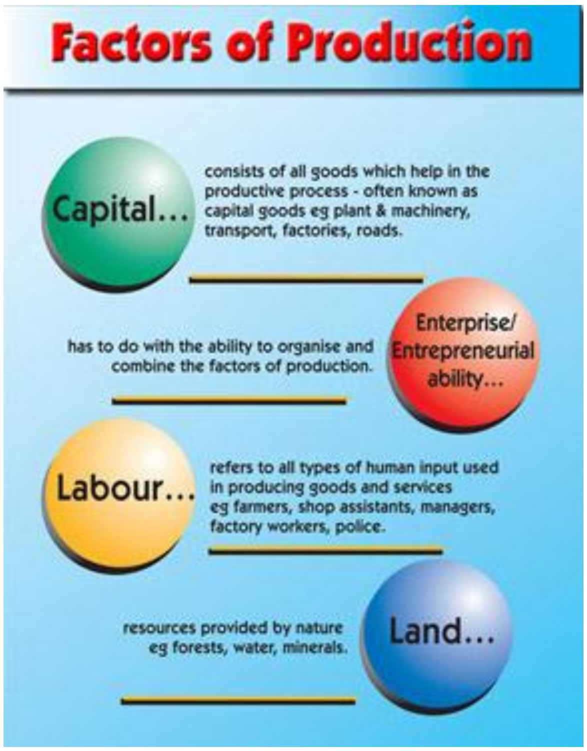
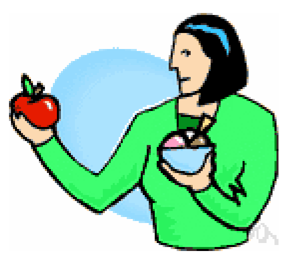
Economics
Review Guide

Chapter 1 – The Basics

A.) Factors of Production (C.E.L.L.)



Trade-Off – giving up on thing in order to obtain another.

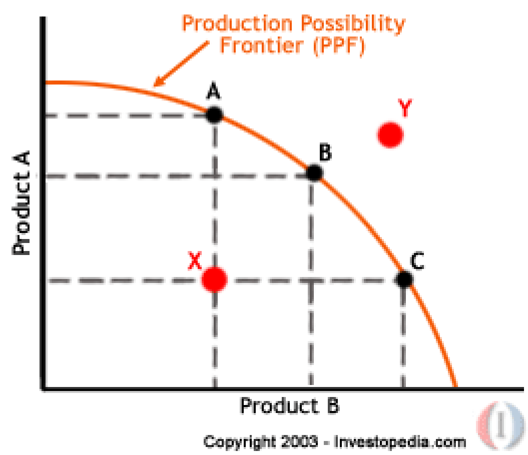


Opportunity Cost – the value/worth of what is given up when a decision is made.

B.) Scarcity v. Shortages

Scarcity	Shortages
• **ALWAYS** Occurs • Finite amount of resources makes **all good & services** technically scarce! • Even if the shelf is full of product the good is still **scarce**!	• **Temporarily** Occurs • Events in the marketplace cause the good/service to be unavailable • Shortages often end when the problem in the market is fixed.

C.) Production Possibility Graph – a tool used to help firms understand the different levels of production available. It is used to help *determine the opportunity cost* due to a change of production.



Underutilization - Any point **inside (X)** of the Production Possibility Frontier. Efficiency is not being achieved!

Future Production – any point that lies **outside (Y)** of the PPF. This production is only possible with additional Factors of Production.

*As the production of **Product A** goes down, the production of **Product B** increases!*

*The exact number of **Product A** goods given up to make more **Product B** goods is the **Opportunity Cost!***

Durable Goods – goods that do not quickly wear out and are able to be used for an extended time.

Nondurable Goods – goods that quickly wear out and need to be replaced often.

D.) Thinking at the Margin – making decisions based on what will an additional amount result in.

Ex -> deciding to invite one more friend, have one more drink, eat one more chicken wing…

Chapter 2 – Economic Systems

A.) Three Economic Questions – the basic questions a society must answer when using scarce resources.

B.) Economic Systems – is a system for producing, distributing and consuming goods and services. Each nation has its own unique economic system depending on the **economic goals.**

Economic Goals	
Economic efficiency	Making the most of resources
Economic freedom	Freedom from government intervention in the production and distribution of goods and services
Economic security and predictability	Assurance that goods and services will be available, payments will be made on time, and a safety net will protect individuals in times of economic disaster
Economic equity	Fair distribution of wealth
Economic growth and innovation	Innovation leads to economic growth, and economic growth leads to a higher standard of living.
Other goals	Societies pursue additional goals, such as environmental protection.

Free-Market/Capitalism

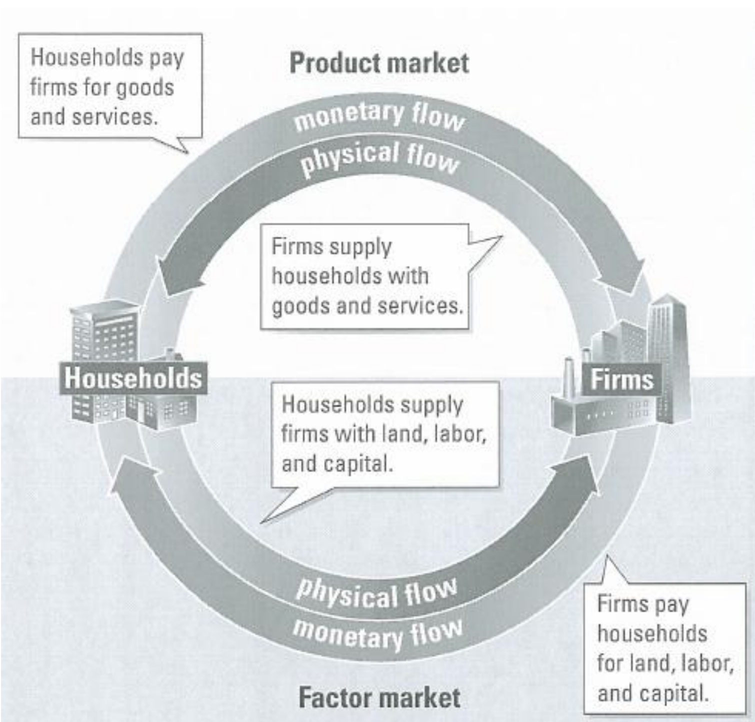
Socialism/Communism

C.) Quick Comparison of 3 Basic Eco Systems

Traditional	Capitalist	Command/Centrally Planned
- Agricultural based - **Communal ownership** of the factors of production. - Small population size - **Self-sufficient** - **Barter** System - Habit, custom and ritual answer the 3 economic questions.	- Industrial based - **Private ownership** of the factors of production. - Global population size - Intradependent - Global **markets** - **Self Interest & Competition** - Supply & Demand answer the 3 economic questions.	- Industrial/Agricultural based - **Gov't ownership** of the factors of production. - Nation state population size - Some global trade, mainly with other command economies. - **Rationing** - Government planning answers the 3 economic questions.

Markets – an environment that brings buyers and sellers together.

D.) The Free Market System



In a free market economy, economic decisions are based on exchange, or trade. Households supply land, labor, and capital to firms in exchange for payment. Firms supply households with goods and services in exchange for payment.

Markets – Environments that bring buyers and sellers together!

Private Sector – private citizens and businesses spending in the economy.

Public Sector – government spending in the economy.

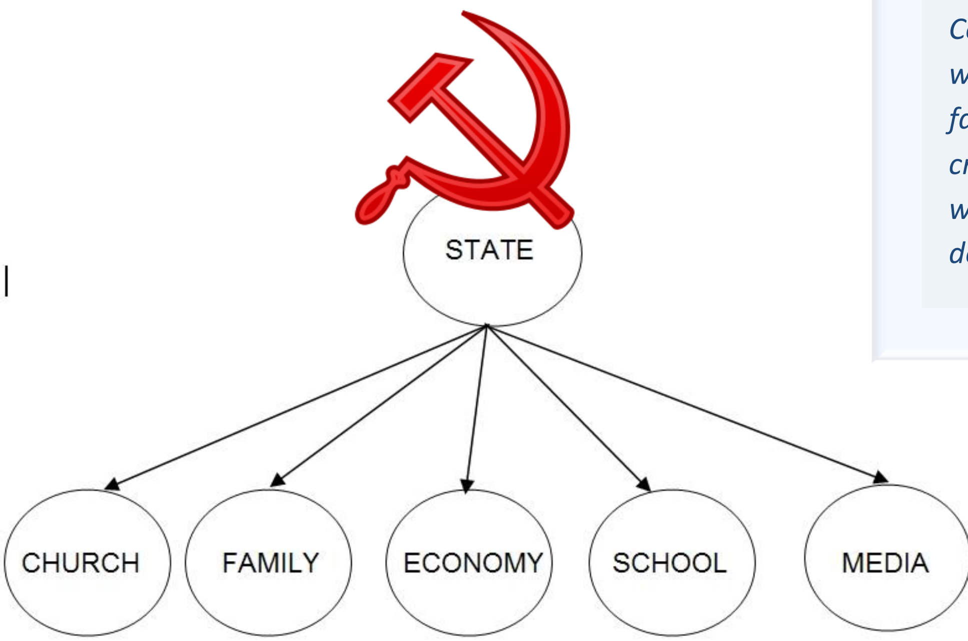
E.) Centrally Planned Economies

In a centrally planned economy, the government owns land and capital and controls labor. Government planners allocate resources to producers and specify what will be produced.

Socialism – the belief that the government through public policy can redistribute resources to help those who need economic assistance.

Communism – the belief that violent revolution led by the working class is needed to redistribute resources and eliminate the capitalist class and their control over the government & economy.
- Karl Marx & Friedrich Engels

Communists believe that workers control of the factors of production will create a classless society where class warfare does not exist!

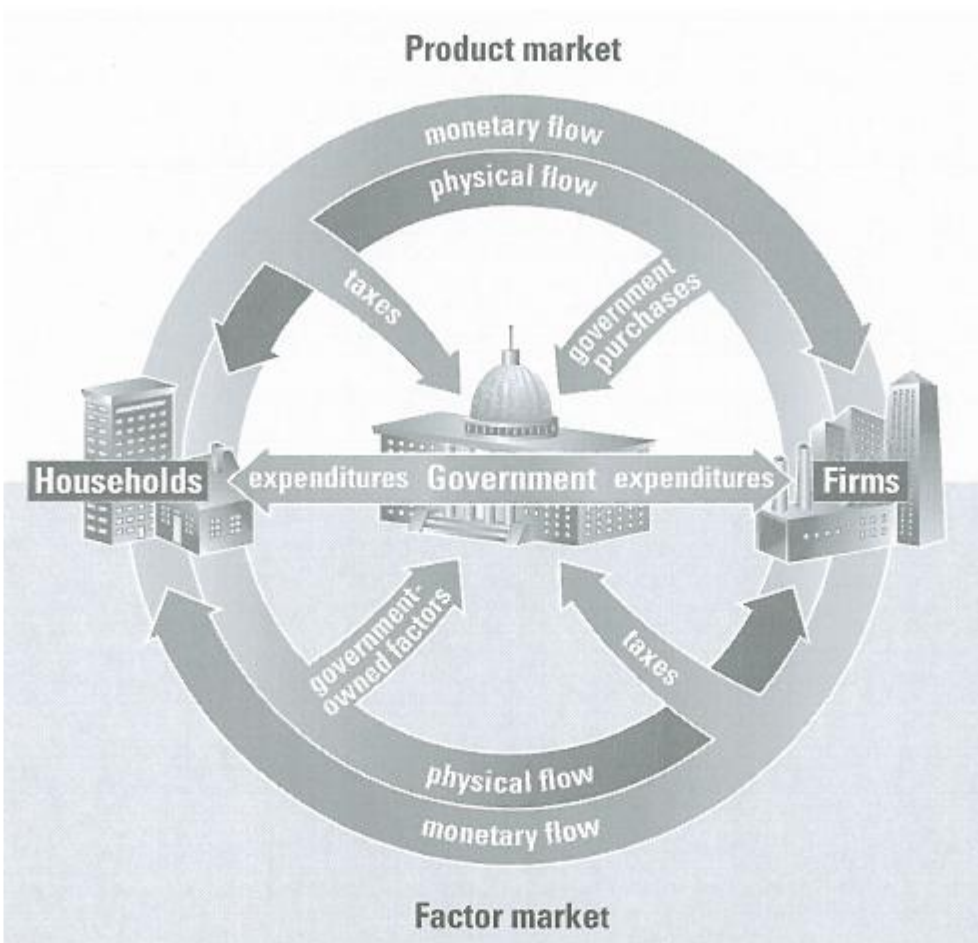


F.) Modern Economies

- No one economic system has all the answers!
- No one economic system is exactly alike.
- No one economic system is purely free-market or controlled by the government.

Mixed Economy – an economic system that has features of Capitalism and Centrally Planned within it.

All free-market economies have some sort of government regulation or involvement

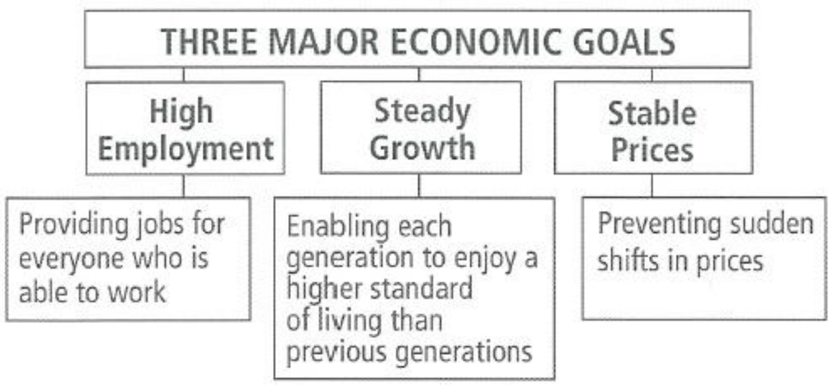


Chapter 3 – American Free Market System

A.) Characteristics of America's Free Market

B.) Government Role

- Since the beginning of the Great Depression, the Federal Government has assumed responsibility to make sure the economy continues to run smoothly.
- Government has authority to tax and to regulate industries whose good and services impact the public good.



C.) Measuring Economic Productivity

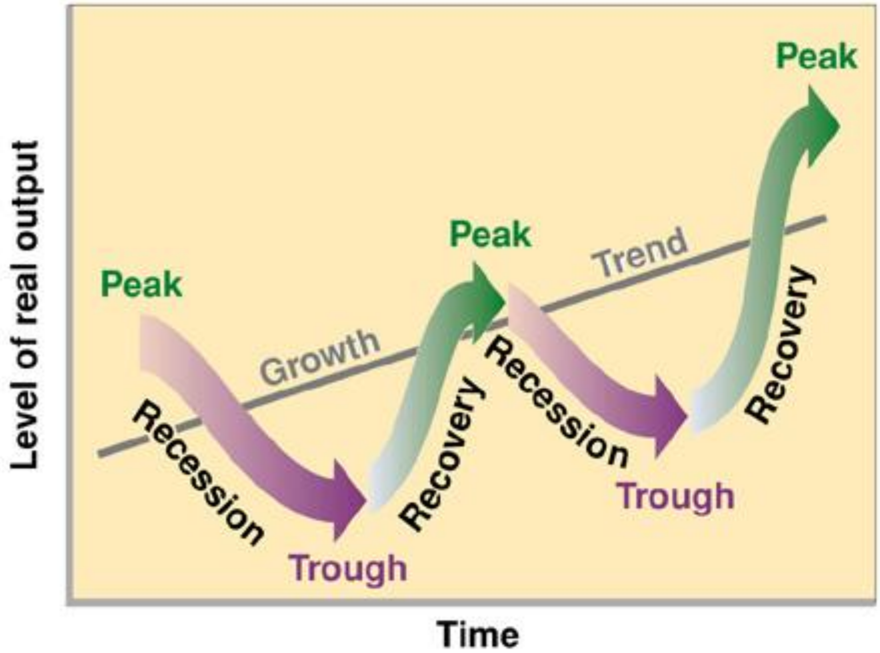
- In order to understand how the economy is doing, economists study 2 areas of economics.
  Microeconomics – the study of the behavior and decision making of small unit within an economy.
  Macroeconomics – the study of the behavior of and decision making of entire economies.

D.) Gross Domestic Product

- Is the total value of all final good and services produced within a country within a year.
- The **GDP** is used to determine if a nation's economy is growing or shrinking.
- Technological breakthroughs have helped to promote the growth of the US economy.

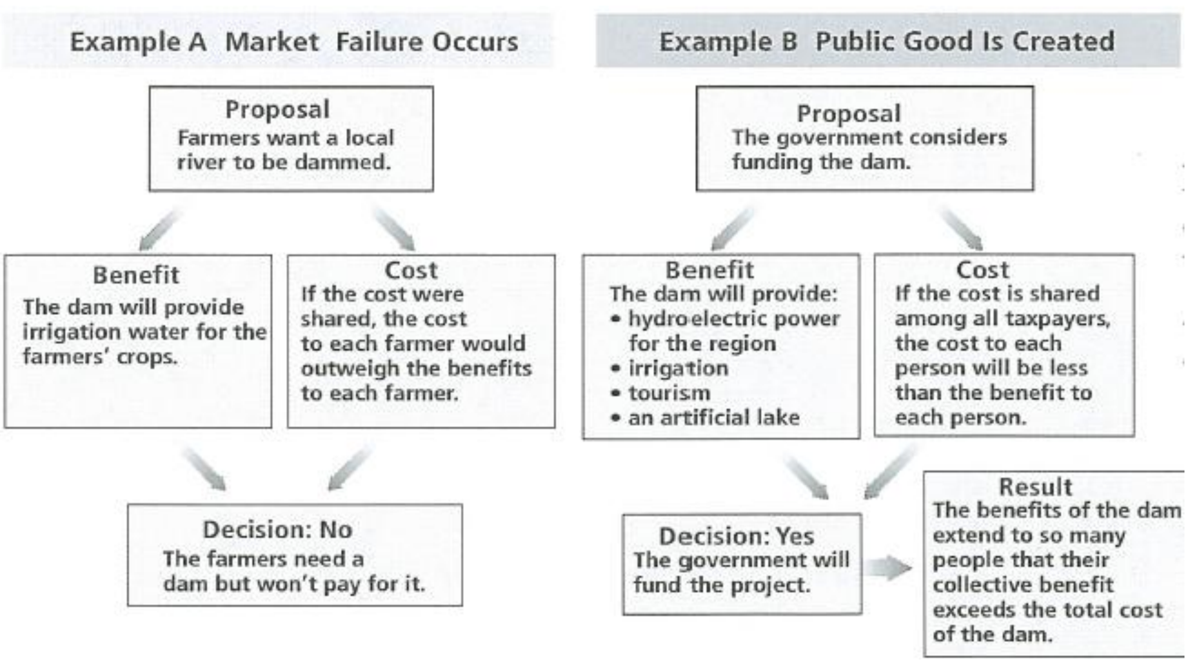
E.) Business Cycle - Periods of macroeconomic growth followed by period of macroeconomic decline.

Recession – a period of macroeconomic decline **Depression** – an extended recession that lasts years within an economy.



F.) Public Goods

Public Good – a shared good or service that is paid for through taxes.
EX → schools, police & fire departments, military, public parks, highways, roads, dams, etc.



G.) Externalities

Externality – economic side effect of a good or service, the government encourages the creation of positive externalities and works to limit the creation of negative ones.

Externalities

A small town is allowing its first chain store—a gigantic grocery store—to establish a business. The company purchased a burnt-out section of old stores and is building there. It has agreed with the town to widen and repave the narrow, pothole-ridden street out front as it completes construction.

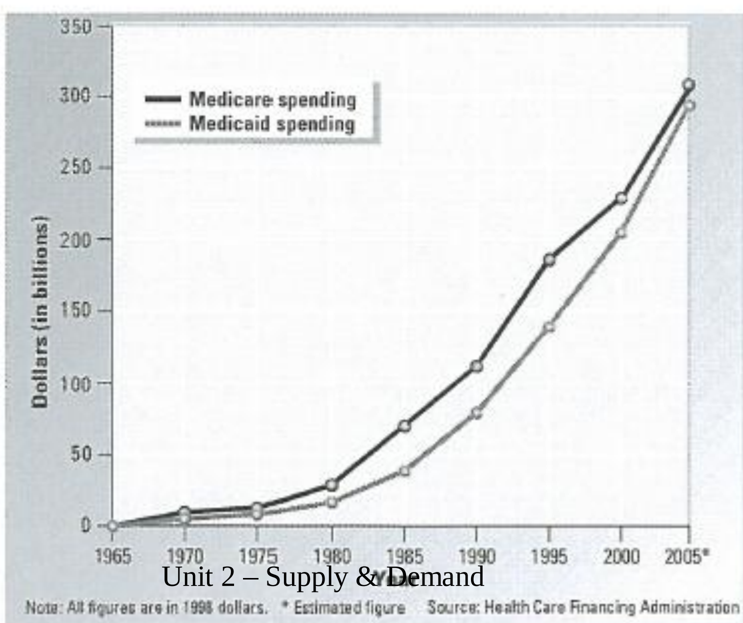
Super Grocery Store	
Positive Externalities	**Negative Externalities**
Replacement of ruined buildings beautifies neighborhood	Historic buildings are torn down rather than restored
Improved street	More traffic, along with the noise and pollution it brings
Increased job opportunities for the community	Small family-run stores may be put out of business

F.) Safety Nets – government programs created to assist people struggling economically.

Poverty Threshold – an income level that which is below needed to support a family. If a family is considered under the “poverty line” they can receive **welfare** i.e. safety nets.

Cash Transfers	Direct cash payments to the poor/needy. (SSI & Unemployment)
In-Kind Benefits	EBT Food stamps, subsidized housing & legal aid
Medical Insurance	Medicaid & Medicare – **THE MOST EXPENSIVE OF THE THREE!**

GRAPHIC SUMMARY: *Spending on Two Government Programs*



Chapter 4 – Demand

A.) The Basics

Demand – the desire for a good and the ability to pay for it.

Law of Demand – as prices fall, consumer demand will increase and vice versa.

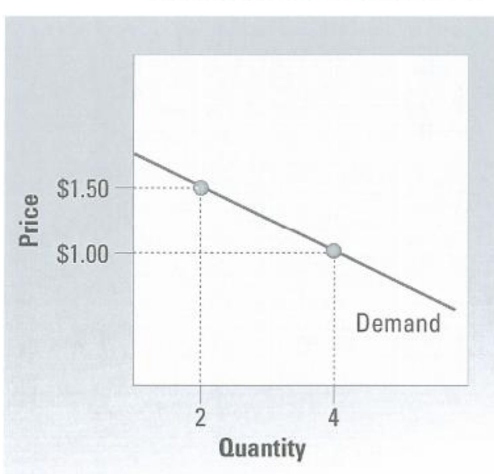
Substitution Effect – as the price of a good rises, consumers are more likely to substitute a good/service in its place.

Income Effect – as the income of consumer changes, so does their demand for goods.
Normal Goods – goods that consumers will demand more of when then income increases
Inferior Goods – goods that consumers will demand less of when their income increases.
Complementary Goods – goods whose demand rise and fall together because they are used together.

B.) Graphing Demand

- Economists and business owners use demand graphs in order to understand how their customers will react to a change of price.
- **Quantity Demanded** – is the exact amount a customer is willing to buy at a specific price
- **Market Demand** – is the exact amount the entire market demands at a specific price.

Price	Quantity Demanded
2.00	
1.00	
.50	



C.) Changes along the Demand Curve

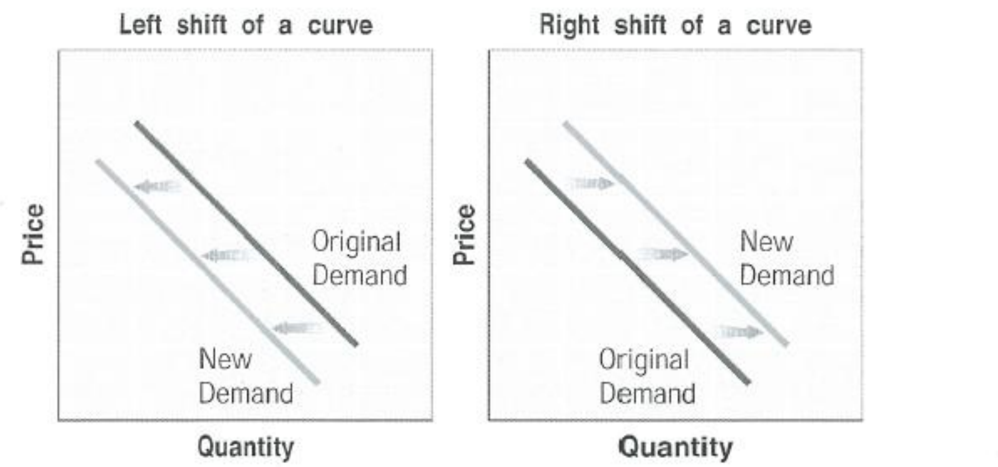
A demand curve is accurate when change in price is the only influence on demand that is taken into account. Under these circumstances, an increase in price will lead to a decrease in the quantity demanded. This effect can be shown as movement *along* the demand curve.

Ceteris Paribus – when price is the only thing that impacts demand!

D.) Shifts of the Demand Curve

- Many factors other than price impact the demand for a good/service.
- Style, brand, advertisements, expectation, recommendation, changes in income, availability of substitutes.

GRAPHIC SUMMARY: *Shifts of the Demand Curve*



An increase in demand causes more of a good to be demanded at all price levels. This shifts the demand curve to the right. A decrease in demand causes less of a good to be demanded, shifting the demand curve to the left.

E.) Elasticity

Elasticity of Demand – a term used by economists to describe how a consumer will respond to a change of price.

THE BIG IDEA

Elasticity of demand describes how people react to changes in prices.

Inelastic – goods/services that consumers will still continue to buy at about the same rate even as prices change up or down.

Elastic – goods/services consumers will buy more or less of depending on the price.

Elasticity of demand depends on a number of factors, including whether the product in question is a necessity or a luxury. This letter illustrates the elasticity of one person's demand in the face of a large price increase.

Chapter 5 – Supply

A.) The Basics

Law of Supply – as the price of a good rises, firms will produce more to make more revenue.
Revenue – the money made from selling a good or service.

- As the price of a good rises, more people are willing to open up firms and sell that product, increasing the amount of supply in the market!

B.) Graphing Supply

- Just like demand, supply can be graphed and analyzed by economists and businesses.

Higher prices lead to higher output, there for the supply curve goes **UP** from left to right!

C.) Elasticity of Supply – responds to how supplies react to a change of price in the marketplace.

- Industries that **CANNOT** quickly change their **output** have an **INELASTIC SUPPLY**
- Industries that **CAN** quickly change their output have **ELASTIC SUPPLY**

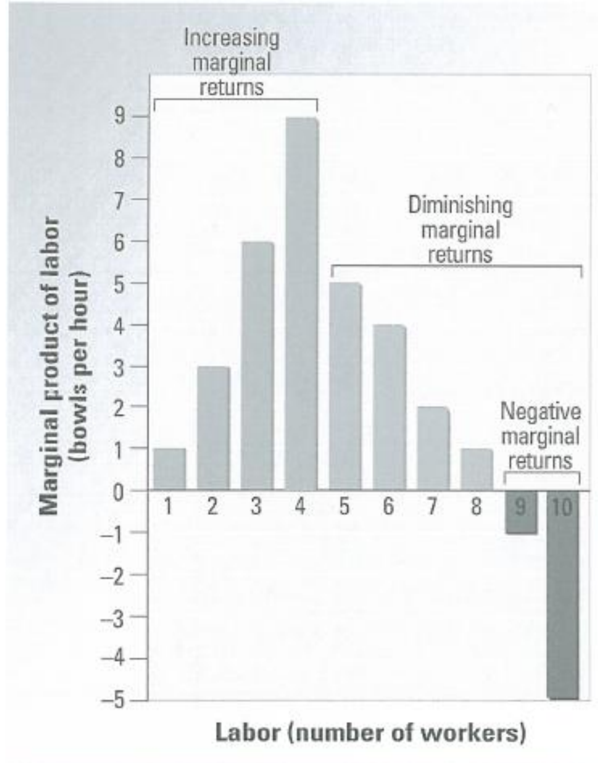
ELASTIC	INELASTIC
Barbershop	Citrus Farmer

D.) Cost of Production

Fixed Costs – cost that does not change no matter how much is produced
Ex → Rent, salary employees,
Variable Cost – cost that changes based on how much is produced
Ex → Materials , hourly wage employees
Total Cost – fixed + variable costs

E.) Change of Output

Marginal Product of Labor – the change in output that occurs from hiring one more employee



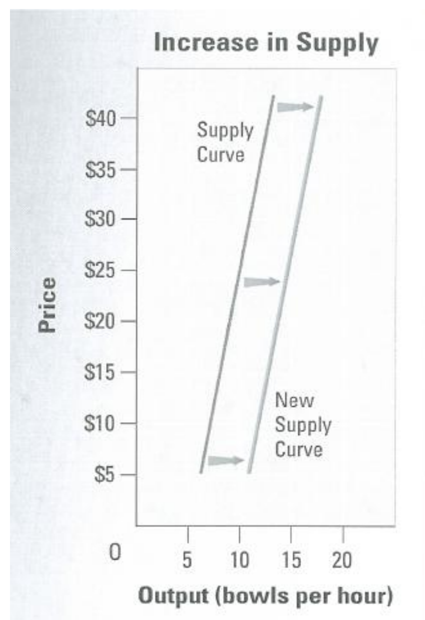
- In the beginning adding more workers will result in positive results = **increasing marginal returns**
- At some point, adding workers lowers productivity = **decreasing marginal return**
- Continuing to add workers will eventually result in a complete loss of productivity **= negative marginal returns**

F.) Changes in Supply

GRAPHIC SUMMARY: *Forces that Affect Supply*

Forces that Increase Supply	Forces that Decrease Supply
Decreases in production costs	Increases in production costs
Increase in Technology	Excise Taxes
Government subsidies	Government regulations
Expectations of future lower prices	Expectations of future higher prices
More firms entering the market	Firms leaving the market

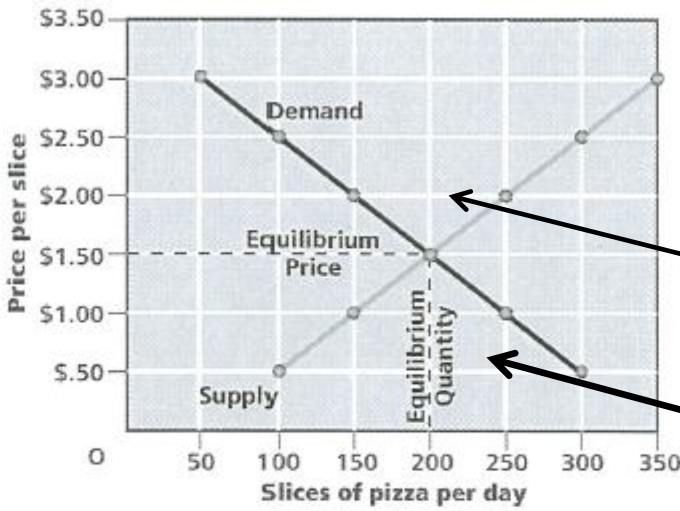
Many different forces are at work in the market place to change the supply of goods and services.



Chapter 6 – Prices

A.) Combining Supply & Demand

Equilibrium – a situation that exists in the marketplace where the quantity demand equals the quantity supplied.



Disequilibrium – a situation that exists in the market where quantity demanded does not equal quantity supplied.

Excess Supply/Surplus – when supply is greater than the demand.
- lower price to reach equilibrium!

Excess Demand/Shortage – When demand is greater that supply.
- raise prices to reach equilibrium!

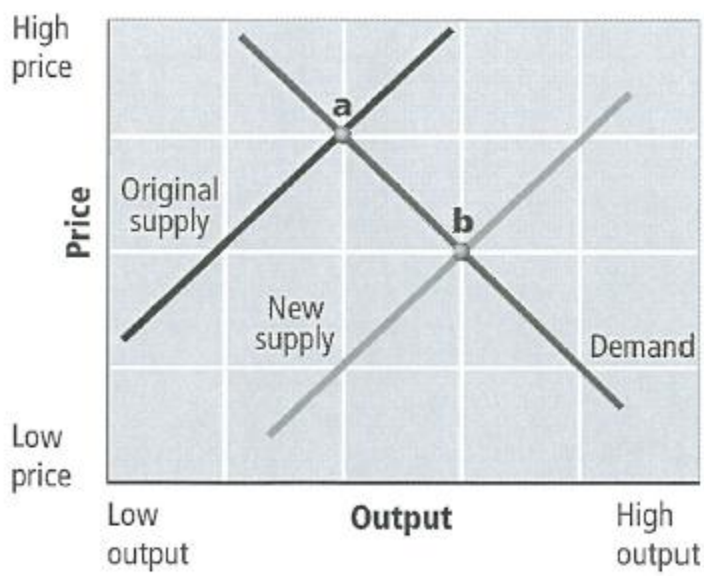
B.) Government Involvement

- Sometimes governments try to control prices in a marketplace, often times interfering with the market equilibrium.
- **Price Ceiling** – the highest price a firm can charge for a good/service.
  Some cities have Rent Control on apartments to keep them affordable for low income people.
- If the price ceiling is lower that market equilibrium, there will always be excess demand!
- **Price Floor** – the lowest price a firm can pay for a good/service.
  Minimum Wage!
- When minimum wage is higher than market equilibrium there will always be and excess supply of workers

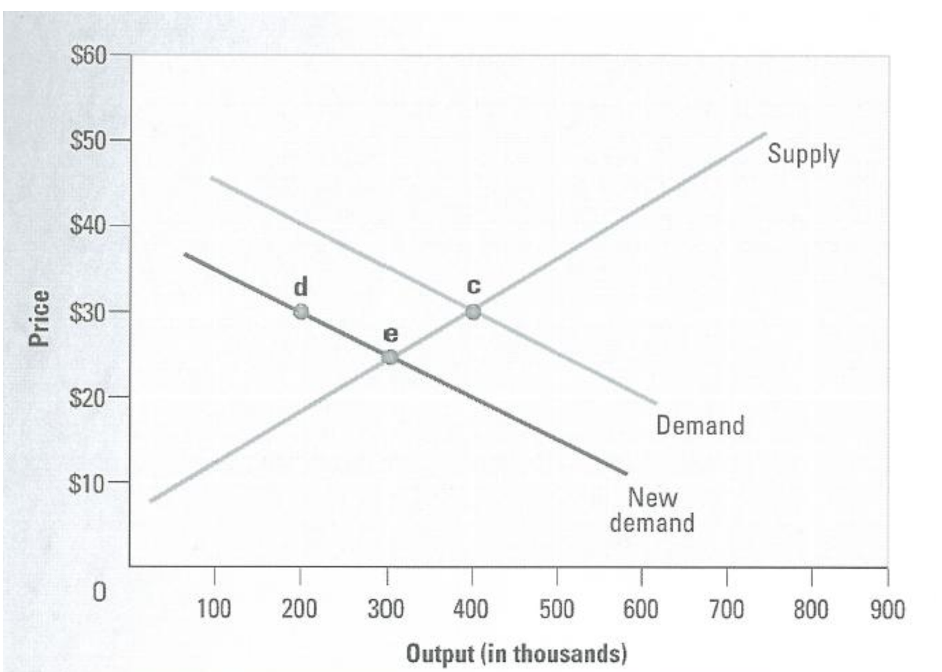
C.) Changes in Market Equilibrium

- When a shift in the **demand** or **supply** curve occurs, **new market equilibrium is created!**
- The old equilibrium point is now considered to be in disequilibrium

GRAPHIC SUMMARY: *A Shift in Supply*



Technological improvements led to a shift in the supply of CD players. On this graph the shift is represented by the curve marked *New supply*. Prices fell and quantity demanded rose, leading to a new equilibrium at point b.



D.) The Role of Prices

	PRODUCERS	CONSUMERS
High price	GREEN PRODUCE MORE	GREEN BUY LESS
Low price	RED PRODUCE LESS	RED BUY MORE

Price acts as a signal for both producers and consumers.

Supply Shock – a sudden shortage of good can lead to a dramatic increase in prices.

Rationing – a system of distributing scarce resources using criteria other than prices.

E.) The Benefit of Prices

1. Measure of value	Prices provide a standard measure of the value of goods and services.
2. Signal	Prices signal whether goods and services are in short supply or readily available. In response, suppliers—seeking profits—increase or decrease production, and consumers decrease or increase spending.
3. Flexibility	Prices can easily be increased to solve a problem of excess demand or decreased to solve a problem of excess supply.
4. Cost	A distribution system based on prices costs nothing to administer. It is effectively run by consumers and suppliers, whose millions of daily decisions set prices and production levels.
5. Choice of goods	A price-driven economy provides a wide choice of goods and services by giving consumers a way to choose among similar products.
6. Efficiency	In a price-based market system, economic resources are allocated efficiently. This means that land, labor, and capital will be used for their most valuable purposes and that resource use will adjust to the changing demands of consumers.

Chapter 7 – Market Structures

Market Structure – describes the environment that a business operates out of.

A.) Perfect Competition

THE BIG IDEA

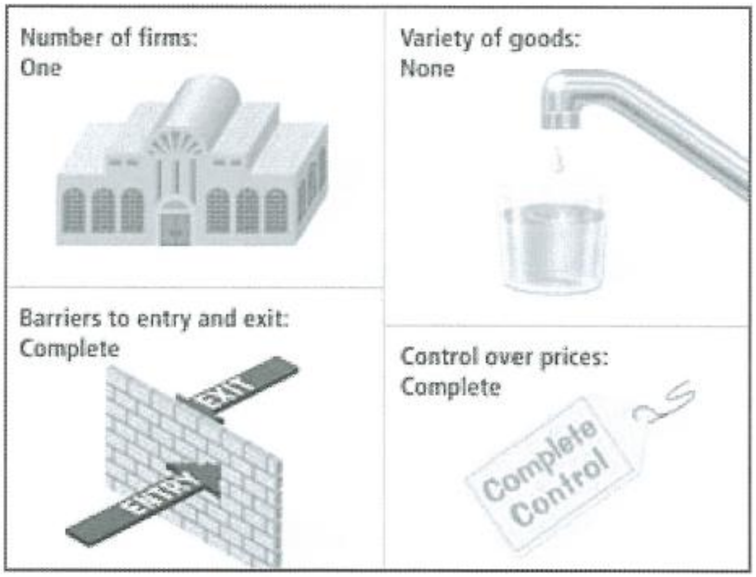
Perfect competition describes a market with many buyers and sellers of the same good.

Few businesses operate in a perfectly competitive marketplace!
Ex → stockbrokers, farmers.

Barriers to Entry

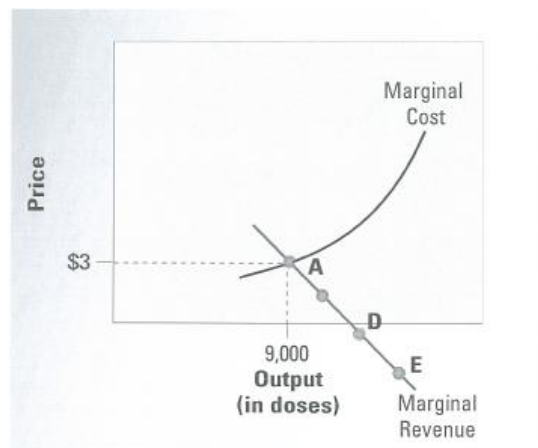
Barrier	Description	Example
Start-up costs	the expenses a firm must pay before it can begin to produce and sell goods	A florist must buy or rent a shop, refrigeration units, cash register, computer, flowers, vases, wrapping, and so on.
Technology	the process used to produce a good or service	A florist must know how to run the equipment, procure and care for flowers, arrange flowers, keep the flowers alive during delivery, efficiently market and deliver the flowers.

B.) Monopoly



Monopoly Setting Output

A monopoly will choose a volume of production that yields the highest profits. This volume has been shown to be the point where marginal revenue equals marginal cost.



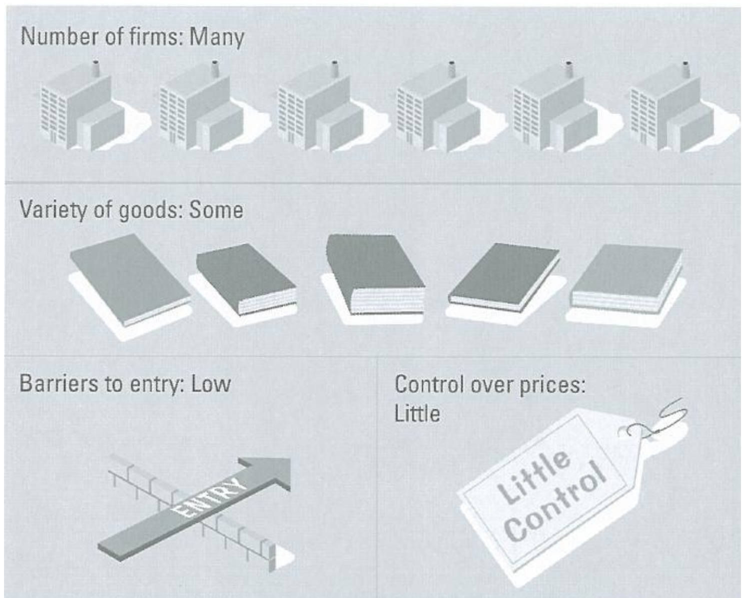
Natural Monopoly – market that runs more efficiently when one firm provides all the output
Local governments give firms the right to operate in their markets. (Time Warner, Frontier)

Patents – gives companies exclusive rights to sell a product for a specific period of time.

License – government issued right to operate a business.

C.) Monopolistic Competition

Monopolistic Competition – is a market in which businesses sell products that are similar but not identical.

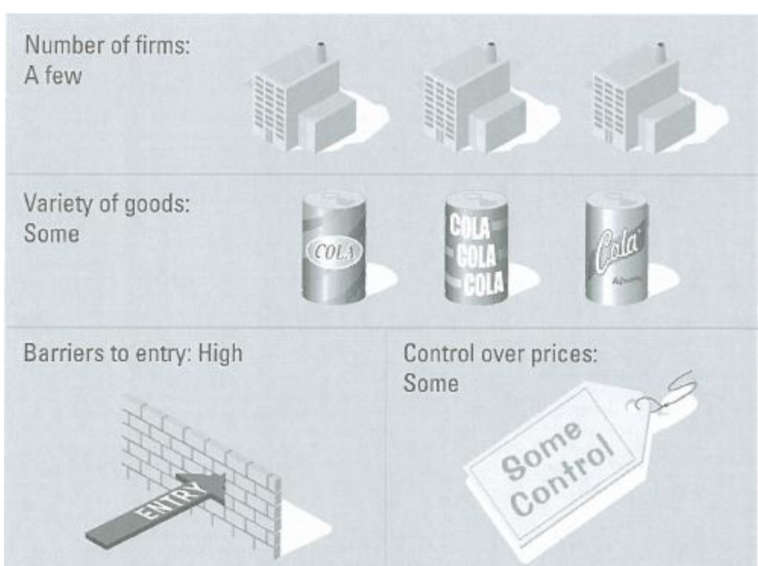


THE BIG IDEA

Most markets fall into one of two categories: monopolistic competition or oligopoly.

Non-price Competition – when business compete with each other by changing things other than the price. (location, flavor, packaging, logo, spokesperson)

D.) Oligarchy – is a market structure where a few firm control most of the marketplace



E.) Government Regulation of Markets

THE BIG IDEA
The federal government tries to promote competition through antitrust laws and deregulation.

- Federal government passes regulations to ensure that competition is able to thrive in the marketplace and that consumers and the environment are protected.

  Anti-trust laws – laws that encourage competition in the marketplace

- There are many government agencies whose goal is to make sure the economy runs smoothly and that competition occurs.

Agency and Date Created	Role
1906 Food and Drug Administration (FDA)	Sets and enforces standards for food, drugs, and cosmetic products
1914 Federal Trade Commission (FTC)	Enacts and enforces antitrust laws to protect consumers
1934 Federal Communications Commission (FCC)	Regulates interstate and international communications by radio, television, wire, satellite, and cable
1958 Federal Aviation Administration (FAA)	Regulates civil aviation, air-traffic and piloting standards, and air commerce
1964 Equal Employment Opportunity Commission (EEOC)	Promotes equal job opportunity through enforcement of civil rights laws, education, and other programs
1970 Environmental Protection Agency (EPA)	Enacts policies to protect human health and the natural environment
1970 Occupational Safety and Health Administration (OSHA)	Enacts policies to save lives, prevent injuries, and protect the health of workers
1972 Consumer Product Safety Commission (CPSC)	Enacts policies for reducing risks of harm from consumer products
1974 Nuclear Regulatory Commission (NRC)	Regulates civilian use of nuclear products

Merger – when 2 or more businesses join together to form one business.

- The government will prohibit businesses from merging together if they feel that it is not in the best interest of the consumer.

Deregulation – is the lifting of government controls over the markets.

- When it is successful, deregulation leads to lower prices and increased competition.
- When it is not successful, negative externalities can occur!

Unit 3

<u>Chapter 8 – Business Organizations</u>

A.) Business Organization – is an establishment formed to carry on commercial enterprise.

Sole Proprietorships

THE BIG IDEA

Sole proprietorships are the most common form of business in the United States. Owners have both full control and unlimited liability.

- Business owned/operated by 1 person
- Owner/operator has complete control over business decisions
- Many are small businesses….only about 6% of all U.S. sales!
- 75% of all businesses in the US are sole proprietorships!
- Have a hard time providing **fringe benefits** to their employees.

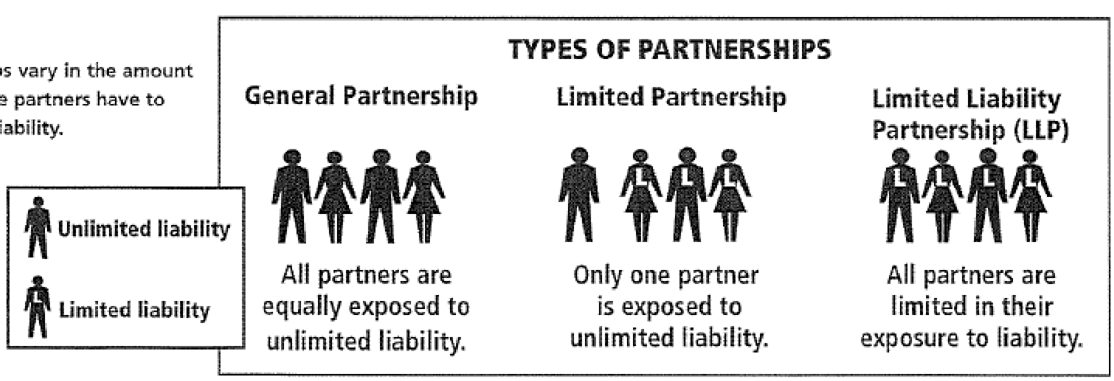
Advantages	Disadvantages
Ease of starting up	Lack of permanence
Full control	Unlimited liability
Sole receiver of profit	Limited access to resources and labor

Partnerships – is a business organization run by 2 or more people

- Partners must agree on how responsibilities and profits will be shared.

Advantages	Disadvantages
1.) Shared liability 1.) Easy to start 3.) Additional resources 4.) Different skills & strengths brought to business.	1.) Share profits 2.) Responsible for actions of partners 3.) Disagreements

Partnerships vary in the amount of exposure partners have to unlimited liability.

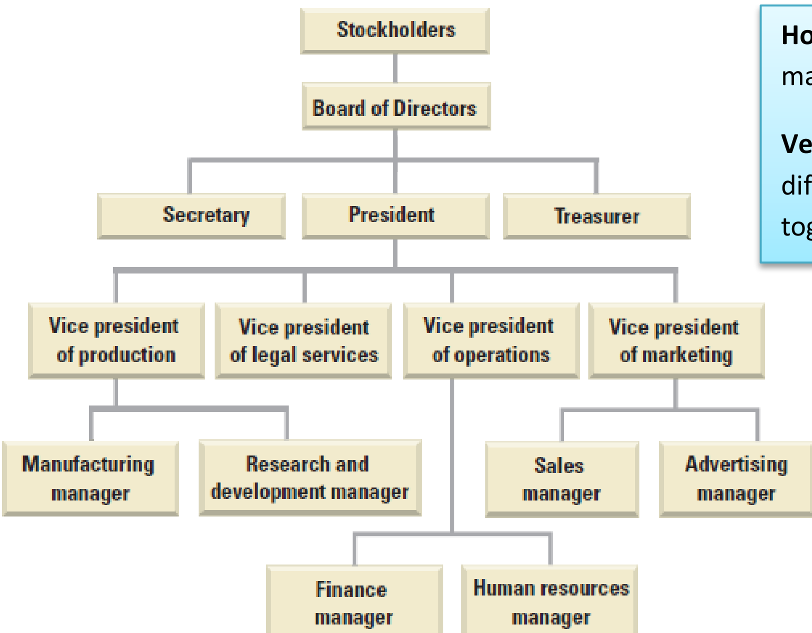


THE BIG IDEA

Corporations are complex business organizations which offer limited liability to their owners, individual stockholders.

Corporations – are large businesses that are considered legal entities, which are controlled by stockholders.

- **stockholders**– people who have purchased stock (partial ownership) in a corporation.
- **Like a person corporations can do the following**
  1.) pay taxes
  2.) enter into contracts
  3.) can bring lawsuits to court.
- All corporations have the same basic organizational structure.



Horizontal merger – when 2 firms in the same market join together.

Vertical merger – when 2 or more firms in different stages of making the good join together.

GRAPHIC SUMMARY: *Corporations—Advantages and Disadvantages*

ADVANTAGES	DISADVANTAGES
• As owners, stockholders have limited liability. • Corporation can sell stocks to raise money. • Corporations can borrow money by selling bonds. • Corporations can continue doing business after death of founders or owners.	• Corporations pay a tax on income, and stockholders also pay personal income tax on payments made to them by corporations. • Corporations are difficult and expensive to start. • Founders may lose control of the company. • Managers and directors do not always act in the best interest of stockholders. • Corporations are subject to more government regulations than other kinds of businesses.

B.) Other Organizations

Business Franchise – semi-independent business that pays fees to a parent company in return for the right to sell their products in a specific location

Franchiser develops the product and business system. → Business owner pays for exclusive rights over a given area. → Franchiser may provide: training, support, standardized quality, advertising programs, financial assistance and centralized buying power.

Advantages	Disadvantages
• Management training and support	• High franchising fees and royalties
• Standardized quality	• Strict operating standards
• National advertising programs	• Purchasing restrictions
• Financial assistance	• Limited product line
• Centralized buying power	

Nonprofit Organization – business that provide goods and services, but not for the benefit of making money

- Provide services to make society a better place
- Museums, public schools, religious organizations,
- Tax Exempt!

Chapter 9 – Labor

A.) Labor Market Trends

Labor Force – non-military workers over the age of 16 who are employed or unemployed

- People who have given up looking for work, who are retired, students or full-time parents are not considered part of the labor force.

The Bureau of Labor Statistics defines who is in the U. S. labor force.

B.) Shifts in the Economy

- The U.S. has changed from an industrial economy that manufactures goods to an industrial economy that **provides services.**
- More women have joined the workforce since the 1960s.
- **Contingent employment –** temporary work, has also increased. It is cost efficient and business can get rid of temporary workers easier than permanent ones.

C.) Education's Impact

- Higher the level of education, the greater probability that a person will have well-paying career
- Less education = cycle of low paying jobs

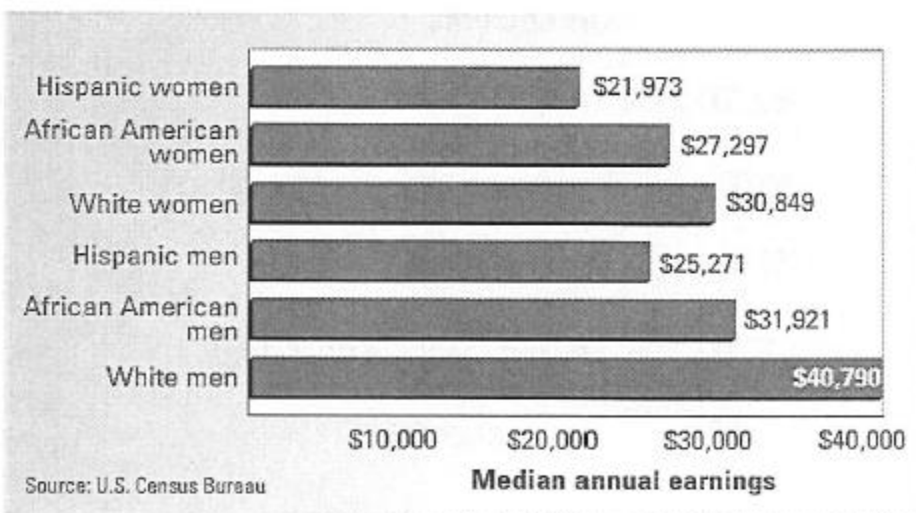
D.) Labor and Wages

- The price of labor/wages is determined largely by **supply and demand**
- Workers are paid based on their **productivity** – the level out output produced.
- Competitive demand for labor drives wages up.
- Some firms cut costs by automating their production, eliminating human workers.

E.) Types of Labor

Unskilled Labor	Required no special skills or training
Semi-skilled Labor	Requires minimal skills and education
Skilled Labor	Requires specialized skills and training
Professional Labor	Requires advanced skills and education

GRAPHIC SUMMARY: *Median Earnings of U. S. Workers*



F.) Organized Labor

THE BIG IDEA

Labor unions were created to improve working conditions for their members.

- Workers began to demand better pay, safer working conditions and other rights as a result of the Industrial Revolution
- **Samuel Gompers** – formed the 1st workers union known as the **American Federation of Labor**
- **Collective Bargaining** – union leaders and business leaders negotiate working conditions and the contracts the workers will follow.
- Union membership grew throughout the late 19th century into the early 20th century and peaked in the middle of the 20th century.
- As America moved away from a manufacturing economy to a service economy, the size and strength of union began to decline across the country.

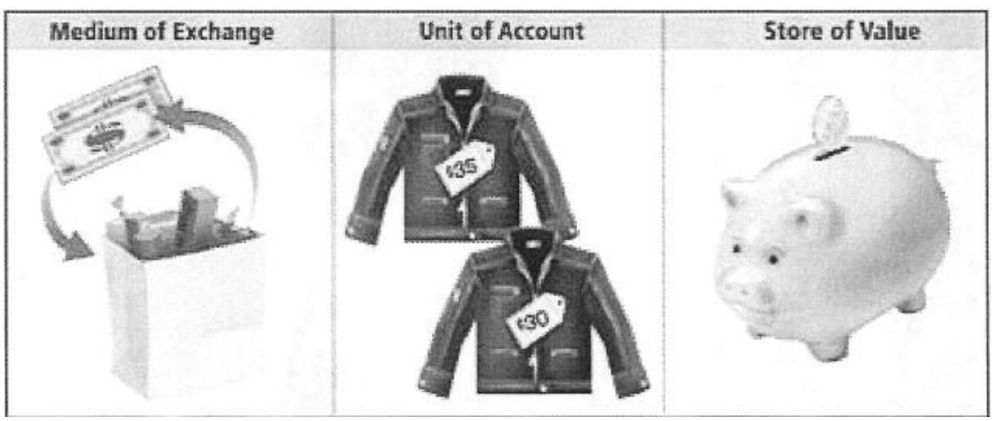
G.) Economic Changes Impact Union

MANUFACTURING DECLINES	MORE WOMEN WORK	JOBS MOVE SOUTH
From 1956 to 2000 manufacturing fell from 70% to 16% of GDP.	From 1960 to 2003 the number of women in the labor force increased from 37% to 47%.	From 1958 to 1998 the North lost 18% and the South gained 46% of manufacturing jobs.
Historically, most union jobs are in manufacturing.	Women tend to work in non-union white-collar jobs.	Historically, the South is less friendly to unions.

These structural changes in the U. S. economy may have contributed to reducing membership.

<u>Chapter 10 – Money & Banking</u>

A.) Money – is anything that serves as a medium of exchange, a unit of account and a store of value.



Currency – the coin and paper bills used as money within a nation
6 Characteristics of Currency
1.) Durable 2.) Portable 3.) Divisible 4.) Uniformity 5.) Scarce 6.) Acceptability

B.) History of American Banking System

Bank – is an institution for receiving, keeping and lending money.

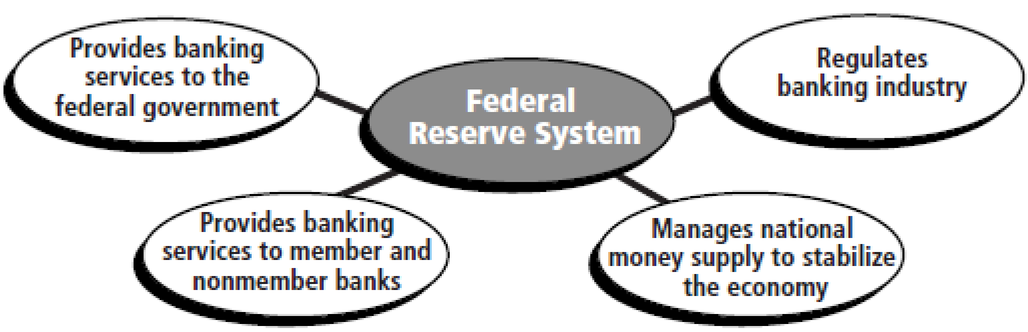
Date	Development
1780s	Federalists and Antifederalists disagree about a banking system.
1791	First Bank of the United States is established.
1811–1816	Period of instability follows expiration of First Bank's charter.
1816	Second Bank of the United States reestablishes stability.
1830s–1860s	President Jackson vetoes recharter of Second Bank in 1832, giving rise to Free Banking Era.
1861–1863	Civil War makes clear the need for a better monetary and banking system.
1863–1864	National Banking Acts of 1863 and 1864 establish national banking system and uniform national currency.
1907	Panic of 1907 leads to creation of the Federal Reserve System.
1913	President Wilson signs the Federal Reserve Act.
1929	The Great Depression begins.
1933	President Roosevelt helps restore confidence in the nation's banks by establishing the FDIC.
1980s	Period of deregulation; S & L's face bankruptcies.
2000s	Banks emerge healthy after two decades of mergers.

The modern American banking system began to take shape with the creation of the Federal Reserve System in 1913 and the Great Depression reforms of 1933.

C.) Modern American Banking System – The FED

- 1913 Congress established the **Federal Reserve**
- It served as the 1st true and continues to be the **central bank** of the US
  "bank of other banks and of the U.S. government"
- **The Fed** regulates financial institutions, manages the nation's money and influences the economy
- By raising and lowering interest rates, creating money and using a few other tricks, the Fed can either stimulate or slow down the economy.

GRAPHIC SUMMARY: *Functions of the Federal Reserve System*



D.) Government Regulation

- The **Great Depression** that struck America beginning in **1929** had its origin in bad banking practices.
- In order to **restore confidence in banks** and in the American system, the government began to pass regulations and create organizations to oversee the banking and financial systems.
- **FDIC** – **Federal Deposit Insurance Corporation** – insures a depositors accounts up to **$250,000**
- **SEC – Securities Exchange Commission –** investigates potential illegal trading and practices.

E.) Commercial Banking Today

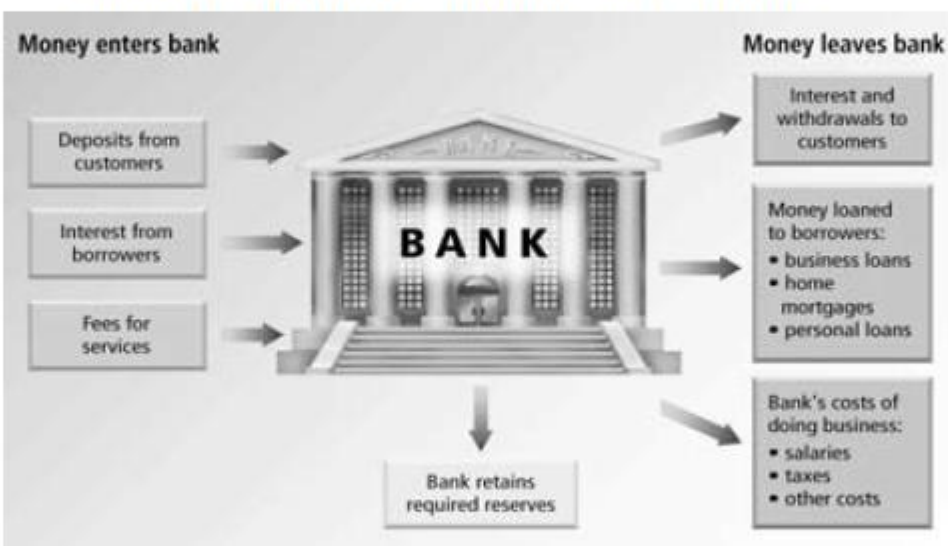
Money Supply – is all the money available in the United States economy.

- **M1** – is money that people can easily use to pay for goods and services, such as currency and deposits in checking accounts. M1 is has high liquidity
- **Liquidity** – the ability to be used as cash or easily turn it into cash.
- **M2** – consists of all the assets in m1 plus other assets which have less liquidity.

THE BIG IDEA

Over the years banks have added more services. Today the Internet and the computer have made it easier for people to manage their money.

GRAPHIC SUMMARY: *How Banks Make a Profit*



F.) Services Banks Provide

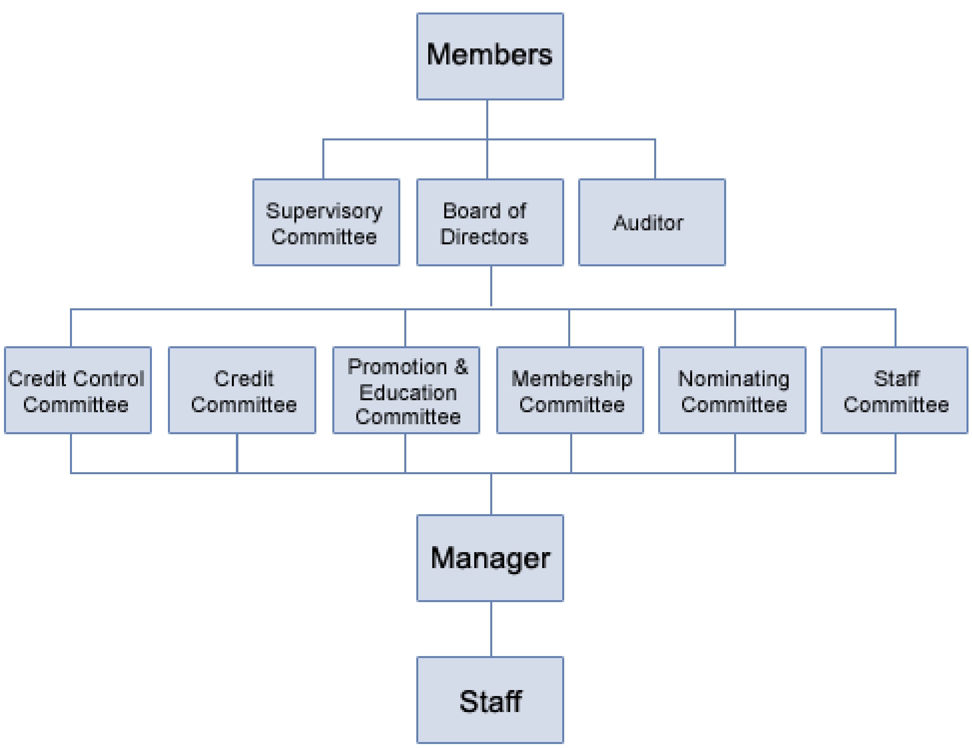
1.) Store/Save Money - savings accounts
- checking accounts
- **certificate of deposits** (C.D.s)
- money market accounts

Banks pay **interest** to these account holders, for letting them loan their monev out.

2.) Loaning Money - **mortgages –** loans for real estate
- private loans
- car loans
- school loans

G.) Other Types of Financial Institutions

- **Credit Cards –** are issued by financial institutions that agree to pay your debts as long as you pay them off the principal plus interest and fees/fines.
- **Insurance Companies**
- **Credit Union** – member owned financial cooperative, its goal is to provide credit and financial services to its members. The actual members are the owners of the credit union unlike in a traditional bank.



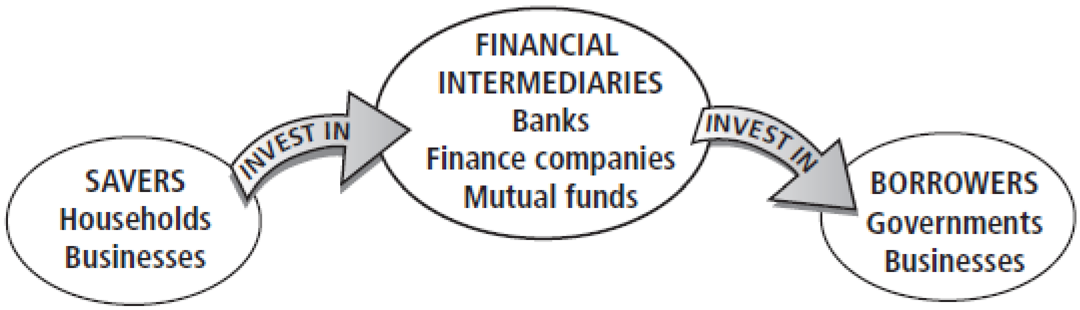
Chapter 11 – Investment & Savings

> **THE BIG IDEA**
> Investment, the key to economic growth, is made possible by a financial system of savers, borrowers, and intermediaries.

A.) The Basics

Investing – the act of redirecting resources from being used today so that they may provide benefits in the future.

Financial System – the global institution that exists making investment possible by allowing the transfer of money between savers and borrowers



Financial intermediaries – are institutions which help channel funds from savers to borrowers.
Mutual Funds – funds which pool savings together from many people and invest this money in different ways.

Diversification – spreading out investments in different areas to reduce risk

Return – is the profit made off of an investment

B.) Types of Investments

Bonds – loans that a government or corporation must pay back to investors.

3 Parts to a **Bond**

1.) **maturity** – the time period when the loan is able to be collected
2.) **par value** – the amount that was initially loaned to the gov't or corporation
3.) **interest rate** – the amount of return the investor can hope to get at the time of maturity.

> **THE BIG IDEA**
> Corporations and governments borrow money by selling bonds and other financial assets.

GRAPHIC SUMMARY: *Types of Bonds*

TYPE	ISSUER	RISK	TAX EXEMPTION	USED FOR
Savings and Treasury Bonds	U.S. Government	Very low	Exempt from state and local taxes	Federal government activities
Municipal bonds	State and local governments	Low	Exempt from income taxes at federal level and in issuing state	State and local government activities
Corporate bonds	Corporations	Moderate	Not tax exempt	Expansion of businesses
Junk bonds	Corporations	High	Not tax exempt	Finance corporate takeovers

Bonds help businesses expand and governments build public works. There are different kinds of bonds to serve different needs and different kinds of investors.

THE BIG IDEA

Corporations sell stock to investors in order to raise money. Stocks are traded in markets called stock exchanges.

B.) Types of Investments (cont.)

Stocks – partial ownership in a corporation

- By selling stocks, corporations raise money that is necessary to start their businesses and keep them growing
- Investors make money in the stock market in 2 ways:
  1.) Selling the stock for more than they paid for it – **capital gains**
  2.) Receiving money from the corporations in times of prosperity – **dividends**

Stock Exchanges –markets in which stocks are bought and sold in, often times called the stock market
- **NYSE**: New York Stock Exchange, largest and most prestigious companies are traded here.
- **Nasdaq**: an electronic exchange, less strict rules to list with them than NYSE. Like NYSE, million & billion dollar companies traded here.

Indexes – are used to get a snapshot of the economy and how it's running by looking at a specific number of corporations and how they are trading on the stock exchanges.
- **The Dow Jones:** the Dow examines the **30 largest** publicly traded companies and how they are doing.

Bull Market – refers to a market in which the value of stocks & corporations is rising

Bear Market – refers to a market in which the value of stocks and corporations is falling

Consumer/Business emotional ride
during a **business cycle!**

THE BIG IDEA

Economists monitor the nation's economic performance using gross domestic product (GDP) and other measures.

Chapter 12 – Gross Domestic Product & Growth

A.) Gross Domestic Product

- The U.S. Department of Commerce collects and analyzes statistics in order to study and report on the economy.
- **Gross Domestic Product –** the final dollar value of all goods and services produced within a year in a country. **(Final sales cost of the house is calculated but not the lumber and nails)**
- Changing prices due to inflation can distort the GDP, so economists use what is called the **real GDP,** which helps them to get a better understanding.

B.) Other Economic Indicators.

GRAPHIC SUMMARY: *Measurements of the Macroeconomy*

Various measures are used by economists to track changes in the nation's economy.

Gross Domestic Product	+	income earned outside U.S. by U.S. firms and citizens	–	income earned by foreign firms and foreign citizens located in the U.S.	=	Gross National Product
Gross National Product	–	depreciation of capital equipment	=	Net National Product		
Net National Product	–	most business taxes	=	National Income		
National Income	–	• firms' reinvested profits • firms' income taxes • social security	+	other household income	=	Personal Income
Personal Income	–	individual income taxes	=	Disposable Personal Income		

C.) Impact of Supply & Demand

Price level – average of all prices in the U.S.

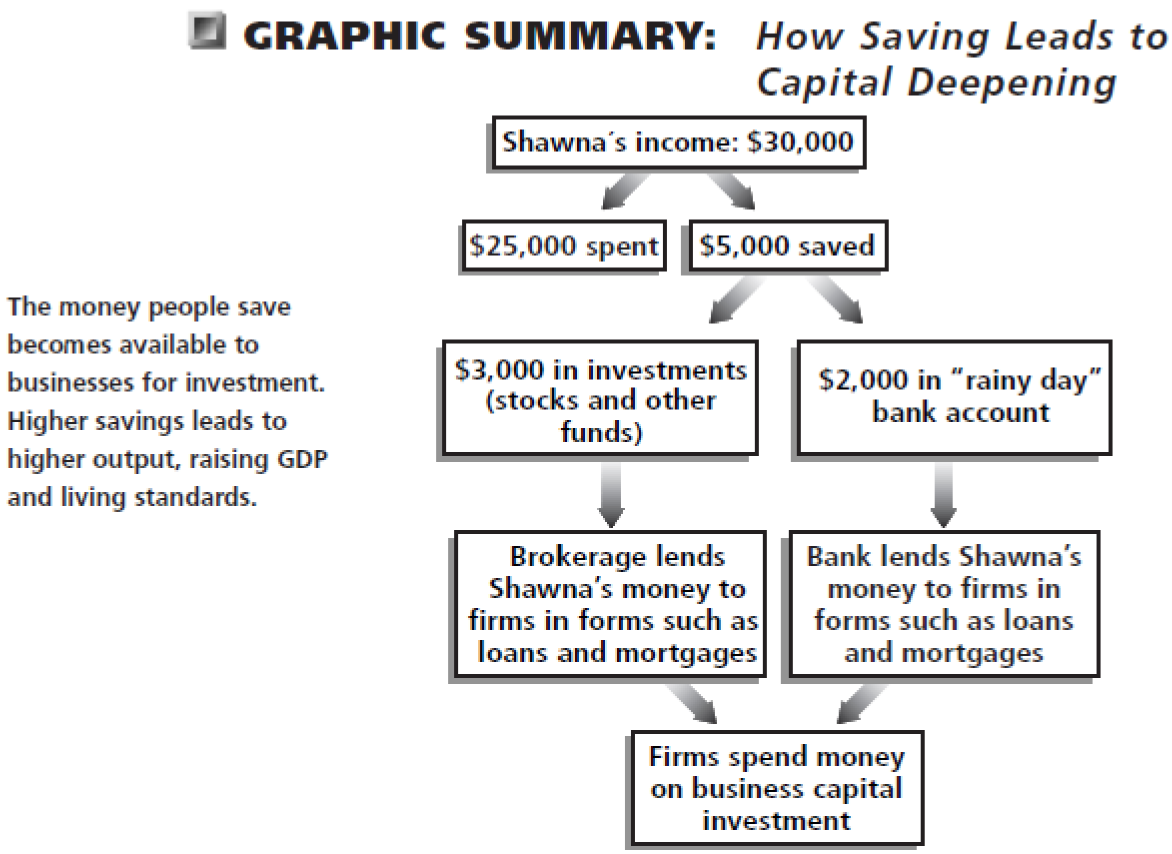
Aggregate Supply – the total amount of goods and service available in the economy
Aggregate Demand- the total amount of goods and services that will be purchased at all possible levels.

D.) real GDP per capita – the best measure of a nation's standard of living
→ real GDP/number of people in the country

- **real GDP per capital** helps economists compare economies over different place and times.

E.) Capital Deepening – the process of increasing the amount of capital per works.

- Capital Deepening is important source of growth in modern economies.
- Better educated workers can produce more output per hour of work
- Saving money also leads to capital deepening.
  Saving - is the money consumers do not spend to purchase goods & services.
- Money that is saved in a financial institution can then be available for investment.
- Higher savings rate = more growth in the **real GDP**

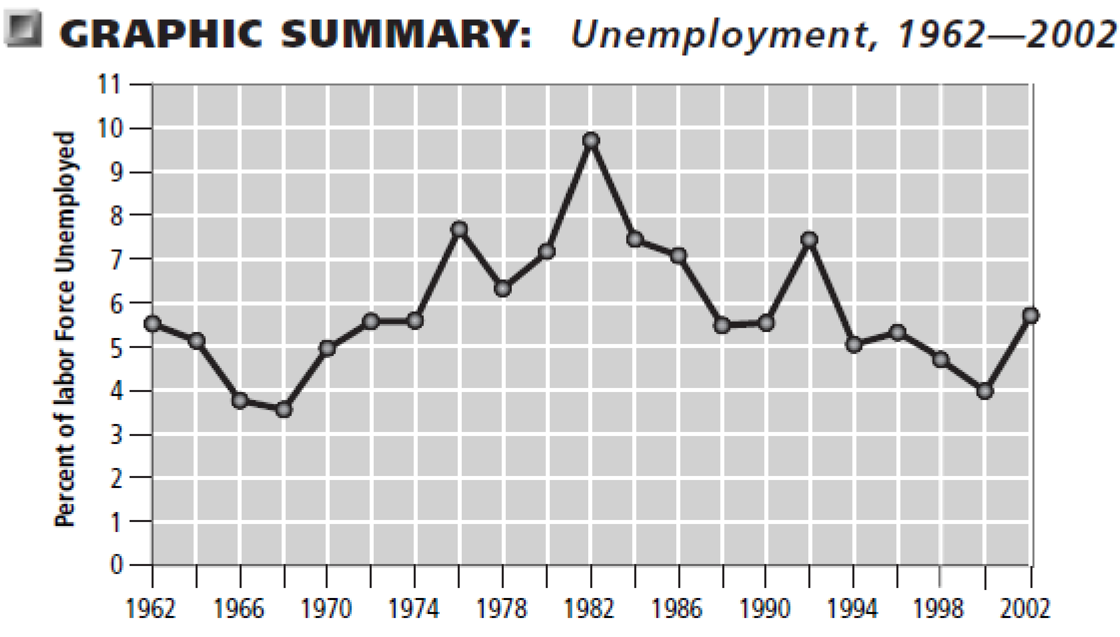


Chapter 13 – Economic Challenges

A.) Unemployment

- Economists study 4 types of unemployment
  1.) Frictional – when people are in between jobs or returning to the workforce after a period of not working
  2.) Seasonal – occurs in industries that slow or shut down during certain parts of the year
  3.) Structural – happens when workers' skills do not match the jobs that are available
  4.) Cyclical – occurs during recessions when demand for goods and services drop

- The unemployment level gives a good picture on the health of the American economy.
  4-6% unemployment is considered **full employment** in an average economy
- **Underemployed** – when people work jobs they are overqualified for or only working part time when then want full time.



B.) Inflation – is a general increase in prices over time.

- Inflation reduces the ability **purchasing power**
- Economists use a **price index** to track the rise in prices over time and thus the inflation rate.

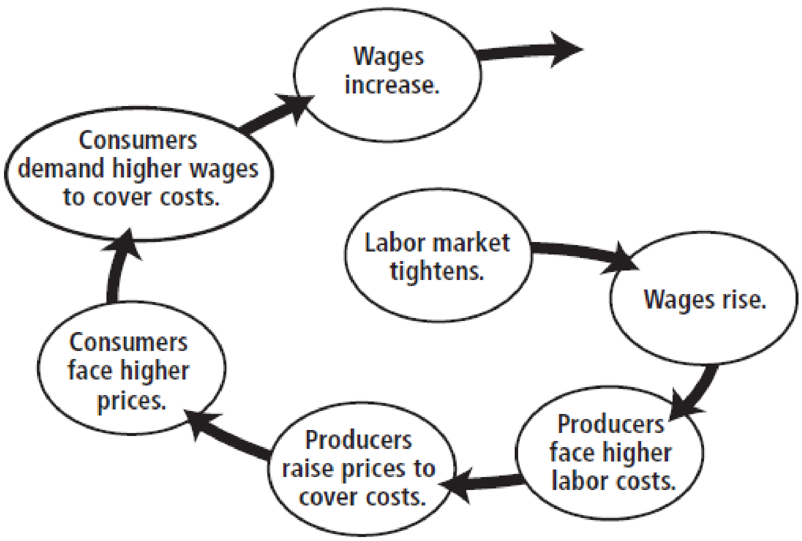
THE BIG IDEA

Rising prices and the inflation rate can affect wages, purchasing power, and many other aspects of daily life.

C.) Why Inflation Occurs

1.) **Quantity Theory** – there is too much money in the economy and this leads to a rise in prices
2.) **Demand-Pull Theory** – inflation occurs as a result of demand exceeding supply
3.) **Cost-Push Theory** – inflation occurs because costs rise for businesses. This leads to a cycle of ever rising prices.

GRAPHIC SUMMARY: *Tracking a Business Cycle*



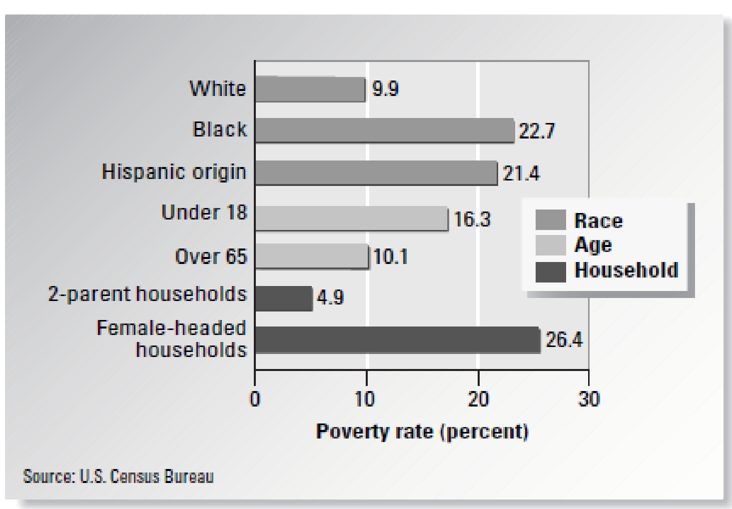
This diagram shows one example of the wage-price spiral. Rising wages can push up the inflation rate.

D.) Poverty

- The government defines a poor family as one whose total income is less than needed to satisfy minimal needs
- **poverty rate** is the percentage of people who live in households below the poverty threshold
- Poverty rates vary among different demographics.

GRAPHIC SUMMARY: *Poverty Rates for Different Population Groups*

Families in some groups are more likely to have incomes below the poverty threshold.



E.) Causes of Poverty

Individual	Societal
Lack of education, skill, experience and intelligence Family structure Health & Age Work Ethic & Drive Discrimination	Low national income & educational system Near total government control of the factors of production Unequal distribution of wealth

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Chapter 14 – Taxes & Government Spending

THE BIG IDEA

Government collects money to run its programs through different types of taxes.

Taxes – are payments that people are required to pay to a local, state or federal government

Tax base – the income, property, good/service that is subject to a tax

A.) How Taxes are Applied

GRAPHIC SUMMARY: *Three Types of Tax Structures*

Type of Tax	Description	Example	Ron's taxes on $50,000 income	Mary's taxes on $150,000 income
Proportional	A constant percentage of income is taken in taxes as income increases	"Flat" tax	$7,500, or 15 percent of income	$22,500, or 15 percent of income
Progressive	A larger percentage of income is taken in taxes as income increases	Income tax	$5,000, or 10 percent of income	$45,000, or 30 percent of income
Regressive	A smaller percentage of income is taken in taxes as income increases	Sales tax	$2,000, or 5 percent of total purchases of $40,000; tax bill is 4 percent of income	$3,000, or 5 percent of total purchases of $60,000; tax bill is 2 percent of income

B.) Federal Taxes

- The federal government has many sources of income.
- **Individual income tax** provides nearly half of federal revenue
  → it is collected on a "pay as you earn" system through weekly withholdings from your paycheck
  → progressive tax structure
- **FICA (Federal Insurance Contributions Act) –** taxes that go towards Social Security & Medicare

C.) Filing Federal Taxes

- At the end of the year employers send employees a report showing how much has been withheld (W2)
- Employees then fill out a **tax return –** a form in which people file in find out if they paid enough in taxes for the year from their withholdings.
- **Deductibles** – are personal exemptions that can be subtracted for an individual and family members. (less things the gov't can tax!)

D.) Corporate Taxes

- All corporations must pay a corporate income tax on the income that they make
- Corporate taxes make up about 10% of federal revenues.
- Like personal taxes, corporate takes are also **progressive taxes.**

E.) Federal Spending

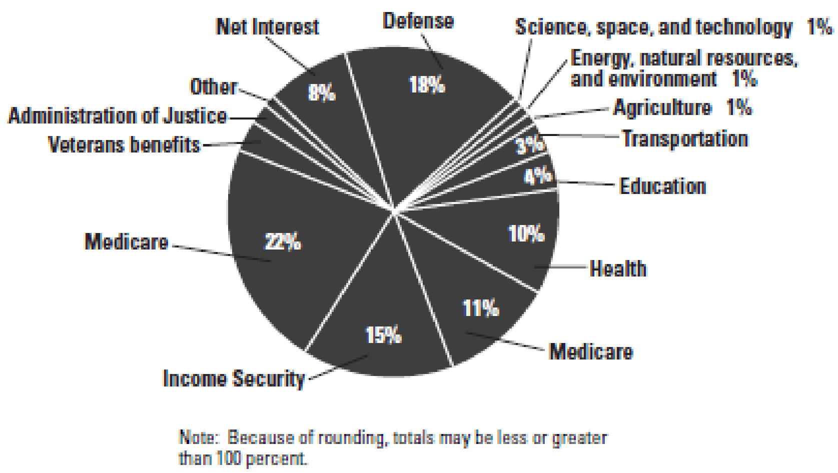
Mandatory Spending – spending that is mandated by law for certain programs and institutions and national debt.

Discretionary Spending – spending that is not mandated and can change from one yearly budget to another. (education, military, technology)

Entitlements – most mandatory spending is on programs for people who meet certain requirements and therefor by law the government is obligated to provide.

Federal government also provides funds to state and local governments.

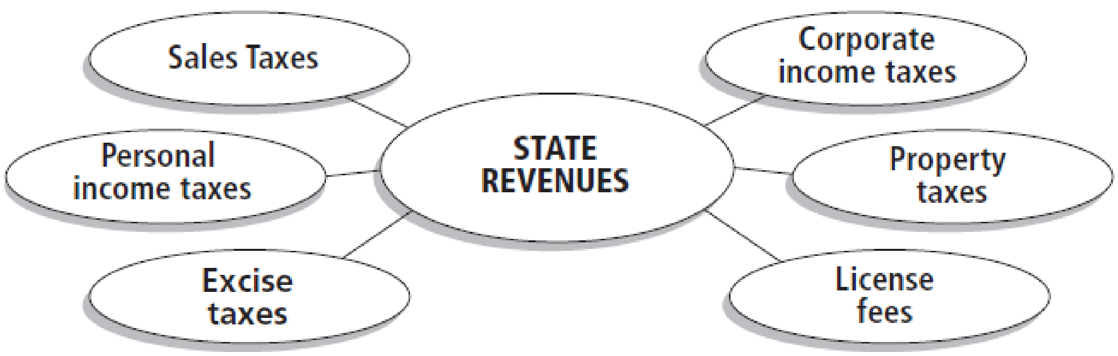
The federal government spends tax money on both mandatory programs, such as Social Security and Medicare, and discretionary programs, such as national defense and education.



F.) State Taxes

- States unlike the federal government cannot run a **budget deficit**
- State governments have 2 budgets
  Operating Budget – pays the day-to-day expenses.
  Capital Budget – pays for major capital, or investment spending. Ex→ bridges & buildings
- Like the federal government, state governments have many sources of revenue

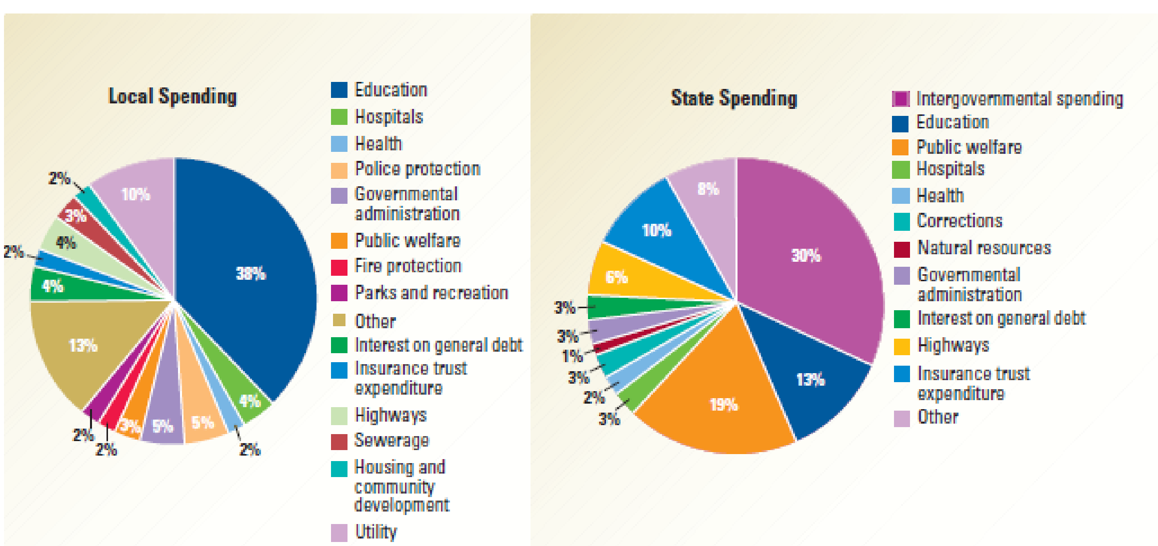
GRAPHIC SUMMARY: *Sources of State Revenues*



Most states get the major part of their revenues from sales taxes and individual income taxes, but each state has its own mix of revenue sources.

State and Local Spending

These graphs show how state and local governments, on average, spend the money they receive from taxes and other revenue.



Chapter 15 – Fiscal Policy

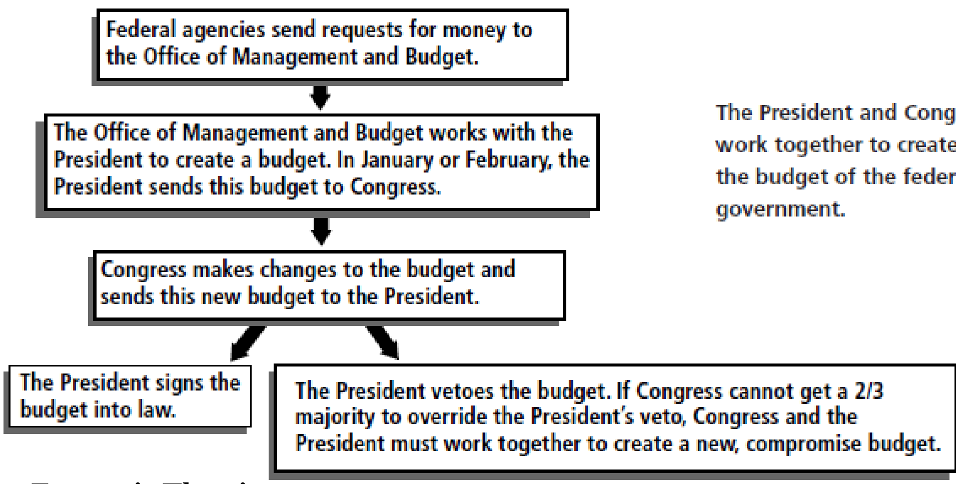
A.) Understanding Fiscal Policy

Fiscal Policy – is the government's use of taxing and spending to keep the nation's economy stable.
Federal Budget – a written document showing how much money the government expects to receive and spend each year

B.) Office of Management and Budget (OMB)

- Receive all the budget estimates from every federal government agency.

GRAPHIC SUMMARY: *Creating the Federal Budget*



The President and Congress work together to create the budget of the federal government.

C.) Competing Economic Theories

- Various theories exist on how the federal government ought to be involved in guiding the economy and promoting growth.

GRAPHIC SUMMARY: *Comparing Economic Theories*

Classical Economics	Keynesian Economics	Supply-Side economics
Markets regulate themselves. As prices rise and fall, supply and demand adjust and the market returns to equilibrium.	In a recession, demand may not increase even if prices drop. If neither consumers nor businesses can spend money, the government spends more to increase aggregate demand.	Aggregate supply is more important than aggregate demand. Lower tax rates are the key to increasing aggregate supply because they make more money available to investors.

Different economic theories have different views about the government's use of fiscal policy.

THE **BIG** IDEA

When the federal spending is greater than revenue, budget deficits and a national debt are the result.

D.) Budget Deficits & the National Debt

Balanced Budget – when federal government spending equals the amount of revenue it took in through taxes.

Budget Surplus – when federal spending is less than the revenue taken in through taxes

Budget Deficit – when federal spending exceeds the revenue taken in through taxes.

- When a government runs a deficit it must figure out a ways to pay for the excessive spending
  1.) Create more money
  2.) Borrow money from another country

National Debt – the total amount of money that the government owes to bondholders

2 Major Problems of a National Debt
1.) reduces funds available for businesses to borrow and invest because people buy government bonds instead of investing in businesses.

2.) government must pay interest to the bondholders, redirecting it away from other programs it could be spent on!

Current National Debt → $16,500,000,000,000…….. and rising!