section 3: Government, the Economy, and You

People form governments to establish order, provide security, and accomplish common goals. A major focus of government programs is to help people in poverty.

◀ Suspension bridge construction across the Houston, Texas, ship channel

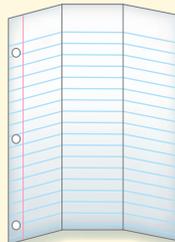
### FOLDABLES™ Study Organizer

**Summarizing Information Study Foldable** Make the following Foldable to help you summarize what you read about the role of government, how it measures the economy, and how you are involved.

**Step 1** Mark the midpoint of the side edge of a sheet of paper.



**Step 2** Fold the outside edges in to touch at the midpoint.



**Step 3** Unfold the paper and label the three columns as shown.



### Reading and Writing

As you read the chapter, note information about the three economics topics in each of the columns. Then write a summary of each topic using the information you noted.



Section  
**1**

# The Role of Government

## Guide to Reading

### Big Idea

Free enterprise is the freedom of individuals and businesses to operate and compete with a minimum of government interference or regulation.

### Content Vocabulary

- private good (p. 631)
- public good (p. 631)
- externality (p. 631)
- monopoly (p. 633)
- antitrust law (p. 633)
- merger (p. 633)
- natural monopoly (p. 634)
- recall (p. 635)

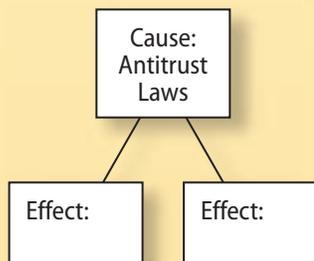
### Academic Vocabulary

- exclude (p. 631)
- achieve (p. 632)
- minimize (p. 634)

### Reading Strategy

#### Analyzing Cause and Effect

As you read, record the results of the government passing antitrust laws on a graphic organizer like the one below.



### *Real World Economics*

Fuels of the future are brought to life at a government-sponsored design exposition in Washington, DC. Scientists, businesspeople, and students are brought together to compete against each other with new ideas about technology and design. This student from Appalachian State University won an award for building a production facility that makes biodiesel fuel from used cooking oil and then recycles the oil's waste to make soap.

▼ Award-winning student with biodiesel fuel



**NORTH CAROLINA STANDARDS**  
Civics and Economics

**9.02** Describe the impact of government regulation on specific economic activities.

**9.04** Assess how current events impact decisions made by consumers, producers, and government policy makers.



# Providing Public Goods

**Main Idea** Governments usually provide public goods, while businesses usually provide private goods.

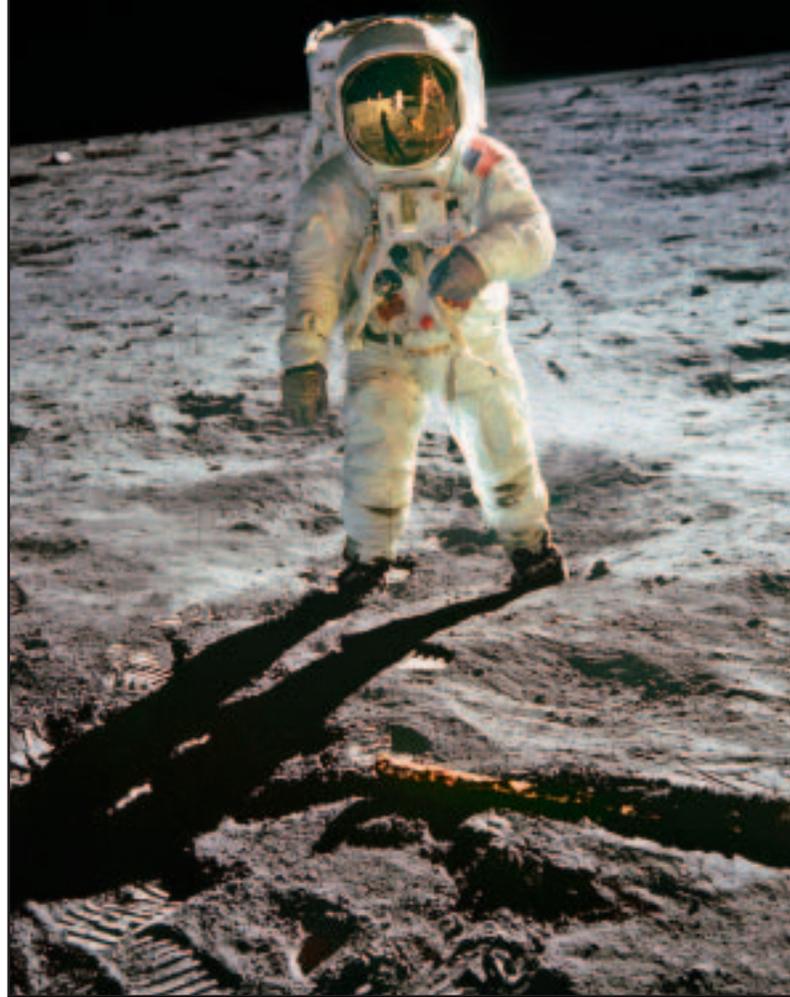
**Economics & You** Would you like to live near an airport? Read to find out what economic idea might influence your decision.

**G**overnment plays several important roles in the economy. One role is providing goods and services—such as national defense—that private businesses do not provide.

**What Are Private Goods?** Most goods and services that businesses produce are **private goods**, or goods that, when consumed by one individual, cannot be consumed by another. Consumption of private goods and services is subject to the exclusion principle. This means that a person is **excluded**, or prevented, from using that good or service unless he or she pays for it. Private goods are the items we buy and replace, for example, clothes and food. Private services include such things as insurance, haircuts, medical services, auto care, and telephone services.

**What Are Public Goods?** This is in contrast to **public goods**, or goods that can be consumed by one person without preventing the consumption of the good by another. Consumption of public goods is subject to the nonexclusion principle. This means that no one is excluded from consuming the benefits of a public good whether or not he or she pays. Examples of public goods include public parks, public libraries, museums, highways, and street lighting.

Because of the difficulty of charging for public goods, the government usually provides them. If government did not provide these public goods and services, then the private sector would not provide them in adequate amounts because it is so difficult to get people to pay for them.



**Public Goods** Public goods include the highway system, national defense, and space exploration. **Analyzing** **Would the private sector provide these goods and services if the government did not?**

As a result, the production of public goods is one of the responsibilities of government. The government still has to pay for them, but it raises the money through taxes and then provides the products to everyone.

## Dealing with Externalities

The government also plays a role in handling externalities. An **externality** is the unintended side effect of an action that affects someone not involved in the action. Suppose a company pays end-of-year bonuses to its workers. Restaurants and stores in the area will probably see their sales go up because the workers have more money to spend. These businesses experience externalities. They were not involved in the paying of bonuses, but they were affected by it.



## Federal Regulatory Agencies

Federal Agency		Responsibility
Environmental Protection Agency (EPA)		Prevents air and water pollution
Centers for Disease Control and Prevention (CDC)		Considers all factors that affect the health of the nation
Occupational Safety and Health Administration (OSHA)		Makes sure that workplaces are safe and healthful
National Institutes of Health (NIH)		Serves as the nation's medical research agency
Food and Drug Administration (FDA)		Makes sure that food, drugs, and cosmetics are pure, effective, and truthfully labeled

### Analyzing Charts

- Identifying** Which agency would regulate a kind of filtering system on a factory smokestack?
- Analyzing** Why do you think the National Institutes of Health is a national agency rather than a state-run agency?

**Positive Externalities** One reason that governments provide public goods is that these goods produce positive externalities. Everyone—not just drivers—benefits from good roads. Good roads make it cheaper to transport goods. As a result, those transported goods can sell for lower prices, which benefits everybody.

Governments can also take actions that indirectly lead to positive externalities. In the 1960s, the government wanted to put a man on the moon. The space program needed someone to develop smaller computers to **achieve**, or reach, this goal. The government provided money to researchers who developed tiny computer chips. Today, those chips

are found in calculators, cars, household appliances, and cell phones, benefiting many people. Many government activities encourage positive externalities.

**Negative Externalities** Some externalities can be negative. That happens when an action harms an uninvolved third party. Suppose a chemical company tried to cut costs by dumping poisonous waste into a river. People who relied on the river water would suffer a negative externality from this pollution. One of the roles of government is to prevent these and other kinds of negative externalities.



**Student Web Activity** Visit [glencoe.com](http://glencoe.com) and complete the Chapter 23 Web Activity.



**Reading Check Describing** How does a government usually pay for public goods and services?



# Maintaining Competition

**Main Idea** One government role is to ensure competition in the economy.

**Economics & You** Have you ever played the game Monopoly? Read to find out for which economic idea this game is named.

**M**arkets work best when there are large numbers of buyers and sellers. Sometimes, however, a market becomes controlled by a **monopoly**, a sole provider of a good or service. With no competition, a monopoly can charge any price it wants, and consumers may suffer.

## Antitrust Laws

Historically, one of the goals of government in the United States has been to encourage competition in the economy. The government tries to meet this objective through its **antitrust laws**, or laws to control monopoly power and to preserve and promote competition.

**Sherman Antitrust Act** In 1890, the federal government passed the Sherman Antitrust Act. This law banned monopolies and other forms of business that prevented competition. In 1911, the government used it to break up the Standard Oil Company, which had a monopoly on oil. More than 70 years later, the government used the act again to regulate American Telephone and Telegraph (AT&T). This action created more competition in telephone service.

**Clayton Act** In 1914 Congress passed the Clayton Act to clarify the Sherman Act. The Clayton Act prohibited or limited a number of business practices that lessened competition; for example, charging high prices in an area where little competition existed. Another part of the Clayton Act restricted the

use of the injunction against labor unions. It also gave legal support to peaceful strikes and boycotts.

## Mergers

Whenever a **merger**, a combination of two or more companies to form a single business, threatens competition, government may step in to prevent it. For example, when the two leading office-supply stores, Staples and OfficeMax, wanted to merge, the federal government prevented it, arguing that a merger of these two giant firms would result in less competition and higher prices for consumers. On the other hand, the government did not prevent the 2001 merger of Hewlett-Packard and Compaq Computer, two leading personal-computer makers.

---

**Oil Trust** John D. Rockefeller took almost total control of the oil industry in the late 1800's until the government broke up his Standard Oil empire. **Explaining** Why did the government want the Standard Oil Company broken up?



# American Biography

## Elaine L. Chao (1953 – )

**E**laine Chao is the first Asian American to hold the position of Secretary of Labor. She was named to the position in 2001 by President George W. Bush.

Chao's father came to the United States in 1958 as an employee of a Chinese shipping company and later opened his own shipping business. He brought his family to America three years later. Elaine graduated from Syosset High School in Westchester County, New York, and earned her bachelor's degree in economics from Mount Holyoke College. She was awarded an MBA from Harvard Business School and also studied at Columbia University, MIT, and Dartmouth College.

Before entering government service, Chao worked for Gulf Oil Corporation and as a loan specialist in the ship financing department of Citicorp. She was accepted as a White House Fellow in 1983 as a special assistant in the Office of Policy Development in the Ronald Reagan administration. Chao's other government positions include Deputy Secretary

at the U.S. Department of Transportation, Chairman of the Federal Maritime Commission, and Deputy Maritime Administrator in the U.S. Department of Transportation. President George H. W. Bush nominated her to head the Peace Corps in 1991.

Chao, the mother of three daughters, is married to the former Assistant Majority Leader of the United States Senate, Senator Mitch McConnell of Kentucky.



Making a Difference

CITIZENSHIP

**Describing** In what departments of government has Chao worked?

## Regulating Market Activities

Recall that governments want to reduce negative externalities. To carry out this work, they regulate some activities by businesses. That is, government agencies make sure that businesses act fairly and follow the laws. Some of the federal agencies that regulate businesses are shown on the chart on page 632. Government regulation is needed in three important areas.

**Natural Monopolies** Sometimes it makes sense to have a single firm produce all of a particular good or service for a market. For example, it would not make sense to have three or four telephone companies compete in a local community if each company had to put up its own set of telephone poles.

This often leads to a **natural monopoly**, a market situation in which the costs of pro-

duction are **minimized**, or lessened, by having a single firm produce the product. In exchange for having the market all to itself, the firm agrees to government regulation. This is why many public services such as natural gas and water are delivered by a single firm.

In the past, the telecommunications industry was usually considered a natural monopoly. Like water companies and railway companies, the existence of several telecommunications companies serving the same area would result in inefficiency.

The large size, or scale, of most natural monopolies seemed to give them economies of scale—by which they could produce the largest amount for the lowest cost. However, advances in technology are making these industries more competitive. The government is making moves to deregulate and open natural monopolies up for competition.



## Advertising and Product Labels

Government is also involved when it comes to truth in advertising and product labeling information. For example, some sellers may be tempted to give misleading information about a product in order to sell it. Even the content of food labels is important because some people are allergic to certain products such as eggs, milk, and peanuts.

The Food and Drug Administration (FDA) is the agency that deals with the purity, effectiveness, and labeling of food, drugs, and cosmetics. The Federal Trade Commission (FTC) deals with problems of false advertising and product claims. The FTC also administers antitrust laws forbidding unfair competition and price fixing.

The FTC has the power to review the advertising claims made about all products sold in interstate commerce. It may

determine whether an advertisement for a product is false or unfair. If it is, the FTC can order the company to change the ad to comply with FTC standards. As a result of one ruling, cigarette manufacturers must place a health warning on cigarette packages.

**Product Safety** Product safety is another important area of regulation. From time to time, the Consumer Product Safety Commission recalls products that pose a safety hazard. In a **recall**, a company pulls a product off the market or agrees to change it to make it safe. In September 2006 producers needed to recall fresh spinach because of suspected E-coli contamination. That same month, 7 million Sony laptop batteries were recalled.

 **Reading Check Explaining** What is a recall? Why are some products recalled?

## Section Review

### 1

#### Vocabulary

1. **Write** a paragraph related to government's role in the economy using the following terms: *private good, public good, externality, monopoly, antitrust law, merger, natural monopoly, recall*.

#### Main Ideas

2. **Explaining** What is a positive externality?
3. **Describing** How can a monopoly control the price of a product?

#### Critical Thinking

4. **Concluding** Think about something that your local government provides for citizens. Could this good or service be supplied by a private business? Why or why not?
5. **BIG Ideas** On a diagram like the one below, give an example of a negative externality and a positive externality of having an airport built near your home.

Airport	
Negative Externality	Positive Externality

#### CITIZENSHIP Activity

6. **Research** Interview a local business owner. Find out what he or she feels about government regulations that affect his or her business. Ask how the business owner would change government policies and programs.
7. **Persuasive Writing** Write a paragraph either supporting or disagreeing with this statement: Private businesses can do a better job than government of supplying water, sewer, and electricity to our community. Give reasons for your opinion.



**Study Central™** To review this section, go to [glencoe.com](http://glencoe.com).



# Issues to Debate



## Does outsourcing jobs to other countries hurt America?

How would you feel if you had a good job for several years, then your company closed its American office and opened a new branch in another country? National news media often report the number of “jobs lost” in the United States from this outsourcing of jobs. Outsourcing is a controversial issue because it causes plant closings and unemployment in the United States. The number of jobs being outsourced has been growing. Who supports outsourcing? Not only do businesses like the idea, but some economists support it because it helps American business to be competitive in world markets. Outsourcing also helps consumers by lowering prices. So, does outsourcing hurt the American economy?



The Vietnamese workers at a Nike plant help the company export about 22 million pairs of shoes each year.

### YES

**Kathleen Madigan**, a *Business Outlook* editor for *BusinessWeek*, warns that outsourcing is not only growing, but it is now hitting skilled and service jobs. Former jobs such as writing computer code are no longer complex enough to be secure, and American technology companies are moving them to other continents. What can be done? Madigan says, “The only way the U.S. will keep one rung ahead of the rest of the world is to ensure that we have a broadly educated workforce that keeps learning. At the corporate level, training programs would help current employees move up to better positions. And the government should overhaul jobless benefits to allow displaced workers the time and money to enter new careers.”

—Kathleen Madigan, August 25, 2003

### NO

**Michael J. Mandel**, *BusinessWeek* chief economist, believes that the United States should not fear outsourcing as long as we continue to be the most innovative economy. Our new technologies are providing more jobs than we are losing. “Despite anecdotes of well-paying jobs being sucked overseas, there’s little evidence that educated workers, overall, are worse off than they were after the last recession.” Mandel believes the key is staying at the top of the innovation ladder. “The biggest danger to U.S. workers isn’t overseas competition. It’s that we worry too much about other countries climbing up the ladder and not enough about finding the next higher rung for ourselves.”

—Michael J. Mandel, August 25, 2003

## Debating the Issue

- 1. Defining** What is outsourcing?
- 2. Identifying** What kind of jobs used to be secure from outsourcing?
- 3. Comparing** What do the authors quoted above suggest the United States should do about outsourcing?
- 4. Analyzing** Why might a stockholder or owner of an American company disagree with a worker in that company about outsourcing?



Joe Tabacco/Bloomberg News/Landov

# Section 2

## Guide to Reading

### Big Idea

An economic system is the way a society organizes the production and consumption of goods and services.

### Content Vocabulary

- real GDP (p. 638)
- business cycle (p. 638)
- civilian labor force (p. 640)
- unemployment rate (p. 640)
- fiscal policy (p. 641)
- inflation (p. 641)
- consumer price index (CPI) (p. 642)

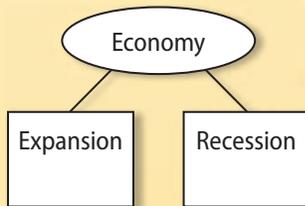
### Academic Vocabulary

- period (p. 638)
- implement (p. 641)

### Reading Strategy

#### Organizing Information

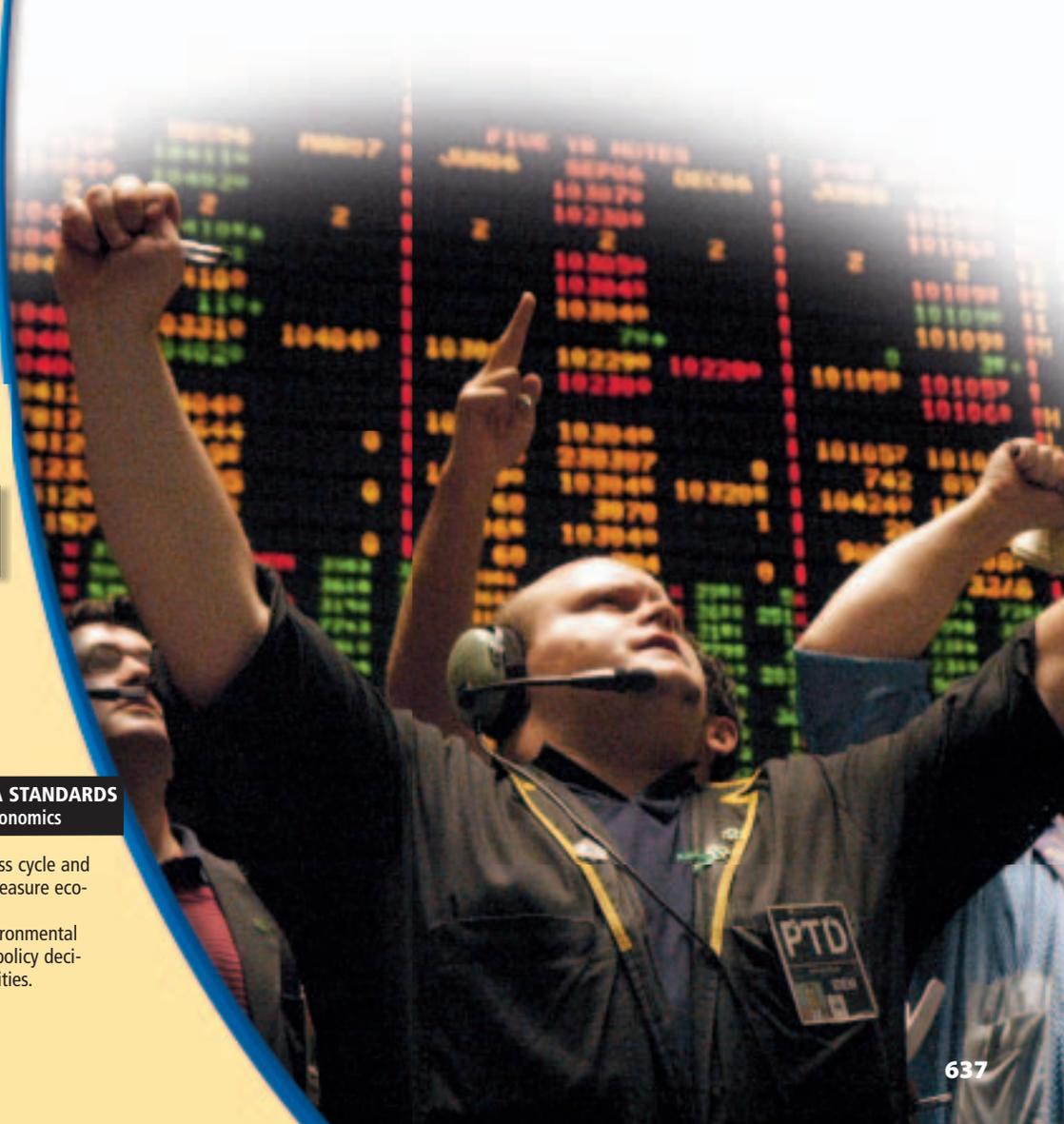
Create a graphic organizer like the one below to describe the expansion and recession that can take place in an economy.



# Measuring the Economy

**Real World Economics** Traders at the Chicago Stock Exchange cheer after receiving encouraging news from the Federal Reserve. Organized in 1848, the Chicago Board of Trade was the first grain futures exchange in the United States. In its early history, the CBOT monitored only the business of agriculture. Today, cotton, grain, soy, and silver are just some of the items bought and sold in the electronic hubbub of the Chicago Board of Trade.

#### ▼ Traders in the Dow Pit of The Chicago Board of Trade



### NORTH CAROLINA STANDARDS Civics and Economics

- 9.01** Identify phases of the business cycle and the economic indicators used to measure economic activities and trends.
- 9.08** Analyze the influence of environmental factors, economic conditions, and policy decisions on individual economic activities.



# Measuring Growth

**Main Idea** The real gross domestic product is the most accurate measure of an economy's performance.

**Economics & You** Have you ever found that an item you wanted to buy had gone up in price? Read to find out how we have to adjust for this phenomenon when we measure economic growth.

Sometimes the economy grows, but sometimes it falters. How do economists decide which **period**, or phase, the economy is in? How do government leaders decide what to do about these changes in economic performance? You will learn the answers to these questions.

One measure of an economy's performance is whether or not it is growing. Economic growth is beneficial to nearly everyone. When the economy grows, businesses are producing more goods and services, and they usually have to hire more workers. People then have more money and buy more.

The gross domestic product (GDP) is a measure of the economy's output. GDP is the dollar value of all final goods and services produced in a country in a year.

## Real GDP

Even if the country produces the same amount of goods and services from one year to the next, the gross domestic product could go up simply because prices increase. That would make it *seem* that the economy was growing even though it really was not. To avoid being misled in this way, another measure, **real GDP**, is used. Real GDP shows an economy's production after the distortions of price increases have been removed. This eliminates the false impression that output has gone up when prices go up.

## The Business Cycle

The economy tends to grow over time, but it does not grow at a constant rate. Instead it goes through alternating intervals of growth and decline that we call the **business cycle**. The graph on this page shows an idealized business cycle. The line on the graph tracks real GDP. When the line moves upward, real GDP is growing. A downward slope shows a decline in real GDP.

According to this model, the phases of a business cycle begin with expansion leading to an economic peak—a period of prosperity. New businesses open, factories are producing at full capacity, and most people can find work. Eventually, however, real GDP levels off and begins to decline. During this part of the cycle, a contraction of the economy occurs. Business activity begins to slow down. At some point, the downward direction of the economy levels off in a trough. A trough is the lowest point in the business cycle. It occurs when real GDP levels off and slowly begins to increase.

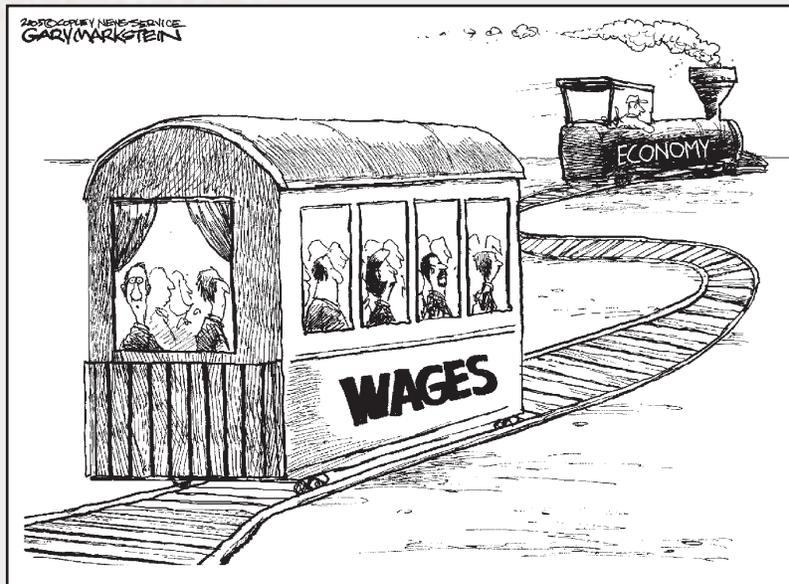
### Model of the Business Cycle

Analyzing Graphs

1. **Identifying** What is the lowest point of the cycle called?
2. **Explaining** At what point in the cycle is the economy the strongest? What leads up to this point?

**Reading Check Explaining** What are the phases of a business cycle?

Political Cartoons



Gary Markstein/Copley News Service

Wages for American workers are the topic of this cartoon by Gary Markstein.

1. What railroad symbolism do you see in this image?
2. How does Markstein use these symbols to comment on wages and on the economy?
3. Do you think Markstein is optimistic or pessimistic about higher wages for American workers? Explain.

Every year, more than half of all Americans do volunteer work. One of the responsibilities of citizens is to help make their role in it. One of the responsibilities of volunteer groups is to help make their small. Perhaps you can help to...

## Business Fluctuations

**Main Idea** The economy goes through alternating periods of growth and decline.

**Economics & You** What did you do the last time you were a little short of cash? Read to find out one way our country copes with economic ups and downs.

In the real world, the business cycles are not as regular as the model shows. An entire business cycle is measured from peak to peak.

### Expansions

An economic expansion takes place when real GDP goes up. It does not matter whether the economy is growing by a little or by a lot. As long as the real GDP is higher from one period to the next, the economy is expanding. At some point, real GDP reaches its

highest point in an expansion. Then it starts to decline.

Expansions are normally longer than recessions. The longest peacetime expansion in U.S. history lasted from March of 1991 until March of 2001, exactly 10 years.

### Recession

A recession takes place when real GDP goes down for six straight months, although most last longer than that. On the business cycle graph, the recessions are shown by a colored background. Fortunately, recessions tend to be shorter than expansions, with the average recession lasting about one year. Even so, recessions are painful times. When the economy declines, many people lose their jobs.

If a recession becomes severe, it may turn into a depression—a state of the economy with large numbers of people out of work, acute shortages, and excess capacity in manufacturing plants.



## Unemployment

Another way of measuring the economy is to look at employment. Economists start by identifying the civilian labor force, which includes all civilians 16 years old or older who are either working or are looking for work. In the United States, about half of all people belong to the **civilian labor force**.

The **unemployment rate** is the percentage of people in the civilian labor force who are not working but are looking for jobs. As the graph on page 642 shows, the unemployment rate tends to rise sharply during recessions and then comes down slowly afterward.

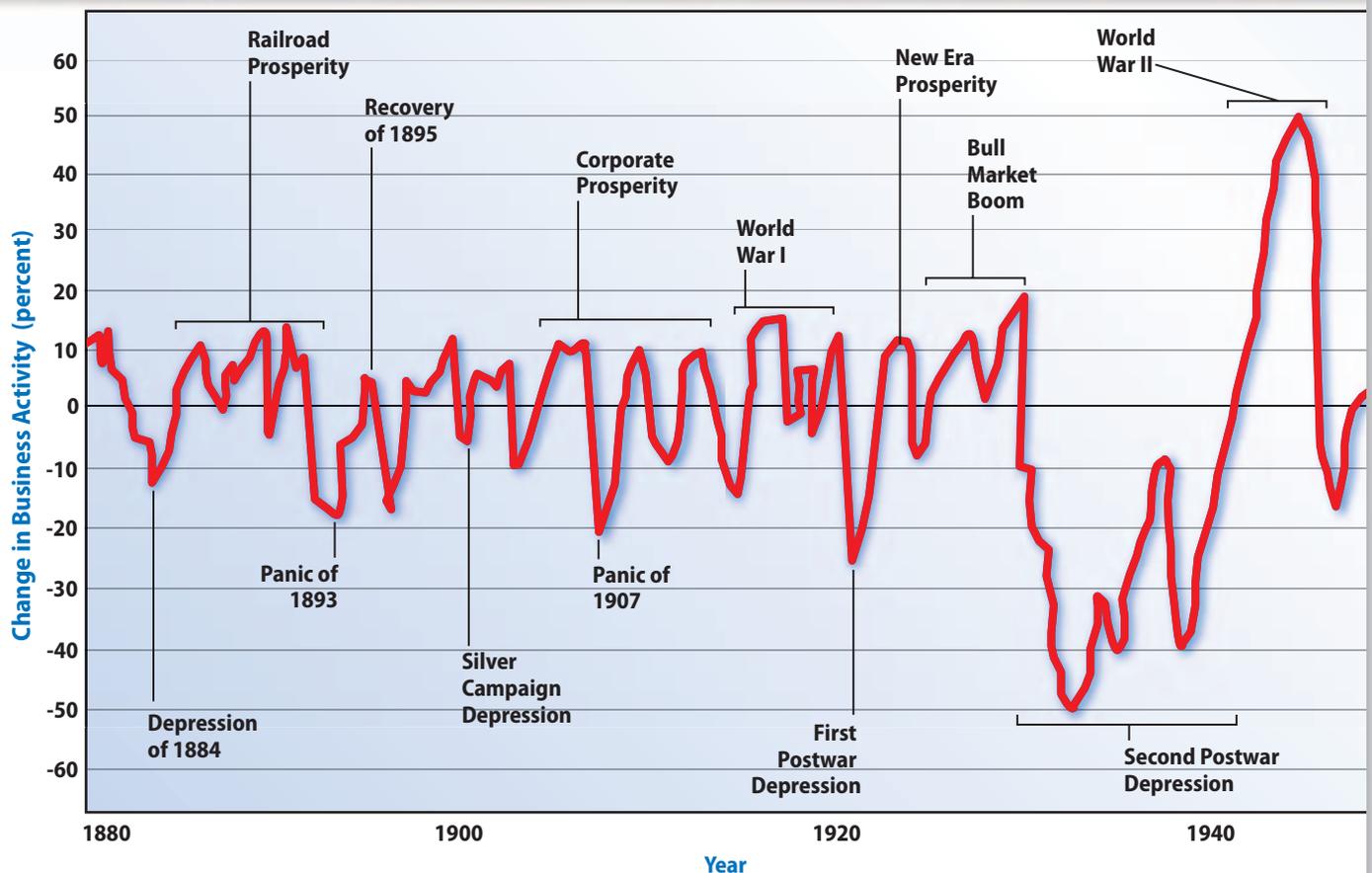
Changes in the unemployment rate are important in terms of the economy as a whole.

A 1 percent drop in the unemployment rate results in a 2 percent rise in total income in the economy. In 2006, total income in the American economy was about \$13.3 trillion. As a result, a 1 percent drop in unemployment would increase total income by about \$266 billion.

Of course, the personal impact of unemployment and lost income can be tremendous. Some people cut back on luxuries, while others must cut back on basic needs such as health care. Some families go deeper into debt by buying more goods on credit.

Times of high unemployment create stress for many people. High unemployment becomes a problem that requires some government action.

### U.S. Business Activity Since 1880



Source: National Bureau of Economic Research; *American Business Activity from 1790 to Today*, 67th ed., Ameritrust Co., January 1996, plus author's projections.



## Fiscal Policy

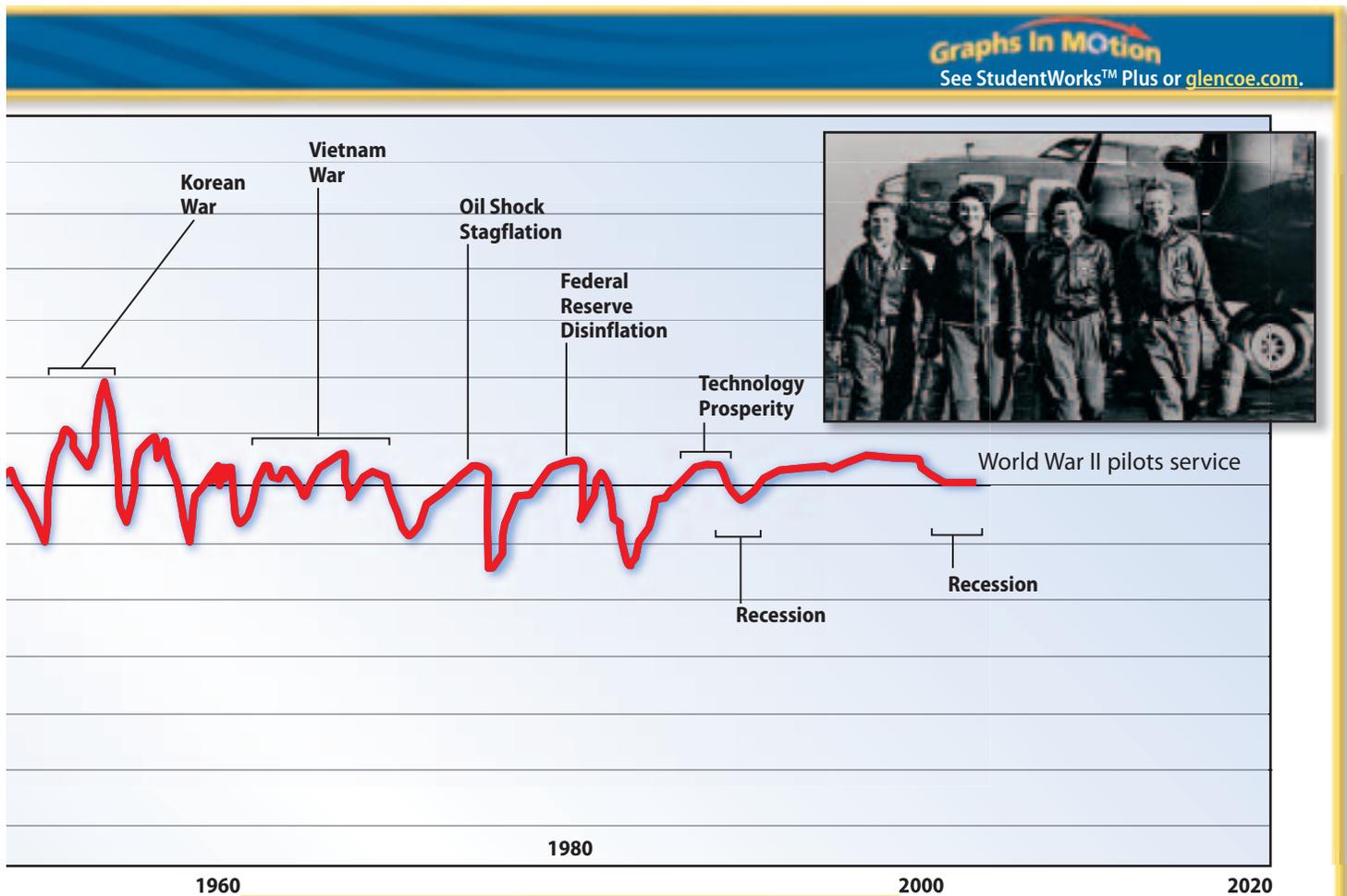
When the government does step in, it uses **fiscal policy**, which is changes in government spending or tax policies. The government might cut taxes, for instance. It does this hoping that with more money in their pockets people will buy more goods and services. This increased demand will convince businesses to hire more workers, reducing unemployment.

Sometimes the government increases spending. By buying more goods and services itself, it tries to convince businesses to hire more workers to boost production. Fiscal policy is an important economic tool because of its ability to affect the total amount of output produced—gross domestic product.

Unfortunately, political differences often prevent the effective use of fiscal policy. Specifically, it is usually difficult to **implement**, or carry out, effective fiscal policies when recessions are short and political leaders have different ideas about whether to cut taxes or to increase spending.

## Price Stability

Another important indicator of an economy's performance is **inflation**. This is a sustained increase in the general level of prices. Inflation hurts the economy because it reduces the purchasing power of money and may alter the decisions people make.



### Analyzing Graphs

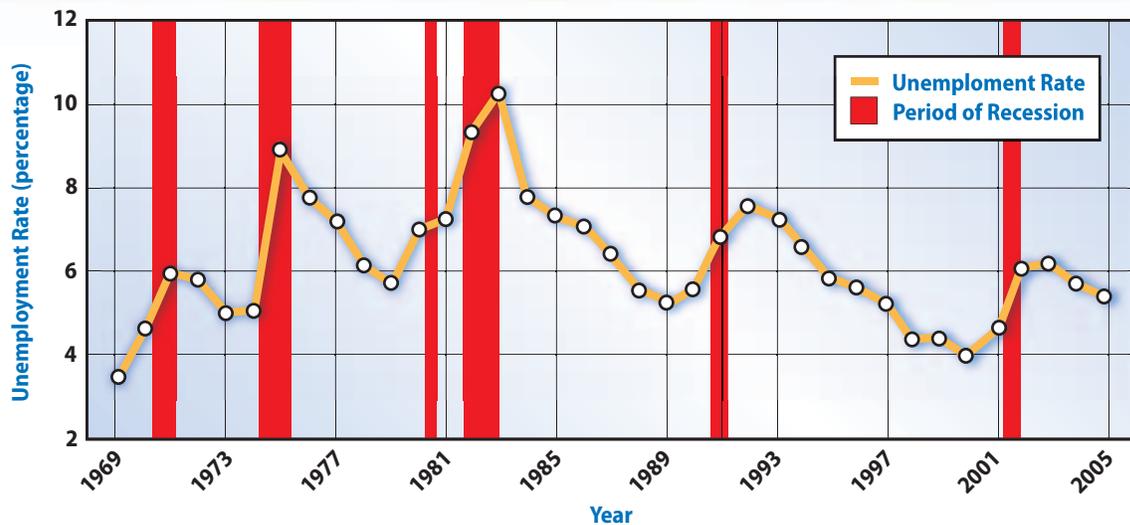
- Sequencing** What economic situation often follows a war?
- Describing** What percentage level of economic activity do all times of prosperity have in common?



## Unemployment and the Business Cycle

Graphs In Motion

See StudentWorks™ Plus or [glencoe.com](http://glencoe.com).



### Analyzing Graphs

- Interpreting** What was the approximate unemployment rate in 1989 and 2005?
- Explaining** What connection is there between periods of recession and periods of unemployment?

**Consumer Price Index** To keep track of inflation, the government samples prices every month for about 400 products commonly used by consumers. The prices of these 400 items make up the **consumer price index (CPI)**, which is a popular measure of the price level. Typically, the prices of some items in the CPI go up every month, and the prices of others go down. However, the change in the average level of prices as measured by the CPI defines the rate of inflation.

### Inflation and the Value of Money

Suppose that an ice-cream cone that costs you a dollar doubles in price. This price increase causes the purchasing power of your dollar to fall because you have to use twice as many dollars to buy the same item. This is why inflation is particularly hard on people who have fixed incomes—people who get a pension or other fixed amount of money. Inflation also reduces the value of money in a

savings account because it will buy less after inflation than before.

Prices provide the signals that help individuals and businesses make the economic decisions that allocate the factors of production. High rates of inflation distort this process because people begin to speculate, or buy things such as land or works of art they think will go up in value.

When speculation takes the place of investment in capital goods or services such as education, the economy begins to suffer. Unfortunately, the government itself can do very little to prevent inflation because inflation results from monetary policy decisions. You will read about monetary policy and how the Federal Reserve System implements monetary policy in the next chapter.

**Reading Check Describing** How does a drop in the unemployment rate affect the nation's economy?



AP Images

# Stocks and Stock Markets

**Main Idea** Stock markets are usually good indicators of the health of the economy.

**Economics & You** You have probably heard a statement like this on the news: “The Dow Jones Industrial Average rose 2 percent today.” Read to find out what statements like these tell us about the economy.

Investors normally want to buy stock if they think they will make money on it. Profits from stock come in two ways—from dividends or from capital gains. Dividends are a share of the corporation’s profits that are distributed to shareholders. A capital gain occurs when

stock can be sold for more than it originally cost to buy. Suppose a person buys stock at \$20 a share and sells it for \$30. The person has had an increase in his or her capital, or wealth, of \$10 a share. Of course, the value of stock may also fall. If a person decides to sell stock at a lower price than he or she paid for it, that person suffers a capital loss. Money may be made or lost on government bonds in much the same way.

## Why Stock Prices Change

The price of a company’s stock, like most other things, is determined by supply and demand. Factors such as changes in sales or profits, rumors of a possible takeover, or news of a technological breakthrough can change the demand for a company’s stock and, therefore, its price.

**The NYSE** To be listed on the New York Stock Exchange, a corporation must prove to the exchange that it is in good financial condition. **Analyzing** How does inflation affect the value of stocks sold on the NYSE?





**Stock Market Indexes** Because most investors are concerned about the performance of their stocks, they often consult stock indexes. These are statistical measures that track stock prices over time and give us an idea of the well-being of the stock market as a whole. The Dow-Jones Industrial Average (DJIA) and Standard and Poor's (S&P) are the two most popular indexes. The DJIA tracks prices of 30 representative stocks. The S&P 500 index tracks the prices of 500 large stocks.

**Stock Exchanges** Stocks in publicly traded companies are bought and sold in a stock market, or a stock exchange, a specific location where shares of stock are bought and sold. The exchange makes buying and selling easy, but you do not have to actually travel to a stock exchange in order to buy or sell stock. Instead, you can call a stockbroker, who can buy or sell your stocks.

Most stocks in the United States are traded on the New York Stock Exchange (NYSE), the American Stock Exchange, or an electronic stock market like the NASDAQ. Computer technology and electronic trading allow investors to trade major stocks around the clock, anywhere in the world.

## The Stock Market and the Economy

Indexes like the DJIA and the S&P 500 do more than tell us about the level of stock prices—they reveal investors' expectations about the future. If investors expect economic growth to be rapid, profits high, and unemployment low, then stock prices tend to rise in what is referred to as a "bull market." If investors are pessimistic, stock prices could fall in what is called a "bear market."

 **Reading Check Explaining** What are two ways investors make money on stocks?

## Section Review 2

### Vocabulary

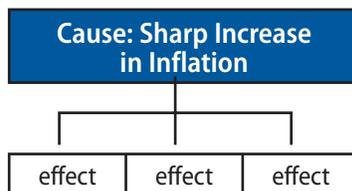
- Write** complete sentences using each of the following terms that will help explain its meaning: *real GDP, business cycle, civilian labor force, unemployment rate, fiscal policy, inflation, consumer price index (CPI).*

### Main Ideas

- Comparing** How do GDP and real GDP differ?
- Describing** How is the unemployment rate computed?
- Explaining** How does supply and demand affect a stock's price?

### Critical Thinking

- Evaluating** Do you think it is the government's responsibility to try to balance the ups and downs of the business cycle? Justify your answer.
- BIG Ideas** On a chart like the one below, evaluate how a sharp increase in inflation might affect people.



- Analyzing Visuals** Study the graph showing the phases of the business cycle on page 638. How are the recessionary periods in this graph illustrated?

### CITIZENSHIP Activity

- Creative Writing** Write a play, short story, poem, or song about a family coping with a down period in the business cycle or a time of high inflation. Share your creative work with the class.



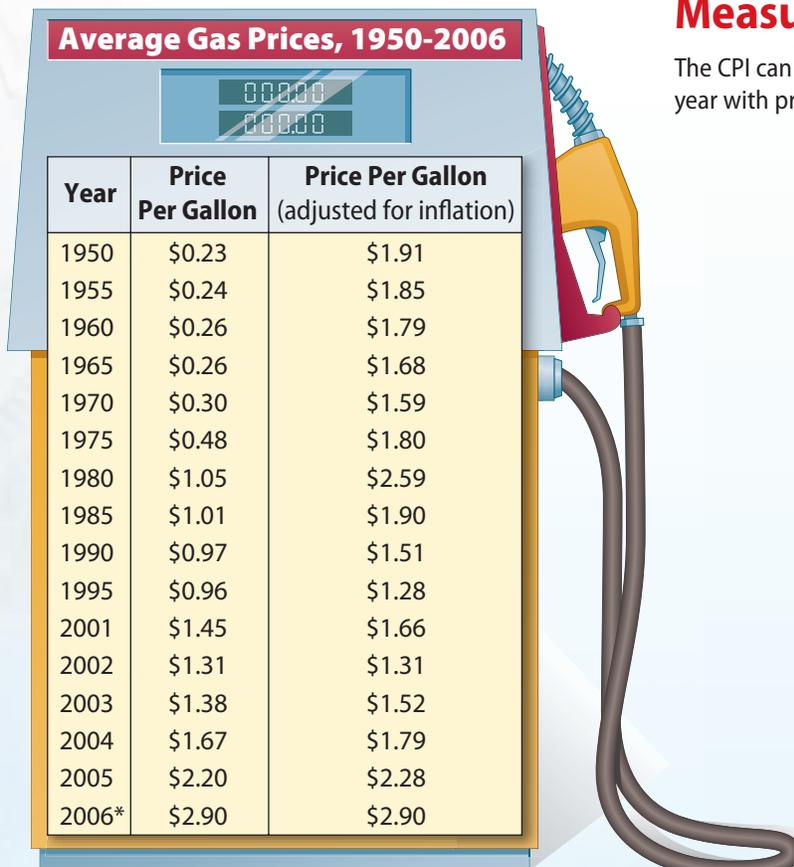
**Study Central™** To review this section, go to [glencoe.com](http://glencoe.com).



# Financial Literacy

## How Much Does It Cost?

If something cost \$64 in 1965, what would be the equivalent price in 2006 dollars? Using the Consumer Price Index (CPI) provides an answer. The CPI is a measure of the average change in prices over time for a specific collection of goods and services.



Source: Department of Energy.

\*April 2006

## Measuring Price Changes

The CPI can be used to compare the price level in one year with price levels in earlier or later periods.

### Use this formula to calculate:

$$2006 \text{ Price} = 1950 \text{ Price} \times (2006 \text{ CPI} / 1965 \text{ CPI})$$

### Here's the calculation:

$$2006 \text{ Price} = \$64 \times (203.0 / 31.5)$$

$$2006 \text{ Price} = \$64 \times 6.44$$

$$2006 \text{ Price} = \$412.16$$

### If something cost \$64 in 2006, what would be the equivalent price in 1965? To calculate, use this formula:

$$1965 \text{ price} = 2006 \text{ price} \times (1965 \text{ CPI} / 2006 \text{ CPI})$$

### Here's the calculation:

$$1965 \text{ Price} = \$64 \times (31.5 / 203)$$

$$1965 \text{ Price} = \$64 \times .155$$

$$1965 \text{ Price} = \$9.92$$



## Analyzing Economics

- Analyzing** What, if anything, surprises you about the average price of gasoline over time?
- Calculating** From one year to the next, which year shows the biggest increase in the actual price?
- Calculating** From one year to the next, which year shows the biggest increase in price adjusted for inflation?



Section  
**3**

# Government, the Economy, and You

## Guide to Reading

### Big Idea

People form governments to establish order, provide security, and accomplish common goals.

### Content Vocabulary

- food stamps (p. 648)
- Women, Infants, and Children (WIC) (p. 648)
- workfare (p. 649)
- progressive income tax (p. 649)
- Earned Income Tax Credit (EITC) (p. 649)

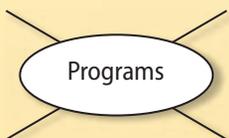
### Academic Vocabulary

- survive (p. 648)
- supplement (p. 649)

### Reading Strategy

#### Comparing Information

On a diagram like the one below, identify four major government programs or policies that are meant to ease the problem of poverty.



***Real World Economics*** “Give me a head start!” exclaims this student enrolled in the federally funded preschool program Head Start. For over 40 years, the Head Start program has been a vital educational resource for lower-income families and their preschoolers. It provides educational support to improve children’s readiness level for public school. Additional programs are offered in the areas of health, nutrition, and family support. Today, Head Start supporters are urging Congress to increase funding.

▼ Louisiana 5-year-old successfully finishes lesson with Head Start teacher



**NORTH CAROLINA STANDARDS**  
Civics and Economics

- 10.02** Develop, defend, and evaluate positions on issues regarding diversity in American life.
- 10.03** Evaluate the importance of supporting, nurturing, and educating oneself in the United States society.
- 10.05** Describe examples of recurring public problems and issues.



# Income Inequality

**Main Idea** Education, family wealth, and discrimination are reasons for income differences.

**Economics & You** Think of a wealthy family in your community. How did they earn their wealth? Read to find out three key factors that can influence a person's income.

**T**hough the United States is a wealthy country, not all Americans are personally wealthy. Income levels vary for many reasons. Some people—such as Tiger Woods, Beyoncé, and Stephen King—have special talents that enable them to earn huge amounts of money.

## Three Influences on Income

Incomes differ for several reasons. Education, family wealth, and discrimination are common reasons for income differences.

**Education** Level of education has a major impact on a person's income. The average income of a college graduate—someone with a bachelor's degree—is nearly twice the average income of a high school graduate. More advanced degrees increase income even more. Education puts people in a better position to get the higher-paying jobs that require a higher level of skills.

Because education contributes so much to income, the federal government tries to encourage people to improve their education. This is why there are many programs that encourage education, from free or subsidized lunches to college grants and low-interest loans.

**Family Wealth** Some people are born into wealth. Having wealthy parents often gives people access to excellent colleges. In addition, wealthy parents can set up their children in a business or pass on their own business.



**Education Opportunities** Students from Columbia University in New York City celebrate graduation *Explaining* **What other factors besides education determine a person's future income?**

**Discrimination** Discrimination is one of the reasons some people do not receive higher incomes. Women and members of minority groups may not be hired into jobs that pay well, or they may not receive promotions for which they are eligible. In addition, salaries for men are normally higher than those for women. This difference is partly a result of discrimination against women.

The government has passed several laws to reduce discrimination. The Equal Pay Act of 1963 requires equal pay for jobs that require equivalent skills and responsibilities. The Civil Rights Act of 1964 bans discrimination on the basis of gender, race, color, religion, and national origin. The Equal Employment Opportunity Act of 1972 strengthened earlier laws. The Americans with Disabilities Act of 1990 extended this protection to people with physical and mental disabilities. People who suffer discrimination can use the courts to enforce these laws.

**Reading Check Explaining** How does the government encourage people to obtain an education?



# Poverty

**Main Idea** Poverty is a major problem in America.

**Economics & You** Do you know a person with a disability who receives money from the government? Read to find out why government helps support people with disabilities.

People living in poverty or those who are at the bottom of the income scale receive special attention from the government. The most effective government programs are those that have incentives that encourage people to go back to work.

## Poverty Guidelines and Programs

The government uses poverty guidelines to determine whether someone is eligible for certain programs. These guidelines are revised annually and are based on conservative estimates of how much it costs to buy enough food, clothing, and shelter to **survive**, or exist.

**People in Poverty** In 2006, a single person was considered to be in poverty if his or her annual income was \$9,800, or about \$27 a day. Today, there are almost 37 million people who fall *below* this income guideline.

**Welfare Programs** Most welfare programs are federal programs. The federal **food stamp** program serves millions of Americans. The goal of the food stamp program is to alleviate hunger and malnutrition by allowing low-income households to obtain a more healthful diet. Some states use electronic debit systems in place of coupons. The program gives low-income families the opportunity to buy food with Electronic Benefits Transfer (EBT) cards.

Another federal welfare program is the **Women, Infants, and Children (WIC)** program. It provides help with nutrition and health care to low-income women, infants, and children up to age 5.

## Erika Herman



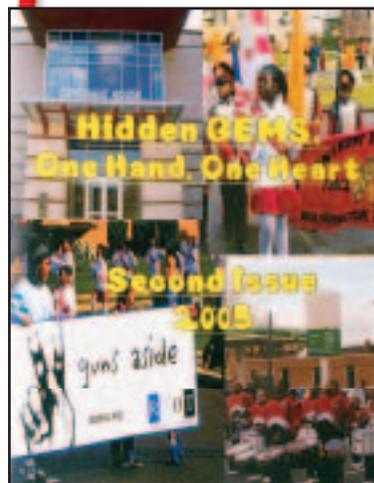
Erika Herman, 18, of Bethesda, Maryland, sees potential in people—that is why she started Project Hidden GEMS (Giving, Educating, Making Solutions).

**QUESTION:** Why did you create Hidden GEMS?

**ANSWER:** The idea clicked in 2004 at a conference about poverty that I attended in Washington, D.C. I met a homeless man who said poetry was his passion but that no one was ever willing to publish his work. I talked to my friend Emily Grunewald about creating a magazine [Hidden GEMS] for people like him. Our goals are to provide an outlet for expression for homeless and inner-city writers; to break down stereotypes and promote awareness among diverse groups of people; and to raise money for individuals and organizations in need.

**Q:** Have you seen changes in people that work on the magazine?

**A:** It gives hope to many homeless individuals whose talents would otherwise be ignored. In one case, a homeless man gained enough self-confidence from seeing that people cared about his writing that he worked hard to get a job. Now he's supporting himself in his own apartment.



Making a Difference

CITIZENSHIP

**Explaining** What does Erika mean by breaking down stereotypes?



**Income Assistance** Other programs pay cash to certain people. Additional, or **Supplemental Security Income (SSI)**, for instance, gives payments to blind or disabled people and to persons age 65 and older. Temporary Assistance to Needy Families (TANF) is another direct cash program. TANF makes payments to families who need help because a parent is dead, disabled, or absent. The number of months that a recipient can receive benefits is limited. The intent of this limit is to make sure that people do not rely on the program but look for paying work.

**Workfare** **Workfare** is a term used to describe programs that require welfare recipients to exchange some of their labor in exchange for benefits. Most of the programs are run at the state level, and most are designed to teach people the skills they need to succeed in a job. Many states also require some form of workfare if families want to

receive TANF benefits. People who are part of workfare often assist law enforcement officials, sanitation and highway crews, or perform other community service work.

**Tax Policies** Another way the government helps poor people is with a **progressive income tax**. That means that the tax rate is lower at lower incomes and higher for higher incomes. This helps lower-income people by taking a smaller proportion of their income in taxes. The federal government provides additional help for low-income families and individuals. Many workers use the federal **Earned Income Tax Credit (EITC)**, which gives tax credits and even cash payments to qualified workers. This program benefits about 20 million working families every year.

 **Reading Check Summarizing** How does the government use poverty guidelines?

## Section Review 3

### Vocabulary

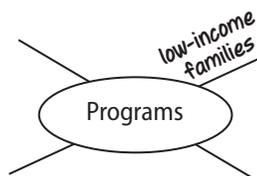
- Define** these terms from the section and make a set of flash cards to help you learn them: *food stamps, Women, Infants, and Children (WIC), workfare, progressive income tax, Earned Income Tax Credit (EITC).*

### Main Ideas

- Describing** What does the Americans with Disabilities Act provide?
- Describing** What does Supplemental Security Income provide?

### Critical Thinking

- BIG Ideas** Which of the anti-poverty programs do you think is the most effective? Explain your answer.
- Identifying** On a graphic organizer like the one below, identify the groups of people who are helped by government income assistance programs.



### CITIZENSHIP Activity

- Summarizing** Scan a local newspaper for a short editorial or article about income. Take notes by writing down the main idea and supporting facts. Summarize the article using only your notes.
- Persuasive Writing** Write a paragraph either supporting or disagreeing with this statement: Welfare programs have a negative effect on poor people and should be eliminated. Give reasons for your opinion.



**Study Central™** To review this section, go to [glencoe.com](http://glencoe.com).



# LANDMARK SUPREME COURT CASE STUDIES

## McCulloch v. Maryland

*How did the national government expand its financial powers to meet the needs of a growing nation?*

### Background of the Case

Alexander Hamilton, the nation's first secretary of the Treasury, urged Congress to pass a law establishing a national bank. With the backing of President George Washington, Congress did so in 1791. The bank's funds were used to build roads, canals, and other projects that would help the nation grow. The first bank lasted until 1811; a second bank was chartered in 1816.

Many citizens withdrew deposits from state banks and reinvested them in the new national bank. Angry over the competition from the national bank, states worked to weaken it. Some states, including Maryland, taxed national bank branches operating inside their boundaries. James McCulloch of the Baltimore branch bank refused to pay the state's \$15,000 tax. Maryland sued him and won in a state court. McCulloch appealed to the Supreme Court.

### The Decision

The Court had to decide if the national bank was constitutional, even though not mentioned in the Constitution. Chief Justice John Marshall wrote the unanimous decision on March 6, 1819:

“*[T]here is no phrase . . . [that] excludes incidental or implied powers; and which requires that everything granted shall be expressly and minutely described. . . . [T]he states have no power, by taxation or otherwise . . . to impede the . . . operations of the constitutional laws enacted by Congress.*”

—Justice John Marshall



Federal Reserve Bank, Washington, D.C.

Marshall based the ruling on Article I, Section 8, which gives Congress powers to “make all laws . . . necessary and proper” for carrying out its duties.

### Why It Matters

The Court's unpopular decision upheld the national bank and denied states the power to tax it. The modern Federal Reserve System eventually grew out of the national bank concept.

The case established the implied powers doctrine, which meant Congress had, under the “necessary and proper” clause, a wide range of powers to carry out the powers that the Constitution *expressly* gave it. *McCulloch v. Maryland* also established the principle of national supremacy, which forbids the states from intruding into the constitutional operations of the national government.

### Analyzing the Court Decision

1. **Describing** How did Marshall justify the *McCulloch* decision?
2. **Analyzing** Do you think the decision affected the ways Americans viewed our federal system?

## Government and the Economy

### Government's Role

- Government provides public goods.
- Government regulates the economy to ensure competition.

### Measuring the Economy

- Real GDP is GDP that has been adjusted for inflation.
- The real gross domestic product is the most accurate measure of an economy's performance.

Workers with more education earn more money

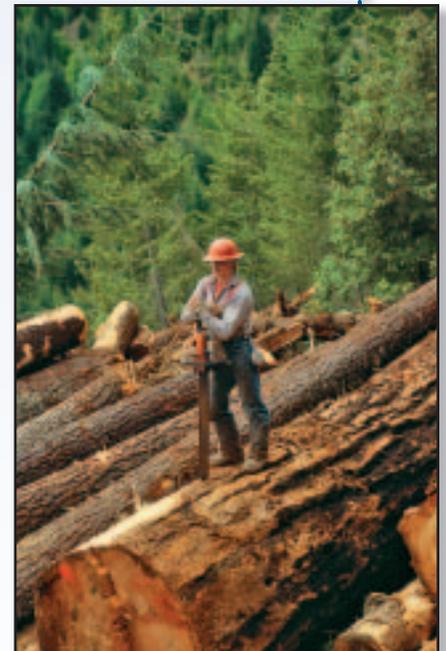


The health of the Stock Exchange is important to the economy

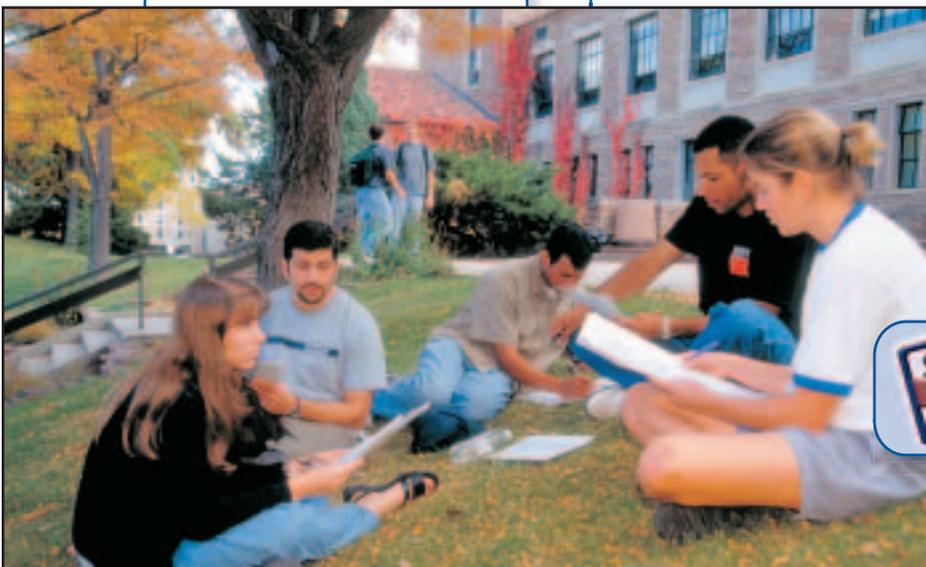
- Government must deal with unemployment, inflation, and periods of growth and decline called the business cycle.
- Stock markets are usually good indicators of the health of the economy.

### The Problem of Poverty

- Education, family wealth, and discrimination are reasons for income differences.
- Government uses several different programs and policies to combat poverty.



Laborers benefit from working for government-funded programs



Study anywhere, anytime! Download quizzes and flash cards to your PDA from [glencoe.com](http://glencoe.com).

# North Carolina End-of-Course Test Civics and Economics Practice

## TEST TAKING TIP

Stay focused on your own test. Do not be distracted if others are finishing early.

### Reviewing Vocabulary

Directions: Choose the word(s) that best completes the sentence.

- Whenever two or more companies try to form a(n) \_\_\_\_\_ that threatens competition, the government may take action to stop it.  
**A** antitrust                      **C** merger  
**B** monopoly                      **D** externality
- What is the term for a nation's economic production that has been adjusted for price changes?  
**A** TANF                      **C** business cycle  
**B** real GDP                      **D** inflation
- Changes in the \_\_\_\_\_ determine inflation.  
**A** fiscal policy                      **C** stock market  
**B** consumer price index                      **D** unemployment rate
- What is the term for an income tax whose rate increases as income level rises?  
**A** public good  
**B** progressive tax  
**C** regressive tax  
**D** real GDP

### Reviewing Main Ideas

Directions: Choose the best answer for each question.

#### Section 1 (pp. 630–635)

- A(n) \_\_\_\_\_ is a good in which one person's consumption takes away from another person's consumption.  
**A** public good  
**B** private good  
**C** monopoly  
**D** externality

- One of the roles of the Federal Trade Commission is to \_\_\_\_\_.  
**A** produce public goods  
**B** reduce negative externalities  
**C** supervise corporate mergers  
**D** deal with the problems of false advertising

#### Section 2 (pp. 637–644)

- A period of business recovery when economic activity increases is called \_\_\_\_\_.  
**A** a recession                      **C** the business cycle  
**B** real GDP                      **D** an expansion
- Which explanation best explains the effects of inflation?  
**A** Consumers have more products to choose from.  
**B** Inflation erodes the purchasing power of the dollar.  
**C** Inflation results in lower prices.  
**D** Demand increases because prices are higher.

#### Section 3 (pp. 646–649)

- What law provides protection for people with physical and mental disabilities?  
**A** Clayton Act  
**B** Sherman Antitrust Act  
**C** Americans with Disabilities Act  
**D** Supplemental Security Income
- What program provides help for nutrition and health care to low-income families?  
**A** Clayton Act  
**B** Federal Trade Commission  
**C** Americans with Disabilities Act  
**D** Women, Infants, and Children (WIC) program

## Critical Thinking

Directions: Choose the best answer for each question.

**2006 Poverty Guidelines**

Size of Family Unit	Poverty Guidelines
1	\$ 9,800
2	\$13,200
3	\$16,600
4	\$20,000
5	\$23,400
6	\$26,800
7	\$30,200
8	\$33,600

Source: Department of Health and Human Services.

Poverty guidelines help the government determine financial eligibility for certain federal programs.

- What was the measure of poverty in 2006 for a family of four?
  - \$13,200
  - \$16,600
  - \$20,000
  - \$41,000
- For family units with more than eight members, how much must be added for each additional member to meet the poverty guidelines?
  - \$1,000
  - \$2,200
  - \$3,400
  - \$9,800

## Document-Based Questions

Directions: Analyze the following document and answer the short-answer questions that follow.

### Two Results of Inflation

The most obvious effect of inflation is that the dollar buys less. Because the purchasing power of the dollar falls as prices rise, a dollar loses value over time.

A second effect is that inflation can cause people to change their spending habits, which disrupts the economy. For example, when prices went up in the early 1980s, interest rates—the price of borrowed money—also went up. This caused spending on durable goods, especially housing and automobiles, to fall dramatically.

- Explain the effect that inflation has on the financial position of lenders and borrowers?
- Evaluate how a sharp increase in inflation might affect the following people:
  - a person who has just withdrawn a considerable amount from a savings account
  - a doctor on staff at a large hospital
  - a retired autoworker on a fixed pension

## Informational Writing

- If we were to enter a period of recession, what would likely happen to demand? What would likely happen to the unemployment rate? The poverty rate? Write an essay in which you answer these questions and provide the reasons for your answers.

**STOP**



For additional test practice, use Self-Check Quizzes—Chapter 23 on [glencoe.com](http://glencoe.com).

### Need Extra Help?

If you missed question...	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Go to page...	633	638	642	649	631	635	639	641	647	648	648	648	642	642	639