Guided Reading and Review Workbook

PRENTICE HALL
ECONOMICS
Principles in Action

- Learn strategies for success in reading, testing, and writing for assessment
- Create your own study guide as you read
- Review main ideas and key terms
Guided Reading and Review Workbook
# Table of Contents

Student Success Handbook ................................................................................. 5

## Unit 1: Introduction to Economics

### Chapter 1: What is Economics?
- Section 1 .......................................................................................................... 17
- Section 2 .......................................................................................................... 18
- Section 3 .......................................................................................................... 19

### Chapter 2: Economic Systems
- Section 1 .......................................................................................................... 20
- Section 2 .......................................................................................................... 21
- Section 3 .......................................................................................................... 22
- Section 4 .......................................................................................................... 23

### Chapter 3: American Free Enterprise
- Section 1 .......................................................................................................... 24
- Section 2 .......................................................................................................... 25
- Section 3 .......................................................................................................... 26
- Section 4 .......................................................................................................... 27

## Unit 2: How Markets Work

### Chapter 4: Demand
- Section 1 .......................................................................................................... 28
- Section 2 .......................................................................................................... 29
- Section 3 .......................................................................................................... 30

### Chapter 5: Supply
- Section 1 .......................................................................................................... 31
- Section 2 .......................................................................................................... 32
- Section 3 .......................................................................................................... 33

### Chapter 6: Prices
- Section 1 .......................................................................................................... 34
- Section 2 .......................................................................................................... 35
- Section 3 .......................................................................................................... 36

### Chapter 7: Market Structures
- Section 1 .......................................................................................................... 37
- Section 2 .......................................................................................................... 38
- Section 3 .......................................................................................................... 39
- Section 4 .......................................................................................................... 40

## Unit 3: Business and Labor

### Chapter 8: Business Organizations
- Section 1 .......................................................................................................... 41
- Section 2 .......................................................................................................... 42
- Section 3 .......................................................................................................... 43
- Section 4 .......................................................................................................... 44

### Chapter 9: Labor
- Section 1 .......................................................................................................... 45
- Section 2 .......................................................................................................... 46
- Section 3 .......................................................................................................... 47
## Unit 4: Money, Banking, and Finance

### Chapter 10: Money and Banking
- Section 1 .................................................. 48
- Section 2 .................................................. 49
- Section 3 .................................................. 50

### Chapter 11: Financial Markets
- Section 1 .................................................. 51
- Section 2 .................................................. 52
- Section 3 .................................................. 53

## Unit 5: Measuring Economic Performance

### Chapter 12: Gross Domestic Product and Growth
- Section 1 .................................................. 54
- Section 2 .................................................. 55
- Section 3 .................................................. 56

### Chapter 13: Economic Challenges
- Section 1 .................................................. 57
- Section 2 .................................................. 58
- Section 3 .................................................. 59

## Unit 6: Government and the Economy

### Chapter 14: Taxes and Government Spending
- Section 1 .................................................. 60
- Section 2 .................................................. 61
- Section 3 .................................................. 62
- Section 4 .................................................. 63

### Chapter 15: Fiscal Policy
- Section 1 .................................................. 64
- Section 2 .................................................. 65
- Section 3 .................................................. 66

### Chapter 16: The Federal Reserve and Monetary Policy
- Section 1 .................................................. 67
- Section 2 .................................................. 68
- Section 3 .................................................. 69
- Section 4 .................................................. 70

## Unit 7: The Global Economy

### Chapter 17: International Trade
- Section 1 .................................................. 71
- Section 2 .................................................. 72
- Section 3 .................................................. 73

### Chapter 18: Economic Development and Transition
- Section 1 .................................................. 74
- Section 2 .................................................. 75
- Section 3 .................................................. 76
- Section 4 .................................................. 77
Success in social studies comes from doing three things well—reading, testing, and writing. The following pages present strategies to help you read for meaning, understand test questions, and write well.

Reading for Meaning

*Do you have trouble remembering what you read? Here are some tips from experts that will improve your ability to recall and understand what you read:*

**BEFORE YOU READ**

Preview the text to identify important information.

Like watching the coming attractions at a movie theater, previewing the text helps you know what to expect. Study the questions and strategies below to learn how to preview what you read.

<table>
<thead>
<tr>
<th>Ask yourself these questions:</th>
<th>Use these strategies to find the answers:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• What is the text about?</td>
<td>Read the headings, subheadings, and captions.</td>
</tr>
<tr>
<td></td>
<td>Study the photos, maps, tables, or graphs.</td>
</tr>
<tr>
<td>• What do I already know about the topic?</td>
<td>Read the questions at the end of the text to see if you can answer any of them.</td>
</tr>
<tr>
<td>• What is the purpose of the text?</td>
<td>Turn the headings into <em>who, what, when, where, why, or how</em> questions. This will help you decide if the text compares things, tells a chain of events, or explains causes and effects.</td>
</tr>
</tbody>
</table>
AS YOU READ

Organize information in a way that helps you see meaningful connections or relationships.
Taking notes as you read will improve your understanding. Use graphic organizers like the ones below to record the information you read. Study these descriptions and examples to learn how to create each type of organizer.

**Sequencing**

A **flowchart** helps you see how one event led to another. It can also display the steps in a process.

**Use a flowchart if the text—**
- tells about a chain of events.
- explains a method of doing something.

**TIP** List the events or steps in order.

**Comparing and Contrasting**

A **Venn diagram** displays similarities and differences.

**Use a Venn diagram if the text—**
- compares and contrasts two individuals, groups, places, things, or events.

**TIP** Label the outside section of each circle and list differences. Label the shared section and list similarities.
Categorizing Information

A chart organizes information in categories.

**Use a chart if the text—**
- lists similar facts about several places or things.
- presents characteristics of different groups.

**TIP** Write an appropriate heading for each column in the chart to identify its category.

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>FORM OF GOVERNMENT</th>
<th>ECONOMY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cuba</td>
<td>communist dictatorship</td>
<td>command economy</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>democracy</td>
<td>free enterprise system</td>
</tr>
</tbody>
</table>

Identifying Main Ideas and Details

A concept web helps you understand relationships among ideas.

**Use a concept web if the text—**
- provides examples to support a main idea.
- links several ideas to a main topic.

**TIP** Write the main idea in the largest circle. Write details in smaller circles and draw lines to show relationships.
Organizing Information

An **outline** provides an overview, or a kind of blueprint for reading.

**Use an outline to organize ideas**—
- according to their importance.
- according to the order in which they are presented.

**TIP** Use Roman numerals for main ideas, capital letters for secondary ideas, and Arabic numerals for supporting details.

**I. Differences Between the North and the South**

**A. Views on slavery**
1. Northern abolitionists
2. Southern slave owners

**B. Economies**
1. Northern manufacturing
2. Southern agriculture

Identifying Cause and Effect

A **cause-and-effect** diagram shows the relationship between what happened (effect) and the reason why it happened (cause).

**Use a cause-and-effect chart if the text**—
- lists one or more causes for an event.
- lists one or more results of an event.

**TIP** Label causes and effects. Draw arrows to indicate how ideas are related.

AFTER YOU READ

Test yourself to find out what you learned from reading the text.
Go back to the questions you asked yourself before you read the text. You should be able to give more complete answers to these questions:
- What is the text about?
- What is the purpose of the text?

You should also be able to make connections between the new information you learned from the text and what you already knew about the topic.

Study your graphic organizer. Use this information as the **answers**. Make up a meaningful **question** about each piece of information.
Taking Tests

Do you panic at the thought of taking a standardized test? Here are some tips that most test developers recommend to help you achieve good scores.

**MULTIPLE-CHOICE QUESTIONS**

Read each part of a multiple-choice question to make sure you understand what is being asked.

Many tests are made up of multiple-choice questions. Some multiple-choice items are **direct questions**. They are complete sentences followed by possible answers, called distractors.

<table>
<thead>
<tr>
<th>Direct Question</th>
<th>A narrow strip of land that has water on both sides and joins two larger bodies of land called?</th>
</tr>
</thead>
</table>
| The distractors | A a bay  
B an isthmus  
C a lake  
D an island |
| **TIP**         | Try each distractor as an answer to your question. Rule out the ones that don’t work.             |
|                | You can rule out A and C because they are bodies of water, not land. You can rule out D because an island is completely surrounded by water. |

Other multiple-choice questions are **incomplete sentences** that you are to finish. They are followed by possible answers.

<table>
<thead>
<tr>
<th>The stem</th>
<th>A narrow strip of land that has water on both sides and joins two larger bodies of land is called</th>
</tr>
</thead>
</table>
| Distractors | A a bay  
B an isthmus  
C a lake  
D an island |
| **TIP** | Turn the stem into a direct question, using who, what, when, where, or why.                     |
|          | What is a narrow strip of land that has water on both sides and joins two larger bodies of land called? |
**WHAT’S BEING TESTED?**

Identify the type of question you are being asked.

Social studies tests often ask questions that involve reading comprehension. Other questions may require you to gather or interpret information from a map, graph, or chart. The following strategies will help you answer different kinds of questions.

<table>
<thead>
<tr>
<th>Reading Comprehension Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>What to do:</strong></td>
</tr>
<tr>
<td>1. Determine the content and organization of the selection.</td>
</tr>
<tr>
<td>2. Analyze the questions.</td>
</tr>
<tr>
<td>Do they ask you to recall facts?</td>
</tr>
<tr>
<td>Do they ask you to make judgments?</td>
</tr>
<tr>
<td>3. Read the selection.</td>
</tr>
<tr>
<td>4. Answer the questions.</td>
</tr>
</tbody>
</table>

**Example:**

**A Region of Diversity**  The Khmer empire was one of many kingdoms in Southeast Asia. Unlike the Khmer empire, however, the other kingdoms were small because Southeast Asia’s mountains kept people protected and apart. People had little contact with those who lived outside their own valley.

Why were most kingdoms in Southeast Asia small?

- A disease killed many people
- B lack of food
- C climate was too hot
- D mountains kept people apart

**TIP** The key word because tells why the kingdoms were small.  
(The correct answer is D.)
WHAT’S BEING TESTED?
(continued)

Map Questions

What to do:  
1. Determine what kind of information is presented on the map.

2. Read the question. Determine which component on the map will help you find the answer.

3. Look at the map and answer the question in your own words.

4. Choose the best answer.

How to do it:  
Read the map title. It will indicate the purpose of the map.
Study the map key. It will explain the symbols used on the map.
Look at the scale. It will help you calculate distance between places on the map.
Look for key words in the stem.
About how far . . . [use the scale]
What crops were grown in . . . [use the map key]

In which of these countries are Thraco-Illyrian languages spoken?

A Romania
B Albania
C Hungary
D Lithuania

TIP Read the labels and the key to understand the map.
(The correct answer is B.)
**Graph Questions**

**What to do:**
1. Determine the purpose of the graph.
2. Determine what information on the graph will help you find the answer.
3. Choose the best answer.

**How to do it:**
- Read the **title**. It indicates what the graph represents.
- Read the **labels** on the graph or on the key. They tell the units of measurement used by the graph.
- Decide which distractor agrees with the answer you determined from the graph.

**Example**

**Religious Persuasion in France**

- **A Circle graph** shows the relationship of parts to the whole in terms of percentages.
- After Roman Catholics, the next largest religious population in France is
  - A Buddhist
  - B Protestant
  - C Jewish
  - D Muslim
- **TIP** Compare the percentages listed in the labels. (The correct answer is D.)

**Immigration to the U.S., 1940–1990**

- **A line graph** shows a pattern or change over time by the direction of the line.
- Between 1980 and 1990, immigration to the U.S. from the Americas
  - A decreased a little
  - B increased greatly
  - C stayed about the same
  - D increased a little
- **TIP** Compare the vertical distance between the two correct points on the line graph. (The correct answer is B.)

**Annual Oil Production in Southwest Asia**

- **A bar graph** compares differences in quantity by showing bars of different lengths.
- Saudi Arabia produces about how many more billion of barrels of oil a year than Iran?
  - A 5 million
  - B 10 million
  - C 15 million
  - D 20 million
- **TIP** Compare the heights of the bars to find the difference. (The correct answer is B.)
Writing for Social Studies

When you face a writing assignment, do you think, “How will I ever get through this?” Here are some tips to guide you through any writing project from start to finish.

THE WRITING PROCESS

Follow each step of the writing process to communicate effectively.

Step 1. Prewrite
- Establish the purpose.
- Define the topic.
- Determine the audience.
- Gather details.
- Illustrate as needed.
- Create a cover, if appropriate.
- Correct any errors in spelling, grammar, and punctuation.
- Edit for clarity of ideas and elaboration.
- Organize information logically in an outline or graphic organizer.
- Write an introduction, body, and conclusion.
- State main ideas clearly.
- Include relevant details to support your ideas.

Step 2. Draft
- Establish the purpose.
- Define the topic.
- Determine the audience.
- Gather details.
- Illustrate as needed.
- Create a cover, if appropriate.

Step 3. Revise
- Edit for clarity of ideas and elaboration.

Step 4. Proofread
- Correct any errors in spelling, grammar, and punctuation.
- Illustrate as needed.
- Create a cover, if appropriate.

Step 5. Publish and Present
- Copy text neatly by hand, or use a typewriter or word processor.
Identify the purpose for your writing.

Each type of writing assignment has a specific purpose, and each purpose needs a different plan for development. The following descriptions and examples will help you identify the three purposes for social studies writing. The lists of steps will help you plan your writing.

**Writing to Inform**

**Purpose:** to present facts or ideas

**Example**
During the 1960s, research indicated the dangers of the insecticide DDT. It killed insects but also had long-term effects. When birds and fish ate poisoned insects, DDT built up in their fatty tissue. The poison also showed up in human beings who ate birds and fish contaminated by DDT.

**TIP**
Look for these key terms in the assignment: explain, describe, report, narrate

**How to get started:**
- Determine the topic you will write about.
- Write a topic sentence that tells the main idea.
- List all the ideas you can think of that are related to the topic.
- Arrange the ideas in logical order.

**Writing to Persuade**

**Purpose:** to influence someone

**Example**
Teaching computer skills in the classroom uses time that could be spent teaching students how to think for themselves or how to interact with others. Students who can reason well, express themselves clearly, and get along with other people will be better prepared for life than those who can use a computer.

**TIP**
Look for these key terms in the assignment: convince, argue, request

**How to get started:**
- Make sure you understand the problem or issue clearly.
- Determine your position.
- List evidence to support your arguments.
- Predict opposing views.
- List evidence you can use to overcome the opposing arguments.

**Writing to Provide Historical Interpretations**

**Purpose:** to present the perspective of someone in a different era

**Example**
The crossing took a week, but the steamship voyage was hard. We were cramped in steerage with hundreds of others. At last we saw the huge statue of the lady with the torch. In the reception center, my mother held my hand while the doctor examined me. Then, my father showed our papers to the official, and we collected our bags. I was scared as we headed off to find a home in our new country.

**TIP**
Look for these key terms in the assignment: go back in time, create, suppose that, if you were

**How to get started:**
- Study the events or issues of the time period you will write about.
- Consider how these events or issues might have affected different people at the time.
- Choose a person whose views you would like to present.
- Identify the thoughts and feelings this person might have experienced.
Follow each step of the writing process to communicate effectively.

After you have identified the purpose for your writing, you may need to do research. The following steps will help you plan, gather, organize, and present information.

**Step 1. Ask Questions**

Ask yourself questions to help guide your research.

What do I already know about the topic?
What do I want to find out about the topic?

**Step 2. Acquire Information**

Locate and use appropriate sources of information about the topic.

Library
Internet search
Interviews

Take notes.

Follow accepted format for listing sources.

**Step 3. Analyze Information**

Evaluate the information you find.

Is it relevant to the topic?
Is it up-to-date?
Is it accurate?
Is the writer an authority on the topic?
Is there any bias?

**Step 4. Use Information**

Answer your research questions with the information you have found. (You may find that you need to do more research.)

Do I have all the information I need?

Organize your information into the main points you want to make. Identify supporting details.

Arrange ideas in outline form or in a graphic organizer.

**Step 5. Communicate What You’ve Learned**

Review the purpose for your writing and choose an appropriate way to present the information.

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Presentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>inform</td>
<td>formal paper, documentary, multimedia</td>
</tr>
<tr>
<td>persuade</td>
<td>essay, letter to the editor, speech</td>
</tr>
<tr>
<td>interpret</td>
<td>journal, newspaper account, drama</td>
</tr>
</tbody>
</table>

Draft and revise your writing, and then evaluate it.

Use a rubric for self-evaluation.
# Evaluating Your Writing

Use the following rubric to help you evaluate your writing.

<table>
<thead>
<tr>
<th></th>
<th>Excellent</th>
<th>Good</th>
<th>Acceptable</th>
<th>Unacceptable</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purpose</strong></td>
<td>Achieves purpose—to inform, persuade, or provide historical interpretation—very well</td>
<td>Informs, persuades, or provides historical interpretation reasonably well</td>
<td>Reader cannot easily tell if the purpose is to inform, persuade, or provide historical interpretation</td>
<td>Lacks purpose</td>
</tr>
<tr>
<td><strong>Organization</strong></td>
<td>Develops ideas in a very clear and logical way</td>
<td>Presents ideas in a reasonably well-organized way</td>
<td>Reader has difficulty following the organization</td>
<td>Lacks organization</td>
</tr>
<tr>
<td><strong>Elaboration</strong></td>
<td>Explains all ideas with facts and details</td>
<td>Explains most ideas with facts and details</td>
<td>Includes some supporting facts and details</td>
<td>Lacks supporting details</td>
</tr>
<tr>
<td><strong>Use of Language</strong></td>
<td>Uses excellent vocabulary and sentence structure with no errors in spelling, grammar, or punctuation</td>
<td>Uses good vocabulary and sentence structure with very few errors in spelling, grammar, or punctuation</td>
<td>Includes some errors in grammar, punctuation, and spelling</td>
<td>Includes many errors in grammar, punctuation, and spelling</td>
</tr>
</tbody>
</table>
Section 1: Guided Reading and Review

Scarcity and the Factors of Production

A. As You Read
As you read Section 1, supply in the space provided an explanation an economist might give showing why each statement is true. Possible answers below

Statement
1. People must make choices to satisfy their needs and wants.
2. Scarcity always exists.
3. Physical capital is an important factor of production.
4. All goods and services are scarce.
5. Entrepreneurs are important to the production of goods and services.

Explanation
1. Goods and services are limited, or scarce.
2. Our needs and wants are always greater than our resource supply.
3. Physical capital can save people time and money.
4. The land, labor, and capital needed to produce them are scarce, or limited.
5. Entrepreneurs bring the factors of production together.

B. Reviewing Key Terms
Complete each sentence by writing the correct term in the blank.

6. A CD player is a ______ want ______ rather than a need because it is not necessary to survival.
7. The study of how people seek to meet their needs and wants by making choices is ______ economics ______.
8. Persons who perform such actions as cutting hair or teaching school are providing ______ services ______.
9. When producers will not or cannot offer goods and services at current prices, a ______ shortage ______ occurs.
10. Land, labor, and capital make up the ______ factors of production ______.
11. When people make resources for producing other goods and services they are creating ______ capital ______.
12. The term ______ land ______ refers to water, forests, and all other natural resources used to produce goods and services.
13. The two categories of capital are physical and ______ human ______.
14. Factories, machinery, and pencils are all examples of ______ physical ______ capital.
15. Leaders who take risks to develop original ideas and start new industries are called ______ entrepreneurs ______.
A. As You Read

As you read Section 2, fill in two supporting facts or details under each main idea by answering each question.  

**Main Idea:** Trade-offs are alternatives that people give up when they choose one course of action over another.

1. Who makes trade-offs?  
   **Possible answers below**
   - **individually, businesses, and governments**

2. Why do decisions involve trade-offs?  
   **Possible answers below**
   - **Resources are limited.**

**Main Idea:** Opportunity cost is the most desirable alternative given up as the result of a decision.

3. How does opportunity cost vary?  
   **Possible answers below**
   - It varies based on what is being given up by making the decision. 
   - The choices of what must be given up vary from situation to situation.

4. Why does opportunity cost vary?  
   **Possible answers below**
   - The choices of what must be given up vary from situation to situation.

**Main Idea:** Deciding whether to do or use one more or one less unit of some resource is thinking at the margin.

5. What does thinking at the margin help with?  
   **Possible answers below**
   - **decision making**

6. What does thinking at the margin help compare?  
   **Possible answers below**
   - **opportunity cost and benefits**

B. Reviewing Key Terms

Answer each of the following questions.  

7. In what way are trade-offs and opportunity costs alike?  
   **Possible answers below**
   - Both trade-offs and opportunity costs are choices/benefits that individuals or groups give up in favor of another choice/benefit.

8. How does an opportunity cost differ from a trade-off?  
   **Possible answers below**
   - An opportunity cost is the most desirable option of all those available, but there may be more than one trade-off.

9. What are “guns or butter” decisions?  
   **Possible answers below**
   - Guns or butter decisions are made by countries/societies when they choose to produce more or less military or consumer goods.

10. How does thinking at the margin change the decision-making process?  
    **Possible answers below**
    - Thinking at the margin considers the relative benefit of doing or using one additional unit of a resource.
A. As You Read
As you read Section 3, complete the chart by indicating where on a production possibilities curve the following information is shown.

### Reading a Production Possibilities Curve

1. Categories or specific goods or services to be compared
   - horizontal and vertical axes

2. Range of choices in the combination of goods or services produced
   - points plotted on the graph

3. Production possibilities frontier
   - line connecting the plotted points

4. An economy working at its most efficient production levels
   - production possibilities frontier

5. An economy working below its most efficient production levels
   - points inside of the production possibilities frontier

6. Future production possibilities frontier if more land, labor, or capital resources become available
   - line outside of the production possibilities frontier

### B. Reviewing Key Terms
Define the following terms.

7. production possibilities curve
   - graph that shows alternative ways to use an economy’s resources

8. production possibilities frontier
   - line on a production possibilities curve that shows the maximum possible output

9. efficiency
   - using resources in such a way as to maximize the output of goods and services

10. underutilization
    - using fewer resources than an economy is capable of using

11. cost
    - alternative that is given up because of a decision

12. law of increasing costs
    - Shifting factors of production from making one good or service to another increases the cost of producing the second item.
**A. As You Read**

As you read Section 1, supply the missing information about economic systems in the spaces provided.

1. Three economic questions answered:
   (a) **What goods and services should be produced?**
   (b) **How should these goods and services be produced?**
   (c) **Who consumes these goods and services?**

2. Economic concept necessitating choices and priorities in any society:
   **Scarcity—resources are limited**

3. Economic question answered by basic social values and goals:
   **Who consumes which goods and services?**

4. Five basic economic goals guiding society’s choice of systems:
   (a) **efficiency**
   (b) **freedom**
   (c) **security and predictability**
   (d) **equity**
   (e) **growth and innovation**

5. Four main kinds of economies:
   (a) **traditional**
   (b) **market**
   (c) **centrally planned**
   (d) **mixed**

**B. Reviewing Key Terms**

Complete each sentence by writing the correct term in the blank.

6. An economic system that relies on habit, custom, or ritual to decide questions of production and consumption of goods and services is a **traditional economy**.

7. An encyclopedia entry illustrating how a hunter-gatherer group collects and shares food resources is describing that society’s **economic system**.

8. When voluntary exchanges in the markets determine decisions on production and consumption, the society’s economic system is a **market economy**.

9. When people earn income for supplying land, labor, capital, or entrepreneurship, they receive **factor payments**.

10. An economic system in which the central government makes all decisions on production and consumption of goods and services is a **centrally planned economy**.

11. People who receive disaster relief from the government after a flood are benefiting from an economic system that provides a **safety net**.
A. As You Read

As you read Section 2, list the role or roles played in a free market economy by each factor in the diagram below.

Roles and Functions in a Free Market Economy

1. Individuals and Businesses
   - own factors of production; produce and buy what they want

2. Households
   - own land, labor, and capital; consume goods and services

3. Firms
   - use resources to produce products, then sell them

4. Self-interest
   - motivates consumers and producers

5. Competition
   - regulates production, buying, and selling

B. Reviewing Key Terms

Match the definitions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided. You will not use all of the terms.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td>c</td>
<td>a. profit</td>
</tr>
<tr>
<td>e</td>
<td>b. competition</td>
</tr>
<tr>
<td>i</td>
<td>c. product market</td>
</tr>
<tr>
<td>h</td>
<td>d. market</td>
</tr>
<tr>
<td>a</td>
<td>e. incentive</td>
</tr>
<tr>
<td>g</td>
<td>f. self-interest</td>
</tr>
<tr>
<td>d</td>
<td>g. specialization</td>
</tr>
<tr>
<td></td>
<td>h. factor market</td>
</tr>
<tr>
<td></td>
<td>i. consumer sovereignty</td>
</tr>
</tbody>
</table>
Section 3: Guided Reading and Review

Centrally Planned Economies

A. As You Read
As you read Section 3, supply the missing information in the chart below.

Central Economic Planning in the Former Soviet Union

1. Main goal: **building national power and prestige**

2. Role of central government:
   (a) control land, labor, and capital
   (b) decide what, how much, and how to produce and distribute goods and services

3. Effects on agriculture:
   (a) Positive **workers were guaranteed employment and income**
   (b) Negative **lack of incentives to produce more or better crops; country could not feed its population**

4. Effects on industry:
   (a) Positive **jobs and wages were guaranteed**
   (b) Negative **lack of worker incentive and innovation; lower quality resources for consumer goods**

5. Effects on consumers:
   (a) Positive **luxuries were affordable**
   (b) Negative **shortages and poor quality of goods and housing**

B. Reviewing Key Terms
Define the following terms.

6. socialism **social and political philosophy advocating equal distribution of wealth throughout a society**

7. communism **political system characterized by a centrally planned economy with all economic and political power resting with the central government**

8. authoritarian **requiring strict obedience to an authority, such as a dictator**

9. collective **a large Soviet farm leased by the state to groups of peasant farmers**

10. heavy industry **industry that requires a large capital investment and that produces items used in other industries**
A. As You Read

As you read Section 4, fill in two supporting facts or details under each main idea by answering each question. Possible answers below

Main Idea: Government intervenes in market economies because some needs and wants of modern societies are hard to answer in the marketplace or may be answered more fairly for all members of society with government involvement.

1. What needs and wants are hard to answer? national defense, roads and highway systems, conservation, environmental protection

2. What needs and wants are answered more fairly with government involvement? education, health care, employment, mass transit

Main Idea: Government intervention dominates in some mixed economies.

3. How does government intervene in North Korea’s economy? Government owns all property and economic output; there is some private production.

4. How is government intervention less extreme in China’s economy? It is moving away from central planning, and one quarter of all enterprises are at least partly owned by individuals.

Main Idea: The market system dominates in some mixed economies.

5. Where is the world’s freest market located? Hong Kong

6. Why is it one of the freest? As a special administrative region of China, Hong Kong is being allowed to continue under the free economic system introduced during British rule.

B. Reviewing Key Terms

Answer each of the following questions. Possible answers below

7. How does free enterprise differ from laissez faire? Under a free enterprise system, the government plays a limited role in the marketplace; under pure laissez faire, the government would play no role.

8. Why is China said to have a transition economy? China is in the process of changing, or making a transition, from central planning to a market-based economy.

9. What does it mean to privatize an industry? An industry is privatized when ownership is transferred from the state to private individuals, thus encouraging competition.

10. Why do the world’s national economies fall inside a continuum? No national economy today relies completely on either central planning or the free market.
Section 1: Guided Reading and Review

Benefits of Free Enterprise

A. As You Read
As you read Section 1, supply the missing information about the American market system in the spaces provided.

Free Enterprise

Basic principles:
1. open opportunity
2. competition
3. private property
4. free contract
5. profit motive
6. legal interest
7. voluntary exchange

Consumer

Basic Roles:
8. economic choices
9. joining interest groups

Government

Basic Roles:
10. public disclosure laws
11. environmental protection
12. consumer protection
13. governmental regulations

B. Reviewing Key Terms
Complete each sentence by writing the correct key term in the blank.

14. When individuals decide to put their house up for sale, they are exercising their _______ private property rights _______.

15. Farmers who feel they need a private organization to influence public policy in their behalf might form a/an _______ interest group _______.

16. Nutritional values printed on candy wrappers or milk cartons are required under _______ public disclosure laws _______.

17. The concerns of the public as a whole make up the _______ public interest _______.

© Pearson Education, Inc.
Section 2: Guided Reading and Review
Promoting Growth and Stability

A. As You Read
As you read Section 2, supply the requested information in the spaces provided.
1. Usual length of the business cycle: __less than a year or many years__

2. Three main outcomes of public policy aimed at economic stability: __high employment, steady growth, stable prices__

3. Requirement for raising living standards for new generations: __economy grows enough to provide additional goods and services__

4. Two indicators of economic stability: __steady prices, health of financial institutions__

5. Government-provided incentives for innovation: __funding of research and development projects, operation of government research institutions, granting of patents and copyrights__

B. Reviewing Key Terms
Define the following terms.
6. macroeconomics _the study of the behavior and decision making of entire economies_

7. microeconomics _the study of the economic behavior and decision making of small units, such as individuals, families, and businesses_

8. business cycle _a period of macroeconomic expansion followed by a period of contraction_

9. gross domestic product _the total value of all final goods and services produced in a particular economy in a year_

10. technology _the process used to produce a good or service_
Section 3: Guided Reading and Review

Providing Public Goods

A. As You Read

As you read Section 3, fill in two supporting facts or details under each main idea by answering each question. Possible answers below

Main Idea: In some situations, the free market does not efficiently distribute resources.
1. What is an example of something that self-interest would not motivate consumers to provide? 
   - an efficient highway system

2. Why might this public good be unreasonable to expect from private providers?
   - Profit incentives would not motivate private builders to construct an efficient highway system.

Main Idea: Cost is an important factor in determining whether a good or service is produced as a public good.
3. How does this factor relate to the individual? 
   - The benefit to each individual must be less than the cost each would pay if it were provided privately.

4. How does this factor relate to society? 
   - The total benefits to society must be greater than the total cost.

Main Idea: A good or service can generate positive or negative side effects for people who do not pay for or produce them.
5. What is an example of a positive side effect? 
   - Cleaning up a run-down property would benefit neighbors by raising their property values.

6. What is an example of a negative side effect? 
   - Pollution by a company may involve cleanup costs for the community.

B. Reviewing Key Terms

Match the definitions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>d</strong> 7. shared good or service for which it would be impractical to make consumers pay individually and to exclude nonpayers</td>
<td>a. externality</td>
</tr>
<tr>
<td><strong>c</strong> 8. situation in which the free market does not distribute resources efficiently</td>
<td>b. public sector</td>
</tr>
<tr>
<td><strong>b</strong> 9. part of the economy that involves the transactions of the government</td>
<td>c. market failure</td>
</tr>
<tr>
<td><strong>f</strong> 10. part of the economy involving transactions of individuals and businesses</td>
<td>d. public good</td>
</tr>
<tr>
<td><strong>a</strong> 11. economic side effect of a good or service that generates unintended benefits or costs to someone other than the person deciding how much to produce or consume</td>
<td>e. free rider</td>
</tr>
<tr>
<td><strong>e</strong> 12. someone who would not choose to pay for a certain good or service, but who can still reap the benefits of it anyway if it is a public good</td>
<td>f. private sector</td>
</tr>
</tbody>
</table>
A. As You Read
As you read Section 4, supply the missing information in the chart below.

<table>
<thead>
<tr>
<th>Program or Program Area</th>
<th>Form of Aid</th>
<th>Recipients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. TANF</td>
<td>cash transfers</td>
<td>needy families or households</td>
</tr>
<tr>
<td>2. Social Security</td>
<td>cash transfers</td>
<td>elderly and disabled</td>
</tr>
<tr>
<td>3. Unemployment Insurance</td>
<td>cash transfers</td>
<td>Workers who are laid off or lose their jobs</td>
</tr>
<tr>
<td>4. Worker’s Compensation</td>
<td>cash transfers</td>
<td>workers injured on the job</td>
</tr>
<tr>
<td>5. Medicare and Medicaid</td>
<td>Health insurance</td>
<td>Medicare: those over 65 and/or disabled; Medicaid: poor unemployed or poor employed but uninsured</td>
</tr>
<tr>
<td>6. Education</td>
<td>programs from preschool to college</td>
<td>poor people, students with disabilities</td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms
Rewrite each statement below to make it agree with the italicized key term.

7. The most common *in-kind benefits* include food giveaways, food stamps, subsidized housing, and farm aid. The most common in-kind benefits include food giveaways, food stamps, subsidized housing, and legal aid.

8. The government institutes *welfare* programs to improve transportation routes. The government institutes welfare programs to benefit the poor.

9. A nation’s *standard of living* indicates its level of income distribution. A nation’s standard of living indicates its level of economic well-being.

10. The *poverty threshold* is the income level below that which is needed to provide the needs and wants of families or households. The poverty threshold is the income level below that which is needed to support families or households.
A. As You Read
As you read Section 1, for each boxed example, fill in the key term the example illustrates in the space provided.

1. the higher the price of pizza, the fewer slices people will buy
   - law of demand

2. eating salad or tacos instead of pizza when the price of pizza goes up
   - substitution effect

3. buying fewer slices of pizza when rising prices reduce real income
   - income effect

4. Price | Quantity
         |      
---|---
1 | 5 
2 | 4 
3 | 3 
4 | 2 
   - demand schedule

5. Price | Quantity
         |      
---|---
1 | 300 
2 | 250 
3 | 200 
4 | 150 
   - market demand schedule

B. Reviewing Key Terms
Complete each sentence by writing the correct term in the blank.

6. A ____________ is a table that lists the quantities of a good a person will buy at each price that may be offered in the market.
   - demand schedule

7. A ____________ is a table that lists the quantities of a good demanded by all consumers at each price that may be offered in the market.
   - market demand schedule

8. A ____________ is a graphical representation of a demand schedule.
   - demand curve

9. The ____________ is the change in consumption resulting from a change in real income.
   - income effect

10. The ____________ says that when a good’s price is lower, consumers will buy more of it.
    - law of demand
Shifts of the Demand Curve

A. As You Read
As you read Section 2, answer the following questions in the space provided. Possible answers below

1. What condition must exist to make a demand curve accurate? ___________________________
   nothing changes but price (ceteris paribus)

2. What happens to a demand curve when there is a change in factors (other than price) that can affect consumers’ decisions about purchasing the good? ___________________________
   the entire curve shifts

3. How does consumer income affect the demand for normal and inferior goods? ________________
   Increased income increases demand for normal goods and decreases demand for inferior goods.

4. How does consumer expectation affect demand for certain goods? ___________________________
   If consumers expect prices to rise in the future, immediate demand will increase; if consumers expect prices to fall in the future, immediate demand will decrease.

5. Explain how the baby boom generation affected demand for certain goods. _______________________
   When baby boomers were infants, demand for baby goods increased; when they reached school age, demand for schools and school-related items increased; when they reached adulthood and married, demand for housing and related items increased.

6. How are consumer tastes and advertising related? ___________________________
   Advertising can affect consumer tastes, causing consumers to develop a desire for certain items and creating demand for goods that were not previously in demand.

7. Explain how demand for a good can affect demand for a related good. ___________________________
   If demand for an item such as snow skis increases, then demand for related goods such as ski boots will also increase since the two items are used together.

8. Give an example of a substitute good. ___________________________
   A snowboard is a substitute for snow skis.

B. Reviewing Key Terms
Match the definitions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td>c</td>
<td>9. all other things held constant</td>
</tr>
<tr>
<td>a</td>
<td>10. goods whose demand increases as consumer income increases</td>
</tr>
<tr>
<td>d</td>
<td>11. goods whose demand falls as consumer income increases</td>
</tr>
<tr>
<td>e</td>
<td>12. goods that are bought and used together</td>
</tr>
<tr>
<td>b</td>
<td>13. goods that are used in place of one another</td>
</tr>
</tbody>
</table>

a. normal goods  
b. substitutes  
c. ceteris paribus  
d. inferior goods  
e. complements
Section 3: Guided Reading and Review

Elasticity of Demand

A. As You Read

As you read Section 3, supply the missing information in the spaces provided. Possible answers below

Calculating Elasticity (Provide a formula or numerical value.)

1. Computation of elasticity of demand: percentage change in the demand of a good divided by percentage change in the price

2. Elastic demand: elasticity value is greater than 1

3. Inelastic demand: elasticity value is less than 1

4. Unitary elastic demand: elasticity value is equal to 1

Factors Affecting Elasticity (How does each affect elasticity?)

5. Substitutes: If there are substitutes available, the demand for a good is elastic. If there are no substitutes for a good, such as life-saving medicine, the demand for the medicine is inelastic.

6. Necessities vs. luxuries: Necessities—demand is inelastic; luxuries—demand is elastic.

7. Changes over time: Demand for a good may be inelastic in the short term because it takes consumers time to change their shopping habits.

Elasticity and Revenue (Define and explain.)

8. Total revenue: Total revenue is the amount of money a company receives for selling its goods and is determined by the price of the goods and the quantity sold.

9. How elasticity affects a company’s pricing: If demand for a company’s product is elastic, a price increase could cause consumers to buy less and reduce total revenue; if demand is inelastic, a price increase will increase total revenue.

B. Reviewing Key Terms

Briefly define or identify each of the following.

10. elasticity of demand _the way that consumers respond to price changes_

11. inelastic _demand for a good continues despite a price increase_

12. elastic _demand decreases after even a small price increase_

13. unitary elastic _the percentage change in quantity demanded is exactly equal to the percentage change in price_
### A. As You Read
As you read Section 1, supply the missing causes or effects on the lines provided in the chart.

<table>
<thead>
<tr>
<th>Cause</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The price of pizza increases.</td>
<td>1. On pizzerias:</td>
</tr>
<tr>
<td></td>
<td>Existing pizzerias will increase output; new</td>
</tr>
<tr>
<td></td>
<td>restaurants will enter the pizza market.</td>
</tr>
<tr>
<td>2. The cost of tomato sauce increases along with the price of pizza.</td>
<td>2. On pizza supply schedule:</td>
</tr>
<tr>
<td></td>
<td>The schedule will have to be remade.</td>
</tr>
<tr>
<td>3. All pizzerias will charge prices in the same range.</td>
<td>3. On market supply curve: Prices will remain the same as on a single</td>
</tr>
<tr>
<td></td>
<td>pizzeria’s supply curve.</td>
</tr>
<tr>
<td>4. Higher prices lead to higher output of a good.</td>
<td>4. On supply curve:</td>
</tr>
<tr>
<td></td>
<td>The curve always rises from left to right.</td>
</tr>
<tr>
<td>5. The supply of a good is not very responsive to price changes.</td>
<td>5. On the value of elasticity of supply:</td>
</tr>
<tr>
<td></td>
<td>The value of elasticity is less than one.</td>
</tr>
<tr>
<td>6. A supplier, such as an orange grower, has a long time to respond</td>
<td>6. On supply:</td>
</tr>
<tr>
<td></td>
<td>The supply becomes more elastic.</td>
</tr>
</tbody>
</table>

### B. Reviewing Key Terms
Read the statements below. In the space provided, write T if the statement is true or F if it is false.

- **7.** Price and quantity supplied are variables on a supply schedule. **T**
- **8.** A supply curve shows price and quantity in a table. **F**
- **9.** Elasticity of supply states that the output of a good increases as the price of the good increases. **F**
- **10.** To create a market supply schedule, an economist needs to know the total output of all suppliers in a given market. **T**
Section 2: Guided Reading and Review

Costs of Production

A. As You Read

As you read Section 2, supply the requested information in the spaces provided.

1. A basic question a producer must answer: **Producers must decide how many workers to hire.**

2. Marginal product of labor benefits gained from worker specialization: **increased output per worker and rising marginal product of labor**

3. Negative effect of a firm’s limited capital: **Total output increases at a decreasing rate, creating diminishing marginal returns of labor.**

4. Curve pattern for marginal product of labor when capital is limited: **increasing marginal returns followed by diminishing marginal returns**

5. Examples of typical fixed costs: **rent, machinery repairs, property taxes, salaries of workers needed to keep the business running even when production is interrupted**

6. Why labor is a variable cost: **The cost of labor changes with the number of workers, which changes with quantity produced.**

7. How the marginal costs of production for the beanbag producer changed after the rate of three bags per hour was surpassed: **Marginal costs increased with each additional bag per hour because the benefits of specialization were exhausted and the diminishing returns of labor set in.**

8. How total revenue and total cost can help set the most profitable output level: **Where total revenue is greater than total cost, find the biggest gap between the two figures.**

9. How marginal revenue and marginal cost can help set the most profitable output level: **The point at which the two figures are equal results in the highest profit level.**

10. Why a producer would continue to increase output even though the marginal cost of production may be rising: **A profit can still be captured as long as marginal cost does not overtake marginal revenue.**

B. Reviewing Key Terms

Define the following terms.

11. marginal product of labor: **change in output resulting from hiring one more worker**

12. diminishing marginal returns: **level of production in which the marginal production decreases with new investment**

13. total cost: **sum of fixed and variable costs**

14. marginal cost: **additional cost of producing one more unit**
Section 3: Guided Reading and Review

Changes in Supply

A. As You Read
As you read Section 3, supply information to complete each statement in the spaces provided.

1. Unable to control price, a profitable producer faced with rising labor and/or materials costs will
   cut production and lower marginal cost until marginal cost equals the lower price

2. New technology affects supply by
   lowering costs and increasing supply at all price levels

3. European governments’ reasons for subsidizing food producers include
   ensuring that their farms can feed their citizens in case imports are cut off, and in France,
   protecting the lifestyle and look of the countryside

4. In the past, Western European governments subsidized banks and airlines by
   promising to pay off these industries’ debts

5. The United States government subsidizes such industries as
   mining, cattle ranching, and tobacco growing

6. An excise tax increases production costs by
   adding an extra cost for each unit sold

7. Consumers may be unaware of excise taxes because
   such taxes are built into the price of the good

8. Government regulations often reduce supply because
   they increase costs

9. During periods of inflation, suppliers may temporarily withhold goods that can be stored
   for long periods because
   such goods retain their value while cash loses its value

B. Reviewing Key Terms
Complete each sentence by writing the correct key term in the blank provided.

10. Government can increase supply by granting producers a(n) ______ subsidy ______.

11. To reduce supply, a government might levy a(n) ______ excise tax ______.

12. Requiring pollution control on automobiles exemplifies government ______ regulation ______.
A. As You Read

As you read Section 1, supply the requested information in the spaces provided.

In the Case of the Pizzerias
1. The market equilibrium price: $1.50
2. The market supply level: 200 slices
3. The market demand level: 200 slices

In Any Market Environment
4. How equilibrium is shown on a supply and demand graph: point at which the supply curve crosses the demand curve
5. Two possible outcomes of disequilibrium: excess supply or excess demand
6. Supplier price response to excess demand: Suppliers will raise prices until demand equals supply.
7. Condition under which market forces will push market toward the equilibrium: whenever the market is in disequilibrium and prices are flexible

In the Case of Government Intervention
8. Purpose(s) of rent control: to prevent inflation during a housing crisis, help renters with the greatest need
9. Negative results of ending rent control: Lower-income people may not be able to afford the new rates; landlords may improve buildings and raise prices beyond the reach of current residents.
10. Effect on labor when minimum wage exceeds equilibrium: excess supply of labor
11. Purpose of Northeast Dairy Compact: to guarantee a minimum price for milk produced on farms in the northeastern states

B. Reviewing Key Terms

Complete each sentence by writing the correct term in the blank provided.

12. When government wants to ensure that “essential” goods or services are within the reach of all consumers, it may impose a(n) price ceiling.
13. If prices rise too high, a market may face the problem of excess supply.
14. The one and only price at which quantities supplied equal quantities demanded indicates the market equilibrium.
15. Minimum wage is an example of a government-imposed price floor.
16. If car manufacturers produce more or fewer cars than customers will buy, the car market will be in disequilibrium.
Section 2: Guided Reading and Review

Changes in Market Equilibrium

A. As You Read

As you read Section 2, complete the chart by supplying an effect for each cause.

<table>
<thead>
<tr>
<th>Cause</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Entire supply curve shifts.</td>
<td>1. Equilibrium price and quantity change.</td>
</tr>
<tr>
<td>2. Technology for making compact disc (CD) players improved.</td>
<td>2. Prices fall.</td>
</tr>
<tr>
<td>3. After a drop in production cost, CD player suppliers become willing to offer 1,200,000 units at the original price, but demand remains at 1,000,000.</td>
<td>3. Excess supply causes suppliers to reduce prices in order to increase demand.</td>
</tr>
<tr>
<td>4. Price of CD players continues to fall.</td>
<td>4. Equilibrium point moves gradually downward and to the right.</td>
</tr>
<tr>
<td>5. Production cost of CD players continues to fall.</td>
<td>5. Supply curve continues to move to the right.</td>
</tr>
<tr>
<td>6. Market’s supply curve shifts to the left.</td>
<td>6. In the market: Price rises and demand falls. On the equilibrium point: Moves up and to the left</td>
</tr>
<tr>
<td>7. Demand curve of a good suddenly shifts right.</td>
<td>7. excess demand for that good at its original price; shortages of the good; long consumer lines at stores; consumer search costs</td>
</tr>
<tr>
<td>8. Signs of excess demand for the good continue over time.</td>
<td>8. On suppliers: Suppliers will raise prices.</td>
</tr>
<tr>
<td>9. Demand for a good falls.</td>
<td>9. On the demand curve: Demand curve shifts to the left.</td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms

Rewrite each sentence so that the italicized term is used correctly.

10. *Shortage* occurs when the quantity demanded falls below the quantity supplied.

   *Shortage occurs when the quantity demanded exceeds the quantity supplied.*

11. Excess demand for a good indicates a market *surplus* of that good.

   *Excess supply of a good indicates a market surplus of that good.*

12. Suppliers pay *search costs* in the form of financial and opportunity costs as they search for a good.

   *Consumers pay search costs in the form of financial and opportunity costs as they search for a good.*
The Role of Prices

A. As You Read

As you read Section 3, answer the questions on the lines provided. Possible answers below

1. What overall, vital role do prices play in the free market? Prices help move land, labor, and capital into the hands of producers and finished goods into the hands of buyers.


3. What signals do high prices send to producers and consumers? High prices tell existing producers to produce more and new producers to enter the market; they also tell consumers to think carefully before buying.

4. Why do suppliers use price rather than production to resolve the problem of excess demand? Prices are flexible and can be changed easily and quickly, but changing production can be costly and time consuming.

5. What drives the distribution system in the free market? The millions of decisions made daily by consumers and suppliers.

6. How does a price-driven economy allow for a wide diversity of goods? It gives consumers a way to choose among similar products and allows producers to target the audience they want with goods that will sell best to that audience.

7. What was the goal of the Soviet planned economy? To create a society in which everyone was equal.

8. How did the Soviet economic system affect consumer goods? There was little variety of goods, and although inexpensive, goods were hard to get.

9. How does the free market ensure an efficient allocation of resources? The free market ensures that resources go to uses consumers value most and that resource use will adjust to consumers' changing demands.

10. What motivates suppliers to increase production in the face of high demand and high prices? Profit incentive.

11. What three problems in the free market work against the efficient allocation of resources? Imperfect competition, spillover costs, and imperfect information.

B. Reviewing Key Terms

Define the following terms.

12. supply shock sudden shortage of a good

13. rationing dividing up scarce goods and services using criteria other than price

14. spillover costs costs of production, such as air and water pollution, that affect people who have no control over how much of a good is produced
A. As You Read
As you read Section 1, supply the missing cause or effect in the spaces provided.

The Perfect Market Structure

1. Cause: So many independent buyers and sellers make it unlikely that large enough groups will work together to bargain for better prices.
   Effect: The market determines price without influence from suppliers or consumers.

2. Cause: The buyer will not pay extra for one particular company's goods when goods are identical.
   Effect: Identical products are key to perfect competition.

3. Cause: Entrepreneurs are less likely to enter a market with high start-up costs.
   Effect: Markets with high start-up costs are less likely to be perfectly competitive markets.

   Effect: Firms freely enter and leave a perfectly competitive market.

5. Cause: Many sellers compete to offer commodities to buyers.
   Effect: Prices are forced down to the point where they just cover the seller's costs of doing business.

6. Cause: No producer can influence prices in perfectly competitive markets.
   Effect: Producers adjust their output decisions based on their most efficient use of available land, labor, and capital.

B. Reviewing Key Terms
Briefly define or identify each of the following.

7. perfect competition a market with many well-informed buyers and sellers, identical products, and free entry and exit

8. commodity a product considered the same regardless of who makes or sells it

9. barrier to entry any factor that makes it difficult for new firms to enter a market

10. start-up costs expenses a new business must pay before the first product reaches the customer
Section 2: Guided Reading and Review
Monopoly

A. As You Read
As you read Section 2, supply the missing information in the spaces provided. Possible answers below

In the Monopolist Market

Natural Monopolies
1. Why they exist Competing sellers would create a___
   less efficient market.
2. Two examples public water companies, or public ___
   electric or gas utility companies
3. Advantage of can avoid wasting resources for ___
   duplicate facilities
4. Government role in Government may allow one firm in each geographic area, it then controls pricing and what services are to be offered.

Government Monopolies
5. Type set up by patents technological
6. Why government grants patented monopolies to encourage research and development that benefits society
7. Example of an industrial monopoly professional sports leagues
8. Two examples of government monopolies by license radio and television broadcast frequencies; city public parking lots

Production and Pricing
9. Effect of a monopolist’s price increase It will generally sell less.
10. Relationship between price and marginal revenue when a monopolist cuts the price to sell more Marginal revenue is less than price.
11. How a monopolist maximizes profits chooses a level of output where marginal cost equals marginal revenue

B. Reviewing Key Terms
Complete each sentence by writing the correct key term in the blank.
12. In a market with only one seller, that seller has a monopoly.
13. Characteristics that cause a producer’s average cost to drop as production rises are economies of scale.
14. A contract issued by a local authority that gives a single firm the right to sell its goods within an exclusive market is a franchise.
15. A monopoly offering targeted discounts is practicing price discrimination.
A. As You Read

As you read Section 3, fill in the information requested on the charts.

### Monopolistic Competition Market Structures

<table>
<thead>
<tr>
<th>Defining Conditions</th>
<th>1. many firms</th>
<th>2. no artificial barriers to entry</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3. slight control over price</td>
<td>4. differentiated products</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Forms of Nonprice Competition</th>
<th>5. different physical characteristics</th>
<th>6. location of sale</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7. customer service level</td>
<td>8. advertising, image, or status</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Price-Output Relationship</th>
<th>9. One rises as the other falls.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Curbs on High Profits</th>
<th>10. fierce competition</th>
<th>11. new firms entering the market</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Consumer Advantages</th>
<th>12. wide variety of goods at fairly reasonable prices</th>
</tr>
</thead>
</table>

### Oligopoly

<table>
<thead>
<tr>
<th>Conditions Encouraging Formation</th>
<th>13. significant barriers to entry</th>
<th>14. high start-up costs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>15. economies of scale</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Practices that Concern Government</th>
<th>16. price leadership</th>
<th>17. collusion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>18. cartels</td>
<td></td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms

Read the statements below. In the space provided, write T if the statement is true or F if it is false.

F 19. Firms selling identical products create monopolistic competition.

T 20. Providing better customer service, introducing a new lipstick color, and sophisticated advertising are examples of nonprice competition.

T 21. Price fixing is an outcome of collusion.

F 22. A cartel is most successful when each member produces as much product as possible.
A. As You Read
As you read Section 4, supply the missing information about government market intervention in the numbered web boxes.

1. Goal
keep firms from controlling the price and supply of important goods

2. Antitrust Powers
watch and regulate industry; stop formation of cartels or monopolies; break up existing monopolies

3. Complaints Against Microsoft
requiring manufacturers to include Microsoft browser with Microsoft operating system and predatory pricing

4. Complaints Against AT&T
using legal monopoly in local service to take control over markets for long-distance phone calls and communications equipment

5. Guidelines for Mergers
must prove that merger would lower costs and consumer prices or lead to a better product

6. Recently Deregulated Industries
airlines, trucking, banking, railroads, natural gas, television broadcasting

B. Reviewing Key Terms
Use a key term to rewrite each sentence correctly.

7. Price fixing is the practice of setting the market price below cost for the short term to drive competitors out of business. Predatory pricing is the practice of setting the market price below cost for the short term to drive competitors out of business.

8. A monopoly occurs when a company joins with another company to form a single firm. A merger occurs when a company joins with another company to form a single firm.

9. Perfect competition means that the government no longer decides a company’s market role and pricing. Deregulation means that the government no longer decides a company’s market role and pricing.
A. As You Read
As you read Section 1, supply the missing information in the spaces provided.

**Sole Proprietorships**

1. Owned and managed by: **single individuals**
2. Percentage of U.S. businesses: **75 percent**
3. Percentages of U.S. sales generated: **6 percent**

List and explain the advantages of sole proprietorships.

4. **Ease of start-up—small amount of paperwork, usually only need to obtain licenses; obtain a certificate of occupancy if not working at home; and register a business name if not using one's personal name**
5. **Relatively few regulations—may be subject to zoning laws, but face very few legal requirements**
6. **Sole receiver of profit—do not need to share profits with anyone**
7. **Full control of business—can respond quickly to changes in the marketplace because you make all the decisions**
8. **Easy to discontinue—other than debts and taxes, there are no legal obligations when deciding to stop doing business**

List and explain the disadvantages of sole proprietorships.

9. **Unlimited personal liability—you are personally responsible for any debts your business might incur**
10. **Limited access to resources—usually lack physical and human capital and may not be able to keep up with demand as a result**
11. **Lack of permanence—no one will maintain business but you; hard to keep employees because of lack of fringe benefits**

B. Reviewing Key Terms
Find the term that does not belong in each set and explain how it does not relate to the other three. **Possible answers below**

12. (Business license, certificate of occupancy, business organization, registration of business name) **Business organization refers to an establishment formed to carry on a commercial enterprise. The other three items are typical requirements a sole proprietorship must meet.**

13. (Liability, health codes, zoning laws, dangerous chemical codes) **Liability refers to the legally bound obligation to pay debts. The other three terms are examples of some regulations to which sole proprietorships may be subject.**

14. (Human capital, fringe benefits, physical capital, financial resources) **Fringe benefits are payments other than wages or salaries. The other terms are examples of resources to which a sole proprietor may have limited access.**
Section 2: Guided Reading and Review

Partnerships

A. As You Read
As you read Section 2, supply the requested information in the spaces provided.

1. Typical examples of a general partnership
   - professionals such as lawyers, doctors, accountants;
   - small retail stores, farms, construction companies,
   - and family businesses

2. What limited partners do and do not do
   - do—contribute money; do not—manage business or
   - have unlimited personal liability

3. How limited liability partnerships compare with general partnerships
   - functions the same except that all partners in a limited
     liability partnership are limited from personal liability
     in certain situations

4. Items often covered under articles of partnership
   - each partner’s rights and responsibilities; how partners
     will share profits and losses; how new partners may be
     added to the firm; duration of partnership; tax
     responsibilities

5. Capital and taxation advantages of partnerships
   - pooled assets improve the firm’s borrowing capacity;
     can add partners to raise funds; ability to offer more
     advantages helps attract talented employees; business
     not subject to special taxes

6. Liability disadvantages of partnerships
   - general partner(s) have unlimited liability and so can
     lose personal property as well as investment; one
     partner’s actions can cost the whole firm

B. Reviewing Key Terms
Complete each sentence by writing the correct term in the blank.

7. Only one partner is required to be a general partner in a limited partnership.

8. Money and other valuables make up a person’s or firm’s assets.

9. Ownership interests and management responsibilities are legislated under the Uniform Partnership Act.
Section 3: Guided Reading and Review
Corporations, Mergers, and Multinationals

A. As You Read
As you read Section 3, supply the missing information in the graphic organizer.

1. Corporate Structure
   board of directors, who appoints corporate officers, who hire managers and employees that work in various departments

2. Advantages for Stockholders
   limited liability; stocks can be sold

3. Advantages for Businesses
   growth potential; long life potential

4. Start-up Procedure
   apply for state license; receive charter from state

5. Taxation
   corporation pays taxes on income; stockholders pay taxes on dividends and capital gains

6. Regulatory Requirements
   annual shareholders meetings; careful recordkeeping; annual and quarterly reports to SEC

7. Possible Combinations
   horizontal merger; vertical merger; conglomerate

B. Reviewing Key Terms
Read the statements below. In the space provided, write T if the statement is true, or F if it is false.

8. Companies in the same business might form vertical mergers.  F
9. Multinational corporations usually headquarter in several countries.  T
10. If you buy stocks, you own part of a corporation.  T
11. Corporate bonds pay dividends.  F
12. Corporations have a legal identity.  T
13. Dividends represent a portion of corporate profits.  T
14. Privately held corporations are also closely held corporations.  T
15. The federal government issues a company’s certificate of incorporation.  F
16. A conglomerate merges more than three companies making unrelated products.  T
17. Publicly held corporations sell stocks to the Securities and Exchange Commission.  F
18. Stockholders must pay a capital gains tax whenever they sell their shares.  F
### A. As You Read

As you read Section 4, supply the missing information under the headings on the chart.

Possible answers below

<table>
<thead>
<tr>
<th>Business Franchises</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td><strong>Disadvantages</strong></td>
</tr>
<tr>
<td>1. built-in product reputation; management training and support; standardized quality; national advertising programs; financial assistance from parent company; centralized buying power</td>
<td>2. submission to parent company’s guidance; high franchise fees, royalty payments; strict operating standards; purchasing restrictions; limited product line</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cooperative Organizations</th>
<th>Nonprofit Organizations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Membership and/or Purpose</strong></td>
<td><strong>Categories</strong></td>
</tr>
<tr>
<td>3. formed by individuals for shared benefits</td>
<td>4. consumer cooperatives, service cooperatives, producer cooperatives</td>
</tr>
<tr>
<td>5. usually formed to benefit society, mostly providing services rather than goods</td>
<td>6. museums, public schools, hospitals, adoption agencies, churches, professional organizations, business associations, trade associations, and labor unions</td>
</tr>
</tbody>
</table>

### B. Reviewing Key Terms

Briefly define or identify each of the following.

7. royalties _share of earnings given as payment_

8. trade association _a nonprofit organization that promotes the interests of a particular industry_

9. cooperative _a business organization owned and operated by a group of individuals for their mutual benefit_
A. As You Read

As you read Section 1, fill in two supporting facts or details under each main idea by answering each question.  

Possible answers below

Main Idea: The Bureau of Labor Statistics (BLS) tracks changes in the labor force.

1. How do economists define labor force?  
   The labor force is defined as all nonmilitary people who are employed or unemployed.

2. What criteria define unemployment?  
   People are unemployed if they are temporarily without work or not working but have looked for jobs within the last 4 weeks.

Main Idea: The changing economy has brought along a changing job market.

3. How did the electronics boom of the mid-twentieth century impact the job market?  
   It created a new surge in factory jobs.

4. What new jobs were created beginning in the 1970s?  
   The invention of the computer chip created growth in computer-related jobs.

Main Idea: Changes in the labor force can be traced to a number of causes.

5. How has higher education contributed?  
   It has increased human capital.

6. Why are there more women in the labor force?  
   Women have increased their human capital.

Main Idea: For about the past 20 years, the trend in average wage earnings can be described as slightly downward.

7. Have all workers received lower wages?  
   No, earnings of college graduates have increased, while earnings of others have decreased by a large amount.

8. How has competition affected wage earnings?  
   Competition from foreign companies has decreased the demand for low-skilled workers, while deregulation may have forced firms to cut wages as competition intensified.

B. Reviewing Key Terms

Answer each of the following questions in a complete sentence.  

Possible answers below

9. How might the learning effect influence wage trends?  
   Education may increase productivity and result in higher wages.

10. According to the screening effect, how may employers view job applicants who have a college education?  
    Employers may view such applicants as intelligent and hard-working.

11. To what kinds of jobs does contingent employment refer?  
    Contingent employment refers to temporary and/or part-time jobs.
Section 2: Guided Reading and Review

Labor and Wages

A. As You Read

As you read Section 2, complete each of the following sentences.

1. Employment in a labor market depends on how closely the demand for workers meets ______the supply______.

2. The price of labor (earnings) depends on ______conditions in the labor market______.

3. Professional labor requires ______advanced skills and education______.

4. In a competitive market, workers are usually paid according to ______how much revenue they produce______.

5. Higher labor prices decrease the ______amount of labor demanded______.

6. Firms can respond to higher wages by replacing ______human capital with physical capital______.

7. Higher wages increase the ______quantity of labor supplied______.

8. Jobs in the skilled labor category require ______specialized skills and training______.

9. A high equilibrium wage is the result of ______low supply and high demand in a given field of labor______.

10. The Equal Pay Act of 1963 provided that ______male and female employees in the same workplace performing the same job had to receive the same pay______.

11. Title VII of the 1964 Civil Rights Act forbids job discrimination on the basis of ______race, sex, color, religion, or nationality______.

12. Lack of human capital and possible discrimination contribute to low wages for ______women and minority workers______.

13. Negative effects on nonunion wages can be reduced when unions ______pressure firms to avoid job cuts as wages are forced up______.

B. Reviewing Key Terms

Define the following terms.

14. labor force ______all nonmilitary people who are employed or unemployed______.

15. equilibrium wage ______the wage rate that produces an excess of neither the supply of nor the demand for workers in the labor market______.

16. glass ceiling ______an unofficial, invisible barrier preventing women and minorities from advancing in businesses dominated by white men______.

17. featherbedding ______practice of negotiating labor contracts that keep unneeded workers on a company’s payroll______.
A. As You Read
As you read Section 3, supply the information requested by the heading in each box.

Major U.S. labor organizations formed between 1869 and 1955:
1. (1869) Knights of Labor
2. (1886) American Federation of Labor
3. (1938) Congress of Industrial Organizations
4. (1955) AFL-CIO

Anti-union strategies used by U.S. employers before the 1930s:
5. identified and fired union organizers
6. forced workers to sign yellow-dog contracts
7. asked for injunctions to end strikes
8. hired their own militias to harass union organizers

Economic changes that have affected unions:
9. reduction in manufacturing
10. manufacturing job location
11. reduction in employment for key union industries

Ways in which unions have declined in traditional strongholds:
12. decline in blue-collar manufacturing jobs
13. foreign competition causing worker layoffs
14. rising proportion of women in labor force
15. industries relocating to the South, which is generally unfriendly to unions

Major issues covered under a union contract:
16. wages and benefits
17. working conditions
18. job security

B. Reviewing Key Terms
Match the definitions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided. You will not use all of the terms.

Column I
19. union and company representatives meeting to negotiate a contract
20. worker in a professional job receiving a salary
21. measure banning mandatory union membership
22. worker in an industrial job
23. settlement technique using third party reviews
24. organized work stoppage

Column II
a. arbitration
b. strike
c. blue-collar worker
d. collective bargaining
e. white-collar worker
f. mediation
g. right-to-work law
Section 1: Guided Reading and Review

Money

A. As You Read
As you read Section 1, supply the requested information in the spaces provided.

Describe the three uses of money.
1. medium of exchange—measure of value during exchange of goods and services
2. unit of account—way to compare values of goods and services
3. store of value—keeps its value if held onto instead of being spent

Define the six characteristics of money.
4. durability—it does not wear out quickly
5. portability—it is easily carried
6. divisibility—it is easily divided into smaller denominations
7. uniformity—any two units of money are the same in terms of what they will buy
8. limited supply—there is a limit to the supply kept in circulation
9. acceptability—everyone can exchange it for goods and services

B. Reviewing Key Terms
Match the definitions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td>b 10. something that keeps its value if held</td>
<td>a. barter</td>
</tr>
<tr>
<td>i 11. objects that have value because the holder can exchange them for something else of value</td>
<td>b. store of value</td>
</tr>
<tr>
<td>c 12. money that has value because the government says it is acceptable for paying debts</td>
<td>c. fiat money</td>
</tr>
<tr>
<td>f 13. anything that is used to determine value during the exchange of goods and services</td>
<td>d. currency</td>
</tr>
<tr>
<td>a 14. exchange of one set of goods or services for another</td>
<td>e. money</td>
</tr>
<tr>
<td>d 15. coins and paper bills used as money</td>
<td>f. medium of exchange</td>
</tr>
<tr>
<td>h 16. way to compare the value of goods and services relative to each other</td>
<td>g. commodity money</td>
</tr>
<tr>
<td>e 17. anything used as a medium of exchange, a unit of account, and a store of value</td>
<td>h. unit of account</td>
</tr>
<tr>
<td>g 18. objects that have value in themselves as well as for their use as money</td>
<td>i. representative money</td>
</tr>
</tbody>
</table>
A. As You Read

As you read Section 2, fill in two supporting facts or details under each main idea by answering each question. Possible answers below

Main Idea: Before the Civil War, banking in the United States shifted between a centralized system and independent state and local banks.

1. What were the first two attempts to centralize U.S. banking, and when were they in operation? The First Bank of the United States (1791–1811) and the Second Bank of the United States (1816–1832)

2. What problems were associated with the Free Banking Era (1837–1863), dominated by state-chartered banks? Bank runs and panics, wildcat banks, fraud, and many different currencies

Main Idea: Reforms of the late 1800s stabilized the banking system.

3. How did the National Banking Acts of 1863 and 1864 promote stability? They gave the federal government the power to charter banks, require banks to hold adequate gold and silver reserves, and issue a single national currency.

4. How did the gold standard promote stability? It stabilized the currency and gave the public confidence by setting a value of gold per dollar and by requiring the government to issue only as much currency as the amount of gold in the treasury.

Main Idea: Banking reforms early in the twentieth century helped strengthen and centralize American banking.

5. How did the Federal Reserve System, established in 1913, begin to manage the money supply? Regional Federal Reserve Banks stored some of their member banks' cash reserves and made loans to member banks to meet short-term demands; Federal Reserve notes allowed the Federal Reserve to regulate the amount of money in circulation according to business needs.

6. What guarantee was made available to bank customers in 1933? The Federal Deposit Insurance Corporation (FDIC) was established to insure individual deposits of up to $2,500 (now $100,000) if a bank fails.

B. Reviewing Key Terms

Complete each sentence by writing the correct term in the blank provided.

7. One advantage of the gold standard was that the government could only issue currency if it had gold in the treasury to back it.

8. The greenback was a paper currency printed with green ink that was issued by the U.S. Treasury during the Civil War but not backed by gold or silver.

9. A(n) bank receives, keeps, and lends money.

10. The nation's central banking system is the Federal Reserve System.
Section 3: Guided Reading and Review

Banking Today

A. As You Read

As you read Section 3, supply the requested information on the lines provided.

Define M1.
1. money that people can gain access to easily to pay for goods and services

Define M2.
2. all assets in M1 plus other assets such as savings accounts and money market mutual funds

List five services that banks offer.
3. storing money
4. saving money
5. issuing loans
6. issuing mortgages
7. issuing credit cards

Describe four types of financial institutions.
8. Commercial banks, which traditionally provided services to businesses, offer checking services, accept deposits, and make loans.
9. Savings and Loan Associations, which originally offered home loans from a general fund of member deposits, now offer many of the same services as commercial banks.
10. Savings banks, originally mutual savings banks owned by depositors, offer a type of checking account that pays interest.
11. Credit unions are cooperative lending associations for particular groups, such as employees of a company; some provide checking services.

B. Reviewing Key Terms

Define the following terms.
12. money supply all the money available in the U.S. economy
13. liquidity the ability to be used as, or directly converted to, cash
14. demand deposit the money in checking accounts
15. money market mutual fund a fund that pools money from small investors to purchase government or corporate bonds
16. fractional reserve banking a banking system that keeps only a fraction of funds on hand and lends out the remainder
17. default failure to pay back a loan
18. mortgage a specific type of loan that is used to buy real estate
19. credit card a card entitling its holder to buy goods and services based on the holder’s promise to pay for these goods and services
20. interest the price paid for the use of borrowed money
21. debit card a card used to withdraw money
22. creditor a person or institution to whom money is owed
### A. As You Read

As you read Section 1, supply the missing information about the functions of the financial intermediaries in the chart below.

<table>
<thead>
<tr>
<th>Financial Intermediaries</th>
<th>Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Banks, Savings and Loan Associations, Credit Unions</td>
<td>1. They receive deposits from savers, then lend some of the deposited funds to businesses and individuals.</td>
</tr>
<tr>
<td>2. Finance Companies</td>
<td>2. They make loans to consumers and small businesses.</td>
</tr>
<tr>
<td>3. Mutual Funds</td>
<td>3. They pool savings of many investors and invest in a variety of stocks, bonds, and other financial assets.</td>
</tr>
<tr>
<td>4. Life Insurance Companies</td>
<td>4. They provide financial protection for the family or other beneficiaries of the insured. Policies pay money to survivors; companies lend out part of the premium payments they receive.</td>
</tr>
<tr>
<td>5. Pension Funds</td>
<td>5. They collect deposits and distribute payments; managers invest deposits (usually in stocks and bonds). Companies and/or employees pay into such funds, which provide income after retirement.</td>
</tr>
</tbody>
</table>

### B. Reviewing Key Terms

Complete each sentence by writing the correct key term in the blank provided.

6. Before putting money into mutual funds, a potential investor can review the fund’s performance in its ______ prospectus _______.

7. The use of assets to earn income or profit constitutes an ______ investment _______.

8. To transfer money between savers and borrowers, allowing investment to take place, an economy needs an ______ financial system _______.

9. Securities is another name for ______ financial assets _______.

10. The lower the risk in an investment, the lower its ______ return _______.

11. The collection of all one’s financial assets makes up one’s ______ portfolio _______.
Section 2: Guided Reading and Review

Bonds and Other Financial Assets

A. As You Read

As you read Section 2, answer the questions on the lines provided. Possible answers below

1. How does an investor earn money by buying bonds at a discount? The investor buys bonds below par value and earns full par at redemption in addition to the interest.

2. What are Standard & Poor’s and Moody’s ratings based on? The issuer’s ability to make future interest payments and to repay the principal when the bond matures.

3. What advantages do bonds offer to firms that issue them? The interest rate is fixed despite a possible rise in overall interest rates. The firm does not have to share profits with bondholders.

4. What disadvantage do bonds present for the issuer? The issuer pays set amount of interest even in bad years or if interest rates drop. The bonds of a firm in poor financial health may be downgraded, making them hard to sell unless offered at a discount or high interest rate.

5. (a) What types of government bonds are available to investors? Savings bonds; Treasury bonds, bills, and notes; municipal bonds

   (b) Which type offers the greatest tax advantage? Municipal bonds

6. What three organizations help ensure value and prevent dishonesty in the bond market? Standard & Poor’s, Moody’s, Securities and Exchange Commission

7. (a) What is the investment advantage of money market mutual funds over CDs and savings accounts? Higher interest rates

   (b) What is the disadvantage? Slightly riskier—not insured by the FDIC

8. (a) In financial asset markets, how do capital markets differ from money markets? In capital markets, money is lent for periods longer than a year; in money markets, for shorter periods.

   (b) How do primary markets differ from secondary markets? Primary assets that can only be redeemed by the original holder are sold on primary markets; secondary assets that can be resold are sold on secondary markets.

B. Reviewing Key Terms

Define the following terms.

9. maturity Time at which payment to a bondholder is due

10. corporate bond Bond issued by a corporation to raise money for expansion

11. junk bond Lower-rated, potentially higher-paying bond

12. coupon rate Interest rate that a bond issuer will pay a bondholder
Section 3: Guided Reading and Review

The Stock Market

A. As You Read
As you read Section 3, supply the missing information to complete each sentence in the spaces provided.

1. Income stocks pay dividends at regular times during the year.
2. Growth stocks can be profitable because they reinvest earnings in the business and increase in value over time.
3. Investors experience capital gains when they sell stock for more than they paid for it.
4. Investors suffer capital losses when they sell stock for less than they paid for it.
5. Stocks are riskier than bonds because dividends depend on profits, and if a firm goes bankrupt, stockholders receive dividends only if there is money left over after bondholders are paid.
6. Blue chip stocks are traded on the New York Stock Exchange.
7. A put option is the option to sell shares of stock at a particular price at a specified time in the future.
8. During a bear market, investors sell because they expect lower profits over time.

B. Reviewing Key Terms
Match the descriptions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided. You will not use all the terms.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td>f</td>
<td>9. steady, extended rise in stock market</td>
</tr>
<tr>
<td>h</td>
<td>10. electronic marketplace for stock not listed on an organized exchange</td>
</tr>
<tr>
<td>g</td>
<td>11. claims of ownership in a corporation</td>
</tr>
<tr>
<td>i</td>
<td>12. making high-risk investments with borrowed money in the hope of getting a big return</td>
</tr>
<tr>
<td>j</td>
<td>13. market for buying and selling stock</td>
</tr>
<tr>
<td>a</td>
<td>14. person who links buyers and sellers of stocks</td>
</tr>
<tr>
<td>d</td>
<td>15. 1929 collapse of the stock market</td>
</tr>
<tr>
<td>e</td>
<td>16. business specializing in trading stocks</td>
</tr>
<tr>
<td>b</td>
<td>17. contracts to trade stock at a specific price and time in the future</td>
</tr>
</tbody>
</table>
Section 1: Guided Reading and Review

Gross Domestic Product

A. As You Read

As you read Section 1, answer the following questions about gross domestic product.

1. What is the gross domestic product?
   - The dollar value of all final goods and services produced within a country’s borders in a given year.

2. How is the expenditure approach used to calculate it?
   - In this approach, economists estimate annual expenditures on consumer, business, and government goods and services, and net exports or imports of goods and services.

3. How is the income approach used to calculate it?
   - Economists add up all the incomes in the country.

4. What is the difference between nominal GDP and real GDP?
   - Nominal GDP is measured in current prices; real GDP is expressed in constant, or unchanging, prices.

Describe four limitations of using GDP to measure economic growth:

5. GDP does not measure nonmarket activities—goods and services that people make or do themselves.

6. It does not measure underground economy—production and income never reported to the government.

7. It does not measure negative externalities—unintended economic side effects are not reflected in the GDP.

8. There are things not counted by GDP that contribute to people’s quality of life.

9. How is the gross national product derived from the gross domestic product?
   - by subtracting earnings by foreign firms and residents in the United States from GDP and earnings by U.S. firms and residents outside the U.S.

10. How is GDP related to aggregate supply and aggregate demand?
    - Aggregate supply is the real GDP; aggregate demand calculates GDP using the expenditure approach.

B. Reviewing Key Terms

Match the descriptions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided. You will not use all the terms.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td>h</td>
<td>a. real GDP</td>
</tr>
<tr>
<td>f</td>
<td>b. nominal GDP</td>
</tr>
<tr>
<td>b</td>
<td>c. aggregate supply</td>
</tr>
<tr>
<td>d</td>
<td>d. nondurable goods</td>
</tr>
<tr>
<td>a</td>
<td>e. price level</td>
</tr>
<tr>
<td>j</td>
<td>f. intermediate goods</td>
</tr>
<tr>
<td>g</td>
<td>g. depreciation</td>
</tr>
<tr>
<td>c</td>
<td>h. national income accounting</td>
</tr>
<tr>
<td>e</td>
<td>i. gross domestic product</td>
</tr>
<tr>
<td>k</td>
<td>j. durable goods</td>
</tr>
<tr>
<td>l</td>
<td>k. gross national product</td>
</tr>
<tr>
<td>i</td>
<td>l. aggregate demand</td>
</tr>
</tbody>
</table>
A. As You Read
As you read Section 2, fill in each item in the following diagram.

![Diagram of Business Cycle Phases, Contributing Factors, and Cycle Indicators]

B. Reviewing Key Terms
Define the following terms.

12. business cycle: a period of macroeconomic expansion followed by a period of contraction
13. expansion: a period of economic growth as measured by a rise in real GDP
14. economic growth: a steady, long-term increase in real GDP
15. peak: the height of an economic expansion, when real GDP stops rising
16. contraction: a period of economic decline marked by falling real GDP
17. trough: the lowest point in an economic contraction, when real GDP stops falling
18. recession: a prolonged economic contraction
19. depression: a recession that is especially long and severe
20. stagflation: a decline in GDP combined with a rise in the price level
21. leading indicators: key economic variables that economists use to predict a new phase of a business cycle
Section 3: Guided Reading and Review

Economic Growth

A. As You Read

As you read Section 3, fill in supporting facts or details under each main idea by answering each question. Possible answers below

Main Idea: Capital deepening is an important source of growth in modern economies.

1. How does capital deepening increase output per worker? With more capital, workers can be more efficient and productive and produce more output per hour of work.

2. How is human capital deepened? Through training programs and on-the-job experience of workers

Main Idea: The rate of saving and investment affects the economy.

3. What happens when saving rises? More investment funds become available to business firms and these firms then spend more on capital.

4. How does increased investment help the economy? Businesses spend the extra money on capital investment, to expand the stock of capital in the business sector.

Main Idea: Population, government, and trade all directly affect the economy.

5. What happens when population grows and capital remains constant? The amount of capital per worker shrinks, leading to lower living standards.

6. How do government taxation for consumption spending and importing goods for short-term consumption affect economic growth? Taxing in order to pay for consumption spending decreases the amount of investment. Importing goods for short-term consumption will not make the economy grow any faster, and will leave the country without additional GDP to pay back debts.

Main Idea: Technological progress is a key source of economic growth.

7. How do economists measure the impact of technological progress on economic growth? They determine how much growth in output comes from increases in capital and increases in labor; any remaining growth comes from technological progress.

8. How does the government aid technological innovation? It issues patents and sponsors basic research.

B. Reviewing Key Terms

Complete each sentence by writing the correct term in the blank.

9. __Savings rate__ is the proportion of disposable income spent to income saved.

10. The real GDP divided by the total population is called __real GDP per capita__.

11. Increasing the amount of capital per worker is __capital deepening__.

12. Income not used for consumption is considered __saving__.

13. An increase in efficiency gained by producing more output without using more inputs is called __technological progress__.
A. As You Read

As you read Section 1, supply the missing reason for or type of unemployment on the lines provided in the chart. Possible answers below

<table>
<thead>
<tr>
<th>Reason for Unemployment</th>
<th>Type of Unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. people taking time looking for work after finishing school</td>
<td></td>
</tr>
<tr>
<td>2. changes in consumer demand</td>
<td></td>
</tr>
<tr>
<td>3. lack of education or training for skills in demand</td>
<td></td>
</tr>
<tr>
<td>4. people changing jobs, getting laid off, or taking time off from working for a variety of reasons</td>
<td></td>
</tr>
<tr>
<td>5. a healthy economy that is working properly</td>
<td></td>
</tr>
<tr>
<td>6. industries slowing or shutting down for a season</td>
<td></td>
</tr>
<tr>
<td>7. an economy that is growing too quickly</td>
<td></td>
</tr>
<tr>
<td>8. discovery of new resources</td>
<td></td>
</tr>
<tr>
<td>9. development of new technologies</td>
<td></td>
</tr>
<tr>
<td>10. a downturn in the business cycle</td>
<td></td>
</tr>
<tr>
<td>11. jobs moving to other countries (globalization)</td>
<td></td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms

Complete each sentence by writing the correct term in the blank provided.

12. My cousin Harold is used to seasonal unemployment, since he works for a landscaping company and is laid off every winter.
13. It is easy to find a job these days, since the unemployment rate is so low.
14. People who do not finish high school often suffer from structural unemployment.
15. With full employment, nearly everyone who wants a job has a job.
16. The excellent mechanic who has been working as a clerk at a convenience store since the local garage closed is considered underemployed.
17. My aunt who left her job to care for her sick mother and is now looking for work is an example of frictional unemployment.
A. As You Read

As you read Section 2, answer the following questions.  

1. What would you use to see how prices have changed over time?  
   a price index

2. What does the example of the Barrow’s house increasing from $12,000 to $150,000 over 50 years show?  
   inflation

3. How is the Consumer Price Index (CPI) used?  
   to compare the cost of a group of goods this month with that of a similar group of goods months or years ago

4. How does the Bureau of Labor Statistics determine the CPI?  
   It establishes a base period, and assigns the index number 100 to a “market basket” of goods for that period; each month the cost of the market basket is updated and compared to the base period.

5. What data must you have to calculate the inflation rate for a specific year?  
   the CPI for the year you wish to calculate and the CPI for the previous year

6. What happens when hyperinflation occurs over an extended period of time?  
   Money loses its value; hyperinflation often leads to total economic collapse.

Describe three theories of the causes of inflation.

7. quantity theory—inflation results when there is too much money in the economy

8. demand-pull theory—inflation occurs when demand for goods and services exceeds supplies

9. cost-push theory—inflation occurs when producers raise prices to meet increased costs

How does inflation affect each of the following?

10. purchasing power  
    It erodes purchasing power.

11. fixed income  
    It erodes fixed income.

12. savings  
    If the inflation rate is higher than the interest rate, savers lose money.

B. Reviewing Key Terms

Define the following terms.

13. inflation rate  
    the percentage rate of change in price level over time

14. deflation  
    a sustained drop in the price level

15. Consumer Price Index  
    a price index determined by measuring the price of a standard group of goods representing the “market basket” of a typical urban consumer

16. inflation  
    a general increase in prices

17. wage-price spiral  
    the process by which rising wages cause higher prices and the higher prices cause higher wages

18. price index  
    a measurement that shows how the average price of a standard group of goods changes over time
A. As You Read

As you read Section 3, fill in two supporting facts or details under each main idea by answering each question. **Possible answers below**

**Main Idea:** The U.S. Census Bureau has developed measurements to calculate the number of poor.

1. **What condition must exist for everyone in a household to be counted as poor?**
   
   A family's total income must be below the poverty threshold.

2. **What does the poverty rate help us understand?**
   
   The government considers to be poor and what factors seem to contribute to poverty.

**Main Idea:** Poverty has a number of root causes.

3. **What do statistics show about a lack of education contributing to poverty?**
   
   Statistics show that on average, high school dropouts earn one third less than high school graduates and two and a half times less than college graduates.

4. **What has the divorce rate shown about poverty?**
   
   As the divorce rate has climbed, so has the number of single-parent families. As a result, there are more children living in poverty.

**Main Idea:** Knowing how the nation’s total income is distributed helps people understand poverty.

5. **What percentage of the nation’s total income does the lowest 40 percent of the population receive?**
   
   12.5 percent

6. **What two key factors contribute to the differences in income distribution?**
   
   The differences in the amount of skills and effort among people and the amount of money inherited by people

**Main Idea:** The government has various programs and policies to combat poverty.

7. **What programs and laws help working people achieve an adequate income?**
   
   Job training programs and minimum-wage laws

8. **How might the welfare reform program help reduce poverty?**
   
   It may provide Americans with labor skills and access to a steady, adequate income that they now lack.

B. Reviewing Key Terms

Complete each sentence by writing the correct term in the blank.

9. **The______Lorenz Curve______is the graphed curve that illustrates income distribution in the economy.**

10. **The program that requires work in exchange for assistance is called_____workfare_____.**

11. **The______poverty rate______is the percentage of people in a particular group who are officially considered living in poverty.**

12. **The level of income below which income is insufficient to support a family or household is called the____poverty threshold_____.**
Section 1: Guided Reading and Review
What Are Taxes?

A. As You Read
As you read Section 1, supply the requested information in the spaces provided.
Explain what gives the government the power to collect taxes.

1. Article 1, Section 8, Clause 1 of the Constitution gives Congress the power to tax.

List four ways in which the government’s power to tax is limited.

2. Taxes cannot be used for individual interests.
3. Federal taxes must be the same in every state.
4. Taxes cannot be collected on exports.
5. Taxes must be divided among the states based on population.

List and define the three types of tax structures.

6. Proportional tax: Percentage of income paid remains the same for all income levels.
7. Progressive tax: Percentage of income paid increases as income increases.
8. Regressive tax: Percentage of income paid decreases as income increases.

List and define the characteristics of a good tax.

9. Simplicity: Tax laws should be easy to understand; taxpayers should be able to prepare tax forms themselves.
10. Efficiency: Taxes should be paid and collected without costing taxpayers or administrators too much time or money.
11. Certainty: Taxpayers should clearly understand when and how much tax is due and how it should be paid.
12. Equity: The tax system should be fair, so that no one pays too much or too little of the tax burden.

B. Reviewing Key Terms
Complete each sentence by writing the correct term in the blank provided.

13. The income, property, good, or service that is subject to tax is considered a tax base.
14. The ____incidence of a tax____ is the final burden of a tax.
15. Sales tax is a type of ____regressive____ tax.
16. With a ____proportional tax____ the percentage of income paid in taxes remains the same for all income levels.
17. Income tax is a type of ____progressive____ tax.
18. The income that government receives is called ____revenue____.
A. As You Read

As you read Section 2, fill in supporting facts or details under each main idea by answering each question. Possible answers below

Main Idea: Individual income taxes are imposed on the income of all individuals living in the country.

1. Why do employers withhold a set amount of your income? The income that is withheld pays a portion of your annual income tax payment so that you do not have to pay it in one lump sum and so the government can pay its bills throughout the year.

2. What is taxable income? A person’s total income minus exemptions and deductions

Main Idea: Federal Insurance Contributions Act (FICA) taxes fund two large government programs.

3. What does Social Security provide? Old-age pensions to workers plus benefits to surviving family members of workers and to people who are disabled

4. What is Medicare? A national health insurance program that helps pay for health care for people over 65 and people with specific disabilities

Main Idea: Taxes are sometimes used to affect behavior.

5. What items are taxed for the purpose of changing behavior? Alcoholic beverages and tobacco are taxed to discourage their use; autos that get low gasoline mileage are taxed to encourage the purchase of fuel-efficient cars.

B. Reviewing Key Terms

Match the descriptions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided.

<table>
<thead>
<tr>
<th>Column I</th>
<th>Column II</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. amounts that you can subtract from your income when filing taxes</td>
<td>a. taxable income</td>
</tr>
<tr>
<td>7. form used to file one’s income taxes</td>
<td>b. tariff</td>
</tr>
<tr>
<td>8. income on which tax must be paid</td>
<td>c. tax return</td>
</tr>
<tr>
<td>9. tax on a monetary gift from a living person valued above a certain amount</td>
<td>d. withholding</td>
</tr>
<tr>
<td>10. tax on the total value of the money and property of a person who has died</td>
<td>e. deductions</td>
</tr>
<tr>
<td>11. tax payments taken out of an employee’s pay before he or she receives a paycheck</td>
<td>f. gift tax</td>
</tr>
<tr>
<td>12. tax levied on foreign goods brought into the United States</td>
<td>g. estate tax</td>
</tr>
</tbody>
</table>
Section 3: Guided Reading and Review

Federal Spending

A. As You Read

As you read Section 3, provide examples of the categories of federal spending in the diagram below. Possible answers below

Categories of Federal Spending

1. **Entitlements**
   - Social Security, Medicare, Medicaid, food stamps, supplemental security income (SSI), child nutrition, federal pensions, veterans’ pensions, unemployment insurance

2. **Discretionary Spending**
   - defense, education, training, scientific research, student loans, technology, national parks and monuments, law enforcement, environmental cleanup, housing, land management, transportation, disaster aid, foreign aid, farm subsidies, federal salaries

3. **Aid to States**
   - Medicaid; unemployment compensation; programs to help children, families, refugees, and others; highway construction; education; lower-income housing; employment and training programs

B. Reviewing Key Terms

Define the following terms.

4. **discretionary spending** spending category about which government planners can make choices

5. **mandatory spending** spending on certain programs that is mandated, or required, by existing law

6. **entitlement** social welfare program that people are “entitled to” if they meet certain eligibility requirements

NAME ___________________________ CLASS ___________________ DATE _____________
Section 4: Guided Reading and Review

State and Local Taxes and Spending

A. As You Read
As you read Section 4, fill in examples of each item in the space provided. Possible answers below

Spending
(State Governments)
Provide examples of goods or services on which state taxes are spent for each category.

1. Education: state universities; agricultural and technical colleges; teacher's colleges and two year community colleges; local schools
2. Public Safety: highway patrol; crime labs; corrections systems
3. Highways and Transportation: repairing roads and bridges; waterways and airports
4. General Welfare: hospitals and clinics; water supplies; unemployment compensation benefits
5. Arts and Recreation: state forests, parks, and nature reserves; museums; music and art programs
6. Administration: salaries of state workers

(State Governments)
Provide examples of each type of tax from which states earn revenue.

7. Sales Tax: sales tax on goods and services
8. Excise Tax: “sin taxes;” amusement taxes; gasoline taxes
9. Income Tax: tax on individual income; rates vary from state to state
10. Corporate Income Tax: tax on companies that do business in the state; may be progressive or fixed
11. Business Taxes: licensing fees for professional work such as hairdresser, carpenter, contractor; transfer tax on documents; severance tax on natural resources

(Local Governments)
Provide examples of goods or services on which local taxes are spent for each category.

12. Law enforcement: local police; county sheriff’s departments; park police
13. Public facilities: libraries; airports; public hospitals
14. Public health: restaurant inspectors; water treatment plants; sewer systems

(Local Governments)
Provide examples of each type of tax from which local governments earn revenue.

15. Property Taxes: paid by people who own homes, apartments, buildings, land; rate figured on assessed value of property
16. Other Taxes: sales and excise taxes aimed at tourists; payroll taxes

B. Reviewing Key Terms
Answer each of the following questions. Possible answers below

17. What is the difference between real property and personal property? Real property refers to land and buildings; personal property refers to possessions such as jewelry and furniture.
18. What is the difference between an operating budget and a capital budget? An operating budget is for day-to-day expenses; a capital budget is for major investment expenditures.
19. What is a sales tax? A tax on goods and services
20. What is the relationship between revenues and spending in a balanced budget? In a balanced budget, revenues and spending are equal.
Section 1: Guided Reading and Review
Understanding Fiscal Policy

A. As You Read
As you read Section 1, fill in two supporting facts or details under each main idea by answering each question. Possible answers below

Main Idea: The president and Congress work through a budget process to draw up a spending plan for the following fiscal year.

1. Which part of the executive branch is responsible for preparing the president’s budget proposal? the Office of Management and Budget

2. Which congressional committees submit the final bills that authorize specific spending? the Appropriations Committees for each house

Main Idea: The federal government may use fiscal policy to try to make the economy run more smoothly.

3. Under what conditions might the government use expansionary fiscal policies? when the economy is in a recession or the government is trying to prevent one

4. Under what conditions might the government use contractionary fiscal policies? when there is fast-growing demand and danger of inflation

Main Idea: The federal government has specific policies that it uses to influence the economy.

5. What are its two main expansionary policies? increasing government spending and cutting taxes

6. What are its two main contractionary policies? decreasing government spending and raising taxes

Main Idea: Although fiscal policies may appear to be powerful economic tools, they can be difficult to put into practice.

7. What kinds of entitlement programs make it difficult to change spending levels? Medicaid, Social Security, veterans’ benefits

8. Why does it take so long to put fiscal changes into effect? The changes have to be put into the federal budget, which takes 18 months to prepare; then it takes time for the changes to affect the economy.

B. Reviewing Key Terms Possible answers below
Answer each of the following questions.

9. What is the federal budget? a written document detailing government revenues and expenditures for a certain fiscal year

gives Congress independent economic data for reviewing a budget proposal

10. What is the main function of the Congressional Budget Office? to increase output

11. What is the overall goal of expansionary policies? to increase output

12. What is the overall goal of contractionary policies? to decrease output
Section 2: Guided Reading and Review

Fiscal Policy Options

A. As You Read

As you read Section 2, answer the following questions. Possible answers below

1. What failure of classical economics did the Great Depression highlight? It showed that classical economics did not address how long it would take the economy to return to equilibrium.

2. How did John Maynard Keynes explain the continuation of the Great Depression? He stated that it continued because neither consumers nor business had incentive to spend enough to increase production.

3. (a) According to Keynes, how could the Depression-era government make up for the drop in private spending? by buying goods and services of its own. It would encourage production and increase employment.

(b) What did Keynes say the result would be?

4. (a) What economic data did Keynes say the federal government should track? total level of spending by consumers, businesses, and government

(b) For what purpose? to watch for signs of upcoming recession or depression

5. Why did Keynesian economics lose popularity in the 1960s and 1970s? Economic growth slowed while inflation continued to rise. Government spending was so great that it was hard to adjust spending levels to stabilize the economy.

6. What is a stable economy? one with no rapid changes in the economic indicators

7. When national income is low, how do taxes and government transfer payments help stabilize the economy? Lower income from taxes and higher transfer payments increase consumer spending, which balances against decreased consumer spending resulting from falling income.

8. According to supply-side economics and the Laffer curve, how do higher tax rates affect the economy? They discourage people from working and prevent businesses from increasing production, thus reducing output.

9. What argument lies at the heart of supply-side economics? A tax cut increases employment so much that the government collects more in taxes at the new rate.

10. How did President Kennedy propose to increase demand? by cutting taxes

B. Reviewing Key Terms

Use a key term to complete each sentence.

11. An economy sustains maximum output for a period of time when it operates at productive capacity.

12. The idea that in a free market, people act in their own self-interest, causing prices to rise or fall so that supply and demand will always return to equilibrium is the thinking in classical economics.

13. Taxes and transfer payments act as automatic stabilizers.

14. The idea that every dollar change in fiscal policy creates a greater than one dollar change in the economy explains the multiplier effect.
A. As You Read

As you read Section 3, complete the following sentences. Possible answers below

1. When the government increases the amount of money in circulation to cover large deficits, inflation results because once the economy reaches full employment, the increase in money will mean there are more dollars to buy the same amount of goods and services.

2. Wise federal borrowing allows the government to create more public goods and services.

3. The national debt will grow each year that there is a budget deficit and the federal government borrows money to cover it.

4. The national debt is owned by investors in the United States and around the world who have put their money and trust in the federal government.

5. Historically, national debt as a percentage of GDP rises during wartime.

6. The two problems of a national debt are that it reduces the funds available for businesses to invest, and the government must pay interest to bondholders.

7. The opportunity cost of servicing the debt is that dollars spent servicing the debt cannot be spent on other things, like defense, health care, or infrastructure.

8. Today, many economists think the role of the federal government in the economy should be limited.

B. Reviewing Key Terms

Define the following terms.

9. budget surplus condition when annual government revenues exceed expenditures.

10. hyperinflation very high inflation—at rates of hundreds, even thousands of percent.

11. national debt the total amount of money the federal government owes.

12. Treasury bill short-term government bond, to be repaid within a year or less.
A. As You Read
As you read Section 1, supply the requested information. Possible answers below

1. Sources of confusion and problems with American banking between 1836 and 1907:
   States and federal government chartered different banks. Reserve requirements were difficult to enforce. There was a series of serious bank runs.

2. Why the Federal Reserve System was unable to hold off the Great Depression:
   Each of the twelve regional banks acted independently, often canceling out the actions of other regional banks.

3. How the chair of the Federal Reserve’s Board of Governors is appointed:
   The president appoints one of the seven board members, with the confirmation of the Senate.

4. The function of each Federal Reserve Bank:
   To monitor and report on economic and banking conditions in its district.

5. The makeup of each Federal Reserve Bank’s board of directors:
   Member banks elect three bankers and three leaders in industry, while the Board of Governors of the Federal Reserve appoints the three remaining directors.

6. Which banks join the Federal Reserve System and why they join:
   All nationally chartered banks must join. State-chartered banks may join to receive stock in the system.

7. The main function of the Federal Reserve’s Federal Advisory Council:
   To provide feedback and advice to the Board of Governors concerning the overall financial health of each district.

8. Areas affected by announcements from the Federal Open Market Committee:
   The financial markets, home mortgage rates, and many other economic institutions around the world.

B. Reviewing Key Terms
Define the following terms.

9. monetary policy:
   The actions the Federal Reserve takes to influence the level of real GDP and the rate of inflation in the economy.

10. Federal Reserve Districts:
    The twelve banking districts created by the Federal Reserve Act.

11. Federal Advisory Council:
    The research arm of the Federal Reserve that collects and reports on information about each district.

12. Federal Open Market Committee:
    Federal Reserve committee that makes key decisions about interest rates and the growth of the U.S. money supply.
Section 2: Guided Reading and Review

Federal Reserve Functions

A. As You Read
As you read Section 2, complete each numbered item in the chart.

The Federal Reserve in Action

<table>
<thead>
<tr>
<th>Service Roles</th>
<th>Regulatory Roles</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. sells, transfers, and redeems government securities</td>
<td>8. collects daily reports on banks’ reserves and activities</td>
</tr>
<tr>
<td>2. issues paper currency</td>
<td>9. may force banks to sell risky investments</td>
</tr>
<tr>
<td>3. acts as a clearing center for checks</td>
<td>10. may force problem banks to undergo more frequent examinations</td>
</tr>
<tr>
<td>4. checks up on activities of member banks by sending out bank examiners</td>
<td>11. subjects banks that go to the Fed for emergency loans too often to financial review and close government supervision</td>
</tr>
<tr>
<td>5. uses findings and recommendations of Reserve Banks to approve or disapprove bank mergers and bank holding company charters</td>
<td>12. regulates the nation’s money supply</td>
</tr>
<tr>
<td>6. protects consumers by enforcing truth-in-lending laws</td>
<td>13. compares M1, M2, and M3 measurements with the likely demand for money</td>
</tr>
<tr>
<td>7. in severe recessions, provides commercial banks with emergency loans</td>
<td>14. uses its tools to try to stabilize the nation’s overall economy</td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms
Complete each sentence by writing the correct term in the blank.

15. When a bank borrows money from another bank, the interest rate it pays is called the __federal funds rate__.
16. Ownership of more than one bank constitutes a __bank holding company__.
17. When a bank customer writes a check, the check will go through the process of __check clearing__.
18. A bank’s total assets minus its total liabilities make up its __net worth__.
19. Banks repay loans from the Federal Reserve at a rate of interest called the __discount rate__.
A. As You Read
As you read Section 3, answer the following questions.

1. If you deposit $1,000 of borrowed money in a bank checking account, by how much do you increase the money supply? **$1,000**

2. Why does the Federal Reserve establish a required reserve ratio? **to ensure that banks will have enough funds to meet customers' withdrawal needs**

3. What three tools could the Federal Reserve use to adjust the money supply? **reserve requirements, the discount rate, and open market operations**

4. What two effects, leading to an increased money supply, could a reduced RRR have? **It would free up reserves for banks, allowing them to make more loans. It would also increase the money multiplier.**

5. Why does the Fed seldom, if ever, change bank reserve requirements? **Changing reserve requirements would disrupt the banking system.**

6. How do banks respond to a lowered discount rate? **Banks respond by reducing their excess reserves through loans.**

7. How does a raised discount rate affect bank loans and the money supply? **Banks reduce loans and so reduce the amount of currency in circulation.**

8. What effect does the Fed’s purchase of government bonds have on the money supply? **It increases the money supply.**

9. How does the Fed’s sale of bonds reduce the money supply? **Bond dealers pay with checks drawn on their own banks. The Fed processes these checks, taking the money out of circulation.**

10. Which of its monetary policy tools does the Federal Reserve use most often? **open market operations**

B. Reviewing Key Terms
Rewrite each statement below as needed to make it correct.

11. Money creation is the process by which money is manufactured. **Money creation is the process by which money enters into circulation.**

12. The required reserve ratio is the ratio of reserves to loans required of banks by the Federal Reserve. **The required reserve ratio is the ratio of reserves to deposits required of banks by the Federal Reserve.**

13. The size of loans created with each demand deposit is measured by the money multiplier formula. **The amount of new money created with each demand deposit is measured by the money multiplier formula.**

14. Open market operations refers to the buying and selling of banks by the Federal Reserve. **Open market operations refers to the buying and selling of government securities by the Federal Reserve.**
Section 4: Guided Reading and Review
Monetary Policy and Macroeconomic Stabilization

A. As You Read
As you read Section 4, complete the following sentences.
1. The cost of borrowing or having money is the ________ interest rate ________.
2. If the money supply is high, interest rates will be ________ low ________.
3. Lower interest rates give firms more opportunities for ___ profitable investment ___.
4. The Fed may follow an easy money policy when the macroeconomy is experiencing a ________ contraction ________.
5. The Fed may follow a tight money policy when the macroeconomy is experiencing a ________ rapid expansion ________.
6. The goal of stabilization policy is to smooth out fluctuations in the ________ business cycle ________.
7. If expansionary policies take effect while the macroeconomy is already expanding, the result could be higher ________ inflation ________.
8. One reason for inside lags is that it takes time to __ identify and recognize a problem ___.
9. A second reason for inside lags is that it can take additional time to __ enact appropriate policy ___.
10. Monetary policy can be put in place almost immediately by the ________ Federal Open Market Committee ________.
11. The outside lag can be relatively short for ________ fiscal ________ policy.
12. Outside lags for monetary policy can be lengthy because they primarily affect ________ business investment plans ________.
13. We rely more on the Fed to combat the business cycle because fiscal policy is often delayed by ________ partisan politics and budgetary pressures ________.
14. Economists who usually recommend enacting fiscal and monetary policies believe that ________ economies ________ emerge slowly from recession ________.

B. Reviewing Key Terms
Define the following terms.
15. monetarism ________ the belief that the money supply is the most important factor in macroeconomic performance ________.
16. easy money policy ________ monetary policy that increases the money supply ________.
17. tight money policy ________ monetary policy that reduces the money supply ________.
18. inside lag ________ delays in implementing monetary or fiscal policy ________.
19. outside lag ________ the time it takes for monetary or fiscal policy to have an effect ________.
Section 1: Guided Reading and Review

**Why Nations Trade**

A. As You Read

As you read Section 1, answer the following questions about international trade in the spaces provided. Possible answers below

1. What resources are major influences on a country’s or region’s economy? ______
   *land, labor, capital, natural resources, human capital, and physical capital*

2. Why do countries differ in their capacities to produce different goods and services?
   *Resources are not equally distributed.*

3. Why do specializing nations need world trade?
   *Specialists must trade to obtain the goods and services they cannot or do not produce themselves.*

4. Why does trade benefit both countries with abundance and countries with few resources?
   *Law of comparative advantage—nations benefit from producing goods and services that they have a comparative advantage in supplying, and purchasing the goods that they don’t have a comparative advantage in producing.*

5. How do nations benefit from producing goods and services they have a comparative advantage in supplying?
   *They use the money they earn to buy goods and services they cannot produce as efficiently.*

6. How can international specialization affect some workers?
   *Workers in some industries may lose their jobs.*

7. What possibilities do laid-off workers face?
   *Unemployment, retraining, or relocation*

B. Reviewing Key Terms

Briefly define or identify each of the following.

8. absolute advantage
   *The ability of a person or nation to produce a particular good at a lower cost than another person or nation*

9. export
   *Good sent to another country for sale*

10. import
    *Good brought in from another country for sale*

11. comparative advantage
    *The ability of a person or nation to produce a good at an opportunity cost that is lower than that of another person or nation*
Section 2: Guided Reading and Review

Trade Barriers and Agreements

A. As You Read

As you read Section 2, supply the missing information in the spaces provided.

Current World Trade Considerations

1. Effects of Trade Barriers: force producers to use domestic resources; help domestic producers compete; higher consumer prices; producers lose incentive to become more efficient and produce goods less expensively; trade wars

2. Presumed Advantages of U.S. Protectionism: shelters jobs that could be hurt by foreign competition; shelters infant industries until they can compete with well-developed foreign industries; assures that country will be self-sufficient in case of emergency

3. Progress Under GATT and WTO: average U.S. tariffs reduced to 5 percent; average global tariffs reduced by about one third; can enforce rules that member countries agree upon

4. Results of NAFTA in the United States: Some jobs have been created, but about an equal number have been eliminated; trade with Canada and Mexico has increased.

5. Advantages of Multinational Corporations: Corporations can avoid some shipping fees and tariffs, as well as take advantage of cheaper labor. The host nation gains jobs as well as tax revenue from the corporation’s income, profits, and property.

B. Reviewing Key Terms

Match the definitions in Column I with the terms in Column II. Write the letter of the correct answer in the blank provided. You will not use all of the terms.

Column I

j. use of trade barriers to shield a nation’s industries from foreign competition
a. regional trade organization of 15 European nations
h. self-imposed limitation on the number of products shipped to a particular country
c. means of preventing a foreign product or service from freely entering a nation’s territory
g. limit on the amount of a good that can be brought into a country
i. region where a group of countries agrees to reduce or eliminate trade barriers
e. tax on imports

Column II

a. European Union (EU)
b. infant industry
c. trade barrier
d. NAFTA
e. tariff
f. World Trade Organization (WTO)
g. import quota
h. voluntary export restraint
i. free-trade zone
j. protectionism
A. As You Read
As you read Section 3, supply likely consequences or solutions in the chart. Possible answers below

### In Matters of International Trade

<table>
<thead>
<tr>
<th>If</th>
<th>Then</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. a U.S. tourist wants to buy a newspaper in Beijing</td>
<td>1. the tourist must exchange dollars for Chinese renminbi.</td>
</tr>
<tr>
<td>2. you want to learn current exchange rates</td>
<td>2. you may consult an exchange rate table in a major newspaper or on the Internet.</td>
</tr>
<tr>
<td>3. a strong dollar makes American products more expensive in Japan</td>
<td>3. Japanese consumers will probably buy fewer U.S. goods or services.</td>
</tr>
<tr>
<td>4. the dollar is devalued</td>
<td>4. foreign consumers are more apt to buy U.S. products, and exports will increase. Other nations' products become more expensive and imports will decrease.</td>
</tr>
<tr>
<td>5. an American firm needs to exchange yen for dollars</td>
<td>5. the firm makes the exchange on the foreign exchange market.</td>
</tr>
<tr>
<td>6. low labor costs abroad result in lower prices for U.S. imports</td>
<td>6. U.S. consumers are likely to buy cheaper imports than higher priced domestic goods, and imports will increase.</td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms
Briefly explain the difference between the terms in each pair.

7. fixed exchange-rate system and flexible exchange-rate system  Under a fixed exchange-rate system, governments try to keep currency values constant against one another, while supply and demand determine the rate under a flexible system.

8. trade surplus and trade deficit  A trade surplus occurs when a nation’s exports exceed its imports, but a deficit occurs when its imports exceed its exports.

9. appreciation and depreciation  Appreciation refers to an increase in the value of a currency while depreciation refers to a decrease in value.
Section 1: Guided Reading and Review

Levels of Development

A. As You Read

As you read Section 1, fill in details comparing characteristics of developed nations and less developed countries in the blanks provided.

<table>
<thead>
<tr>
<th>Developed Nations</th>
<th>Less Developed Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>per capita GDP</td>
<td>1. high per capita GDP</td>
</tr>
<tr>
<td></td>
<td>high energy consumption</td>
</tr>
<tr>
<td></td>
<td>signals</td>
</tr>
<tr>
<td></td>
<td>industrialization</td>
</tr>
<tr>
<td></td>
<td>most of labor force</td>
</tr>
<tr>
<td></td>
<td>works in industry and</td>
</tr>
<tr>
<td></td>
<td>services</td>
</tr>
<tr>
<td></td>
<td>well-educated with high</td>
</tr>
<tr>
<td></td>
<td>literacy rate</td>
</tr>
<tr>
<td></td>
<td>People are healthy,</td>
</tr>
<tr>
<td></td>
<td>leading to low</td>
</tr>
<tr>
<td></td>
<td>infant mortality and</td>
</tr>
<tr>
<td></td>
<td>long life expectancy.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3. low per capita GDP</td>
</tr>
<tr>
<td></td>
<td>low energy consumption</td>
</tr>
<tr>
<td></td>
<td>signals</td>
</tr>
<tr>
<td></td>
<td>industrialization</td>
</tr>
<tr>
<td></td>
<td>most of labor force</td>
</tr>
<tr>
<td></td>
<td>works in industry and</td>
</tr>
<tr>
<td></td>
<td>services</td>
</tr>
<tr>
<td></td>
<td>well-educated with high</td>
</tr>
<tr>
<td></td>
<td>literacy rate</td>
</tr>
<tr>
<td></td>
<td>People are healthy,</td>
</tr>
<tr>
<td></td>
<td>leading to low</td>
</tr>
<tr>
<td></td>
<td>infant mortality and</td>
</tr>
<tr>
<td></td>
<td>long life expectancy.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5. low per capita GDP</td>
</tr>
<tr>
<td></td>
<td>low energy consumption</td>
</tr>
<tr>
<td></td>
<td>signals</td>
</tr>
<tr>
<td></td>
<td>industrialization</td>
</tr>
<tr>
<td></td>
<td>most of labor force</td>
</tr>
<tr>
<td></td>
<td>works in industry and</td>
</tr>
<tr>
<td></td>
<td>services</td>
</tr>
<tr>
<td></td>
<td>well-educated with high</td>
</tr>
<tr>
<td></td>
<td>literacy rate</td>
</tr>
<tr>
<td></td>
<td>People are healthy,</td>
</tr>
<tr>
<td></td>
<td>leading to low</td>
</tr>
<tr>
<td></td>
<td>infant mortality and</td>
</tr>
<tr>
<td></td>
<td>long life expectancy.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>7. low per capita GDP</td>
</tr>
<tr>
<td></td>
<td>low energy consumption</td>
</tr>
<tr>
<td></td>
<td>signals</td>
</tr>
<tr>
<td></td>
<td>industrialization</td>
</tr>
<tr>
<td></td>
<td>most of labor force</td>
</tr>
<tr>
<td></td>
<td>works in industry and</td>
</tr>
<tr>
<td></td>
<td>services</td>
</tr>
<tr>
<td></td>
<td>well-educated with high</td>
</tr>
<tr>
<td></td>
<td>literacy rate</td>
</tr>
<tr>
<td></td>
<td>People are healthy,</td>
</tr>
<tr>
<td></td>
<td>leading to low</td>
</tr>
<tr>
<td></td>
<td>infant mortality and</td>
</tr>
<tr>
<td></td>
<td>long life expectancy.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9. low per capita GDP</td>
</tr>
<tr>
<td></td>
<td>low energy consumption</td>
</tr>
<tr>
<td></td>
<td>signals</td>
</tr>
<tr>
<td></td>
<td>industrialization</td>
</tr>
<tr>
<td></td>
<td>most of labor force</td>
</tr>
<tr>
<td></td>
<td>works in industry and</td>
</tr>
<tr>
<td></td>
<td>services</td>
</tr>
<tr>
<td></td>
<td>well-educated with high</td>
</tr>
<tr>
<td></td>
<td>literacy rate</td>
</tr>
<tr>
<td></td>
<td>People are healthy,</td>
</tr>
<tr>
<td></td>
<td>leading to low</td>
</tr>
<tr>
<td></td>
<td>infant mortality and</td>
</tr>
<tr>
<td></td>
<td>long life expectancy.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>10. low per capita GDP</td>
</tr>
<tr>
<td></td>
<td>low energy consumption</td>
</tr>
<tr>
<td></td>
<td>signals</td>
</tr>
<tr>
<td></td>
<td>industrialization</td>
</tr>
<tr>
<td></td>
<td>most of labor force</td>
</tr>
<tr>
<td></td>
<td>works in industry and</td>
</tr>
<tr>
<td></td>
<td>services</td>
</tr>
<tr>
<td></td>
<td>well-educated with high</td>
</tr>
<tr>
<td></td>
<td>literacy rate</td>
</tr>
<tr>
<td></td>
<td>People are healthy,</td>
</tr>
<tr>
<td></td>
<td>leading to low</td>
</tr>
<tr>
<td></td>
<td>infant mortality and</td>
</tr>
<tr>
<td></td>
<td>long life expectancy.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>11. services and facilities necessary for an economy to function</td>
</tr>
<tr>
<td></td>
<td>12. country with low levels of material well-being</td>
</tr>
<tr>
<td></td>
<td>13. a nation’s GDP divided by its total population</td>
</tr>
<tr>
<td></td>
<td>14. more successful less developed country</td>
</tr>
<tr>
<td></td>
<td>15. raising just enough food to feed one’s family</td>
</tr>
<tr>
<td></td>
<td>16. average expected life span of an individual</td>
</tr>
<tr>
<td></td>
<td>17. process by which a nation improves the economic, political, and social well-being of its people</td>
</tr>
<tr>
<td></td>
<td>18. proportion of the population over age 15 that can read and write</td>
</tr>
<tr>
<td></td>
<td>19. country with a higher average level of material well-being</td>
</tr>
<tr>
<td></td>
<td>20. the number of deaths that occur in the first year of life per 1,000 live births</td>
</tr>
<tr>
<td></td>
<td>21. extensive organization of an economy for the purpose of manufacture</td>
</tr>
</tbody>
</table>
Section 2: Guided Reading and Review

**Issues in Development**

A. As You Read

As you read Section 2, supply the missing effects of problems suffered by less developed countries in the spaces provided. Possible answers below

<table>
<thead>
<tr>
<th>Cause: Rapid population growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Effect: <em>A large proportion of population is young and dependent.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: Uneven global distribution of resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Effect: <em>Some nations will have harsh climates, uncertain rainfall, and lack of good farmland or mineral resources.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: Lack of physical capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Effect: <em>Without physical capital, industry cannot grow and people are not able to save money.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: Lack of human capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>4. Effect: <em>Lack of human capital means there are few people who are skilled workers or professionals to make the economy function effectively.</em></td>
</tr>
<tr>
<td>5. Effect: <em>Lack of human capital also means foreign investment is discouraged.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: Colonial dependency</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Effect: <em>Countries were forced to rely on manufactured goods from their colonizers, which prevented development of industry within the colony.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: Government corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. Effect: <em>Government corruption in LDCs meant that leaders made themselves and their friends rich and let their countries crumble.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: Political instability</th>
</tr>
</thead>
<tbody>
<tr>
<td>8. Effect: <em>Political instability leads to money being spent on weapons of war instead of development.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cause: 1973 OPEC price increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>9. Effect: <em>Many LDCs had to borrow more money for oil, making it difficult to pay back debts.</em></td>
</tr>
</tbody>
</table>

B. Reviewing Key Terms

Complete each sentence by writing the correct term in the blank.

10. Land suitable for producing crops is considered **arable**.

11. The increase in a country’s population in a given year is called the **population growth rate**.

12. The difference between a country’s death rate and birth rate is called the **natural rate of population increase**.

13. People who get too little nutritional food suffer from **malnutrition**.
Section 3: Guided Reading and Review

Financing Development

A. As You Read

As you read Section 3, supply the missing information in the spaces provided. Possible answers below

List three advantages economists believe multinational corporations bring to LDCs.

1. They introduce technology.
2. They create jobs and job training.
3. They provide the opportunity for related services and industries to develop.

List three disadvantages economists believe multinational corporations bring to LDCs.

4. Most of the money earned by MNCs goes to foreign investors and does not stay in the LDC.
5. Most of the industries of MNCs are capital-intensive and provide few jobs relative to the size of the labor pool in the LDC.
6. MNCs may pay low wages and may not offer satisfactory working conditions or environmental protection.

Give an example of why nations provide aid to less developed countries. Possible answers below

Humanitarian:
7. to build schools, roads, sanitation systems, and other infrastructure

Political and Military:
8. to help allies win wars or keep enemies from extending influence
9. to rebuild war-torn nations so that they can create stable democracies

B. Reviewing Key Terms

Define the following terms.

10. internal financing financing derived from the savings of a country's own citizens
11. foreign investment investment that originates from other countries
12. foreign direct investment (FDI) the establishment of an enterprise by a foreigner
13. foreign portfolio investment the entry of funds into a country when foreigners make purchases in the country's stock and bond markets
14. United Nations Development Program (UNDP) one of the world's largest sources of grant funding for economic and social development
15. World Bank the largest provider of development assistance
16. International Monetary Fund (IMF) Originally developed to stabilize international exchange rates, it has expanded its role to facilitate development by offering policy advice and technical assistance to LDCs.
17. debt rescheduling lengthening the time of debt repayment and forgiving, or dismissing, part of the loan
18. stabilization program an agreement between a debtor nation and the IMF in which the debtor nation agrees to revise its economic policy to provide incentives for higher export earnings and to lower imports
A. As You Read
As you read Section 4, provide details for each numbered item in the sequence chains below to show the series of events leading toward a free market economy in Russia.  

Transition in Russia

Mikhail Gorbachev introduces glasnost.  
Gorbachev introduces perestroika, which brings economic freedoms such as:  
1. factory managers deciding about production and pricing  
2. people starting their own businesses  
3. farmers getting long-term leases on land  
Economic reforms cause several hardships:  
4. some people lose secure government jobs, benefits, and pensions

Communism falls, and Boris Yeltsin is elected president.  
Boris Yeltsin lifts price controls, which causes:  
5. prices to triple, per laws of supply and demand  
6. wealth to be concentrated in urban areas  
7. corruption and crime to become widespread

B. Reviewing Key Terms
Answer each of the following questions.  

8. Why is the work ethic important to a system of privatization?  
   When businesses become privately owned, individual owners must value hard work in order to succeed in the business.

9. How are glasnost and perestroika related to free enterprise?  
   Glasnost was a policy of openness or political freedom, which Gorbachev believed was necessary for perestroika, or economic change, to successfully lead to free enterprise.

10. How did the focus on light industry benefit consumers?  
   Goods such as clothing, appliances, and bicycles were produced by light industry for consumers.

11. How did economic growth in China’s special economic zones compare to economic growth in the interior regions?  
   The special economic zones experienced rapid economic growth, while the interior regions lagged behind, and large numbers of people left the interior regions for the booming cities.