Chapter 3

Economic Activity in a Changing World

Chapter Objectives
After completing this chapter, you will be able to:

Section 3.1 U.S. Economic History
• Describe the four types of economic shifts the United States has experienced.
• Describe what is shown by GDP, unemployment rate, rate of inflation, and national debt.

Section 3.2 The Business Cycle
• Explain how individuals and the government influence the economy.
• Describe the four stages of the business cycle.

Ask

STANDARD & POOR’S

Understanding Financial Risk

Q: I am a drummer in a band. I can’t decide if I should buy a new drum set now, or wait until next year when we go on the road. Should I buy now, or wait until next year and hope prices don’t go up?

A: Financial risk is always a factor when making major purchasing decisions. You have identified one risk—inflation. Prices may go up, but they also may come down. If you need a loan to buy the drum set, changing interest rates represent another risk. You also have liquidity risk. If the band breaks up, how long will it take you to sell your drums so you can pay off your loan? Some risks can be evaluated mathematically, others cannot.

Mathematics You can calculate the effects of price and interest rate fluctuation on purchases. For example, if a drum set costs $7,500, and the interest rate for one year is 7 percent, the total cost will be $(0.07 \times 7,500) + 7,500 = 8,025. Calculate the total cost with interest for each of the scenarios in the comparison chart and determine the least expensive option.

Comparison Charts A chart can help in comparing different scenarios of price and interest rates.

<table>
<thead>
<tr>
<th>Price</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$7,500</td>
<td>7%</td>
</tr>
<tr>
<td>$7,450</td>
<td>8%</td>
</tr>
<tr>
<td>$8,200</td>
<td>5%</td>
</tr>
</tbody>
</table>
A market economy has its ups and downs. How is the business cycle similar to a roller-coaster ride?
Think of some factors that affect the health of the U.S. economy.

**Academic Vocabulary**
You will find these words in your reading and on your tests. Make sure you know their meanings.

- shifts
- emphasis
- sum
- period

**Graphic Organizer**
Use a timeline like this one to indicate the changes in the U.S. economy from the 1700s to the 2000s. Mark the timeline to designate the following eras: Agricultural, Industrial, Production of Services, and Information Technology.

1700 1800 1900 2000

**Academic Standards**

**Text**
- NCTE 1 Read texts to acquire new information

**Mathematics**
- Number and Operations Understand meanings of operations and how they relate to one another
The Changing U.S. Economy

Sometimes major shifts in certain growth areas can change the emphasis of the U.S. economy. The United States has experienced four major economic shifts.

During the early 1600s, the colonists bartered, or traded, goods and services. This created our service-based economy. In the 1700s, farming was a common way of life. This formed the agriculture-based economy. In the mid-1850s, the Industrial Revolution enabled the advent of big machines for producing goods. This started the industry-based economy. The 1900s saw the rapid movement of information, with the invention of the computer. This created the information-based economy. Computers have transformed the ways that goods and services are produced, delivered, and sold.

While we live in the information age, we also still rely upon aspects of the other types of economies. Agriculture, industry, services, and information all contribute to the health of the U.S. economy.

Net or Newspapers?

No matter what is introduced into the media ecosystem, the oldest of the Big Media survives. Despite decades of doomsayers, newspapers prospered through radio, through TV and cable, through video games, through the Internet...

Not so fast. Suddenly, even sober Wall Street analysts think something new is afoot.

What looms now “is different from all other threats,” says Lauren Rich Fine, a Merrill Lynch & Co. analyst who has covered the industry since the 1980s. Consumers are shifting decisively to online information, says Fine, especially the young, and are no longer yoked to the local newspaper. “Ads are following the eyeballs to where they make transactional decisions.” Fine recently forecast that newspapers’ profit margins are set to enter a long period of decline.

The new and troubling reality for newspapers is that, even if they excel as purveyors of information to appreciative audiences, they still face tough business terrain. “They can try to be the destination where you go online and [can] be really successful with citizen journalism and blogs,” says Fine. But such innovations are “not going to pay a lot of bills.”

CASE STUDY Go to the Introduction to Business Online Learning Center through glencoe.com for the BusinessWeek Reader Case Study.

Active Learning

Newspapers have had to compete as sources of information for a long time. Radio, TV, cable, and the Internet all provide news coverage. Each provides it differently, however, to take the most advantage possible of the distinct features of its medium. Research the same story on TV news, in a newspaper, and on the Internet. How are the presentations similar? How are they different?
Measuring Economic Activity

Baseball fans know that batting averages, strikeouts, RBIs, and ERAs are figures used to measure a player’s performance. Figures are also used to measure economic performance. These figures are called economic indicators. They measure things such as how much a country is producing, whether its economy is growing, and how it compares to other countries.

Gross Domestic Product

One way of telling how well an economy is performing is to measure how many goods and services it produces. The total value of the goods and services produced in a country in a given year is called its gross domestic product (GDP). GDP is one of the most important indicators of the status of an economy. To calculate the GDP, economists compute the sum of goods and services sold to businesses, consumers, the government, and other countries. The United States has a very high GDP compared to other countries.

Standard of Living

Another important measure of a country’s economic health is its standard of living. The standard of living is the level of material comfort as measured by the goods and services that are available. The more goods and services produced per person, the higher the standard of living.

The United States has a high standard of living largely because of its productive workforce. The standard of living refers to the amount of goods and services people can buy with the money they have. In the free-enterprise system, the wealth created by businesses benefits the entire community because businesses pay taxes and provide jobs.

Environmental Awareness

N Critical Reading Life is full of important decisions. Think about the kinds of decisions that you make as you read the question below.

You are a purchasing agent for a large furniture manufacturer. You have received several bids from lumber companies for a supply of teak, a very dense and decay-resistant type of wood. The lowest bid comes from a lumber company that has been known for not placing a strong emphasis on local environmental concerns, especially resource depletion, when it cuts down trees.

N Decision Making How does the lumber company’s reputation affect your decision? Explain your answer.
Unemployment Rate

The unemployment rate measures the number of people who are able and willing to work but cannot find work during a given period. Changes in the unemployment rate show whether an economy is picking up or slowing down.

Identify What does the unemployment rate measure?

Rate of Inflation

Another important measure of economic strength is the rate of inflation. Inflation is a general increase in the price of goods and services. With inflation, one’s buying power decreases because it costs more to buy goods and services.

Inflation has many causes. It can occur after a war because scarce resources were transferred to the war effort. Inflation can be caused by increases in the costs of raw materials, expenses, and salaries. Inflation can also occur when the government allows too much money to circulate in the economy.

When the supply of goods is greater than demand, deflation can result. Deflation is a general decrease in the price of goods and services. When an economy produces more goods than people want, sellers have to lower prices and cut production. As a result, people have less money to buy goods, so the demand continues to go down.

Worker Shortage

In recent years, Japan has found that it does not have enough workers. Corporations have had to react by retaining their skilled laborers. Toyota Motor Corporation is preparing for a shrinking workforce by offering one-year contracts to top employees who turn 60. Japan’s largest untapped source is its women. What steps do you think Japan might take to ease its current labor shortage?
National Debt

Countries can run up large debts. The main source of income for a government is taxes. Governments use tax money to pay for programs such as defense, education, and Social Security. When the government spends more on programs than it collects in taxes, the difference in the amount is called a budget deficit. To pay for the difference, governments borrow money from the public, banks, and even other countries. The total amount of money a government owes is its national debt. If the debt gets too large, a nation can become dependent on other nations or unable to borrow more money. This is the case in many developing nations.

Sometimes, a government’s revenue can exceed its expenditures. When a government’s revenue exceeds its expenditures during a one-year period, it has a budget surplus. The United States experienced several years of budget surpluses in the late 1990s. The government often uses a surplus to cut taxes, reduce the national debt, or increase spending for certain programs.

Section 3.1

Review Key Concepts
1. When did the service-based economy begin?
2. What do economic indicators measure?
3. What is the difference between a budget surplus and a budget deficit?

Academic Skills
4. Mathematics Suppose a recent study shows the U.S. Gross Domestic Product (GDP) is $11.5 trillion. The study also shows that personal spending accounts for 70.4 percent of the total GDP. How much is personal spending in dollars?

Number and Operations: Percents
A percent is a ratio comparing a number to 100. It can also be represented as a fraction, with 100 as the denominator. To find a decimal equivalent, divide the percent by 100. Multiply that decimal by the total amount to determine the dollar amount that it represents.

Go to the Introduction to Business Online Learning Center through glencoe.com to check your answers.
The Business Cycle

Read to Learn
• Describe the four stages of the business cycle.
• Explain how individuals and government influence the economy.

The Main Idea
In a market economy, there is an economic cycle, which includes four stages: prosperity, recession, depression, and recovery. These are also the four stages of the business cycle. In the last few decades, we have experienced the economic cycle a number of times.

Key Concept
• Guiding the Economy
• Four Stages of the Business Cycle

Vocabulary
Key Terms
business cycle
prosperity
recession
depression
recovery

Academic Vocabulary
You will find these words in your reading and on your tests. Make sure you know their meanings.
enormous
purchase
policy
decline

Graphic Organizer
On a figure like the one below, label each of the four boxes with the appropriate stage of the business cycle.

Economic Growth

Time

Academic Standards

English Language Arts
NCTE 1 Read texts to acquire new information
NCTE 4 Use written language to communicate effectively
NCTE 3 Apply strategies to interpret texts

Science
Content Standard A Students should develop abilities necessary to do scientific inquiry, understandings about scientific inquiry
Content Standard F Students should develop understanding of population growth, science and technology in local, national, and global challenges

Go to the Introduction to Business Online Learning Center through glencoe.com for a printable graphic organizer.
Guiding the Economy

The U.S. economy is shaped by a mix of public and private forces. Individuals have an enormous role on the market for goods and services. Congress and the President enact laws that impact fiscal policy. Whenever tax money is spent, it has an effect on the economy. These expenditures are often planned to guide the economy. The Federal Reserve, informally called “the Fed,” is a government agency that guides the economy by regulating the amount of money in circulation, controlling interest rates, and controlling the amount of money loaned. State and local governments may also take steps to influence their local economies.

Four Stages of the Business Cycle

Economies go through ups and downs. This can happen for many reasons, including wars, foreign competition, changes in technology, and changes in consumer wants. Over long periods of time, these changes form patterns. For example, the U.S. economy went through slumps in the 1930s, the 1950s, the 1970s, and the early part of 2000. These slumps in economic activity with increased unemployment were followed by new waves of increased productivity and rises in GDP. The rise and fall of economic activity over time is called the business cycle. There are four stages of the business cycle—prosperity, recession, depression, and recovery. Figure 3.1 illustrates the business cycle.

In a global economy, one country’s economy can affect other trading partners. If a nation is in a period of economic expansion, it may purchase goods and services from other countries, promoting expansion in those countries.

Identify What are the four stages of the business cycle?
Prosperity

When an economy enjoys prosperity, there is a greater demand for goods. What new technologies were developed in the last few decades as a result of good economic conditions?

Prosperity

When unemployment is low, production of goods and services is high, new businesses open, and there is prosperity. Prosperity is a peak of economic activity. This condition spreads throughout the economy. Wages are usually higher, so workers have more income. There is a greater demand for goods to be produced. More people can buy houses, which creates more work for builders. People also want to buy more goods from other countries, which benefits those countries as well.

Recession

During a recession, economic activity slows down. Businesses produce less, so they need fewer workers. As the unemployment rate increases, people have less money to spend. Without a steady source of income, unemployed workers consume fewer goods and services. The general drop in the total production of goods and services makes GDP decline.

In a recession there are downturns in many industries. A downturn in one industry can affect others. For example, a recession in the auto-making industry can lead to a recession in businesses that make parts for cars. When this happens, it is called the ripple effect. Because of the ripple effect, downturns in major industries can bring on a recession.

Science/Tech TRENDS

Jobs in Your Future

Job opportunities result from the relationships between the population, the labor force, and the demand for goods and services. Population changes influence the demand for goods and services. When the population changes, the size and makeup of the labor force change as well.

The Bureau of Labor Statistics recently released a report stating that nearly all of the 20 fastest growing occupations between now and 2014 are related to health care or computers. These occupations include home health aides, network systems specialists, and data communications analysts. During the same period, retail salespeople and registered nurses are expected to gain the most new jobs—more than 700,000 each.

WebQuest

Go to the Introduction to Business Online Learning Center through glencoe.com for links to Web sites where you can research population trends between now and 10 years from now. Make some predictions about how the demand for goods and services will change over the next 10 years.
Depression

During a depression there is high unemployment and low production of goods and services. A depression is a deep recession that affects the entire economy and lasts for several years. It can be limited to one country but usually spreads to related countries. During a depression, many people are out of work, and fewer goods and services are produced. There is also a lot of unused manufacturing facilities. Fortunately, depressions are rare.

The stock market crash on October 29, 1929, or “Black Tuesday,” marked the beginning of the Great Depression. Between 1929 and 1933, GDP fell from approximately $103 billion to $55 billion—a decline of nearly 50 percent. At the same time, the number of people out of work rose nearly 800 percent—from 1.6 million to 12.8 million. During the worst years of the Depression, one out of every four workers was jobless. Even workers who had jobs suffered. The average manufacturing wage, which had reached 55 cents an hour by 1929, plunged to five cents an hour by 1933.

Many banks across the country failed. The FDIC did not exist at the time, so depositors were not protected. To prevent panic withdrawals, the federal government declared a “bank holiday” in March 1933. Every bank in the country closed for several days, and many never reopened. The money supply fell by one-third. Currency was in such short supply that towns, counties, chambers of commerce, and other civic bodies resorted to printing their own money.
Recovery

During a recovery, production starts to increase. A recovery is a rise in business activity after a recession or depression. People start going back to work and have money to purchase goods and services. The new demand for goods and services stimulates more production, and the GDP grows. Recovery leads back to prosperity as new businesses open and existing businesses increase productivity.

A recovery can take a long time or it can happen quickly. In 1939, the United States was only beginning to recover from the depression when World War II began. During the war, the United States recovered much faster because of the demand for war production.

During a recovery, some businesses innovate—meaning that they bring out new goods and services. These innovations can be different from what the businesses previously produced. They could also be different from what their competitors make. If the innovation is popular with consumers, sales increase dramatically, per unit costs decrease, and profitability increases. Businesses grow and economic activity soars.

Section 3.2

Review Key Concepts
1. What is the stage that follows a recession or depression?
2. What is the difference between a recession and a depression?
3. Why may innovation play an important role in the recovery stage of the business cycle?

Academic Skills
4. English Language Arts The business cycle is often described using terms that describe how large bodies of water behave. Two of those terms are ebb and flow and ripple effect. Write a few sentences about each of these terms. Explain what they mean and why they are good metaphors for different aspects of the business cycle.
5. English Language Arts The words listed below are all synonyms, or closely related in meaning. They all can be used to describe negative movement in the business cycle. Notice that some of the words imply a more serious fall in the economy than others. Rewrite the list so that the words are, in your best judgment, ordered from least serious to most serious. Then write a few sentences explaining why you ordered the words as you did.

recession  slump  depression
decline  downturn

Go to the Introduction to Business Online Learning Center through glencoe.com to check your answers.
## Section 3.1 Summary

**U.S. Economic History** Throughout the years, our economic system has evolved and changed. In colonial times, the United States had begun its service-based economy. The 1700s saw the rise of the agriculture-based economy. The Industrial Revolution in the 1850s brought about the industrial economy, characterized by the large-scale manufacturing of goods. During the latter part of the 20th century, the information technology economy revolutionized the business world. To measure the health of our economic system, we use a variety of economic indicators, including GDP, unemployment rate, rate of inflation, and national debt.

## Section 3.2 Summary

**The Business Cycle** In a global economy, one country’s economy can affect the economy of its other trading partners. The Fed adjusts monetary policies to try to level out the ups and downs of the economy. An economic cycle includes four stages: prosperity, recession, depression, and recovery. Prosperity is the peak of economic activity. Recession is a slowdown in economic activity. Depression is a deep recession that affects the entire economy and lasts for several years. A recovery is a rise in business activity after a recession or depression. Fortunately, the United States has not had a depression since the 1930s.

### Vocabulary Review

1. On a sheet of paper, use each of these key terms and academic vocabulary terms in a sentence.

#### Key Terms
- gross domestic product (GDP)
- standard of living
- inflation
- deflation
- budget deficit
- national debt

#### Academic Vocabulary
- shifts
- emphasis
- sum
- period
- enormous
- policy
- purchase
- decline

### Review Key Concepts

2. Describe the four types of economic shifts the United States has experienced.
3. Describe what is shown by GDP, unemployment rate, rate of inflation, and national debt.
4. Explain how individuals and the government influences the economy.
5. Describe the four stages of the business cycle.
Critical Thinking

6. Would the cars made in this country by a foreign-owned company be included in GDP? Why or why not?

7. Which would be included in GDP: babysitting at home or working at a day-care center?

8. Why are people who are unemployed but not looking for work not included in the unemployment figures?

9. Why is inflation especially difficult for retired people?

10. Why might deflation be a bad thing?

11. Suppose you go to a store to buy a soda but notice the price is 20 cents higher than it was last week. Other prices are unchanged. Is this an example of inflation? Why or why not?

12. In which stage or stages of the business cycle would there be more personal bankruptcies? More business formations?

13. Explain why the standard of living is higher in the United States than in many other countries.

14. Many economists believe that some unemployment is necessary because many of the unemployed are between jobs. Write an essay explaining why this might be true.

15. To pay for expenses, the federal government issues bonds. Many of these bonds are bought by foreign countries. Write a paragraph indicating whether you think this is good or bad for America.

16. Write a letter to your school counselor that explains how understanding the unemployment rate can be beneficial to you as you look for a job.

17. Assume the current inflation rate is 3 percent. Write an e-mail to your teacher explaining how that might help you decide where to put your savings.

18. Write a summary of the pros and cons of your starting a new business in the prosperous stage of the business cycle.

19. The unemployment rate in your community has increased considerably because of the closure of two firms. Write a letter to the editor of the newspaper explaining what steps you might take in your business as a result.

Technology Applications

Web Pages

20. You want to do business on the Internet. You know what kind of business you want to open. Use the Internet to research several businesses that might be considered your competition. Write a report that evaluates their Web sites. Print pages from each Web site and include them in your report.

Business Ethics

Dealing with Ethical Systems

21. You are the president of a biotechnology company that produces vaccines. A foreign government has asked to buy a vaccine to help stop a deadly infectious disease, but the negotiator expects a bribe. Should you look the other way so that you can get the vaccine to people who need it?
Chapter 3 Review and Activities

**English Language Arts**

22. Major novelists of the 1920s, a time of prosperity in the United States, and the 1930s, the time of the Great Depression, include John Steinbeck, William Faulkner, F. Scott Fitzgerald, Ernest Hemingway, and John Dos Passos. Find out more about their work and the work of other writers of the period. Make a bibliography of novels that portray everyday life during the 1920s and 1930s. Choose one to read and write a review of it to share with your classmates.

24. The words Internet, interdependent, and international have the same prefix. Write a sentence in your own words telling what the prefix is and what it means. Give examples of other words that use the same prefix, and write sentences using them. Do the same for productivity and prosperity. Then check your work by looking in a dictionary or other resource.

**Mathematics**

23. The Agriculture sector of the U.S. economy produces \( \frac{1}{5} \) of the GDP while the Industry sector produces 18 percent. The rest is produced by the Service sector. What percent of GDP is contributed by the service sector?

25. Find unemployment statistics for the years 1933, 1944, 1955, 1966, 1977, 1988, 1999, and the most recent year for which statistics are available. Present the information in a bar graph. Write a few sentences discussing the reasons for the differences shown in the graph.

**Active Learning**

26. During a two-week period, read the newspaper or watch the national news on television. Pick out three articles or report on three sequences of television news programming that relate to one of the topics discussed in this chapter, such as unemployment, inflation, deflation, and national debt. Write a report or give an oral presentation to the class on your findings.

**Business in the Real World**

27. Identify a businessperson in your community who has been in business for several years and experienced a number of business cycles. Interview the business owner to find out how his or her company performed during periods of recession and periods of prosperity. Then write a report summarizing the business owner's responses.
**Real LIFE skills**

**ASSESSING YOUR SKILLS**
28. These skills are needed by all employees: creative thinking, decision making, and problem solving. Give an example of how you have implemented each skill in the last month. Then indicate which skills you believe you are fairly good at doing. Recommend how you can become better at doing the skill or skills in which you need work.

**COOL Business CAREERS**

**FIND YOUR DREAM JOB**
29. Go to the *Introduction to Business* Online Learning Center through glencoe.com for a link to the Occupational Outlook Handbook Web site. Click on the “OOH Search/A-Z Index” link and enter the job title “economist.” Then write a one-page report about this type of occupation. Conclude your report with a list of things you could do now to prepare yourself to pursue the occupation.

**ANALYZING ECONOMIC INDICATORS**
30. **Situation** You are an intern for a federal bureau that collects and analyzes economic data. You have been asked to research recent economic indicators.

**Activity** Choose a sector of the economy to measure how well the economy is doing. Give a presentation to the bureau’s economists. Sectors include housing construction, gross domestic product, and retail and food services.

**Evaluation** You will be evaluated on how well you meet the following performance indicators:
- Research an economic sector.
- Interpret economic data.
- Answer questions about your findings.
- Present clear and relevant information.
- Project your voice, and use correct grammar and English.

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**Standardized Test Practice**

**Directions** Read the paragraph and answer the question that follows. Write the letter for the answer on a separate piece of paper.

Some reasons for unemployment represent more of a problem for the economy than others. For example, recently graduated students and those who are voluntarily looking for a new job are only temporarily unemployed. Some workers are seasonal workers and only unemployed during part of the year. However, those workers who have lost their jobs because the economy has slowed down may be out of work until the economy recovers.

1. Which best describes the way the paragraph is organized?
   A. sequence of events
   B. comparison
   C. statement and example
   D. cause and effect

**TEST-TAKING TIP** When studying from a textbook, read the chapter summaries. They usually do a good job at summarizing important points.

**READING** Go to the *Introduction to Business* Online Learning Center through glencoe.com for a list of outside reading suggestions.