

The American Economy

★ CITIZENSHIP AND YOU ★

As a consumer, your economic decisions can have far-reaching effects. Keep a list of the economic decisions you make each day. The list might include budgeting, purchasing items, and saving money. Compare your lists in class.



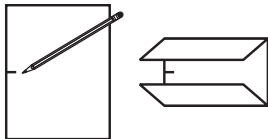
To learn more about factors that affect production of goods and services, view the **Economics & You** video lesson 19: Financing and Producing Goods.



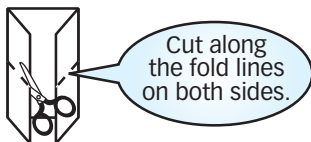
FOLDABLES™ Study Organizer

Summarizing Information Study Foldable Make this foldable to help you organize and summarize what you learn about the American economy.

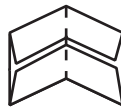
Step 1 Mark the midpoint of a side edge of one sheet of paper. Then fold the outside edges in to touch the midpoint.



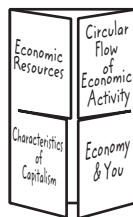
Step 3 Open the paper and cut along the inside fold lines to form four tabs.



Step 2 Fold the paper in half again from side to side.



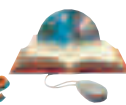
Step 4 Label as shown.



Reading and Writing As you read the chapter, write information under each appropriate tab of your foldable. Be sure to summarize the information you find by writing only main ideas and supporting details on your foldable.

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Chapter Overview Visit the *Civics Today* Web site at civ.glencoe.com and click on **Chapter Overviews—Chapter 19** to preview chapter information.

CONTENTS

Economic Resources

GUIDE TO READING

Main Idea

Four factors of production are required to produce goods and services.

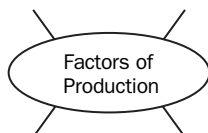
Key Terms

goods, services, factors of production, natural resources, labor, capital, entrepreneur, Gross Domestic Product (GDP), standard of living

Reading Strategy

Categorizing Information

As you read the section, complete a diagram like the one below by identifying the four factors of production.



Read to Learn

- What are the four types of resources or factors of production?
- What is Gross Domestic Product and how is it measured?



Americans in Action



You are listening to the radio. The newscaster says that according to a new government report, the economy is growing and prices are rising only slightly. What exactly does it mean when someone says that the economy has been growing? One of the important measures of the economy's size is Gross Domestic Product, or GDP. U.S. Secretary of Commerce William M. Daley noted, "As we searched for our greatest achievement [of the 20th century, we decided that] it was the invention of . . . the gross domestic product, or GDP." Dr. Simon Kuznets developed the GDP in the early 1930s, and later won a Nobel Prize for his work. Ever since, the GDP accounts have been used by government and business officials to guide their economic policymaking.



An American production worker

Producing Goods and Services

At the beginning of this century, the United States's annual output, or amount produced, totaled about \$10 trillion—nearly 30 percent of the world's total output. Some of this production is in the form of **goods**, or tangible products like books and automobiles that we use to satisfy our wants and needs. More of this production is in the form of **services**, or work that is performed for someone else. Services include haircuts, home repairs, and forms of entertainment such as concerts.

Factors of Production

There are four **factors of production**, or resources necessary to produce goods and services—natural resources, labor, capital, and entrepreneurs. These are broad categories that include many things that are already familiar to you.

Natural Resources

As an economic term, **natural resources** refers to all of the "gifts of nature" that make production possible. Natural resources include fertile fields, abundant rainfall, forests, mineral deposits and other resources that we use to make products.

For example, when your school was built, a certain amount of land was required for the building and grounds. Your school also consists of wood from forests, iron and steel extracted from ore, and bricks and mortar made from other natural materials. When these materials were in their natural state, before they were transformed into something else, they were part of the “natural resources” factor of production.

Labor

Labor is the nation’s labor force or human resources. Labor refers to both physical and mental efforts that people contribute to the production of goods and services. The labor used to construct a building was supplied by carpenters, bricklayers, and electricians. The labor needed to produce the service of education is the effort put forth by your teachers and other support personnel.

Labor is a resource that may vary in size over time. Historically, such factors as population growth, immigration, education,

war, and disease have had a dramatic impact on both the quantity and the quality of labor.

Capital

Another factor of production is **capital**, also called capital goods. These are the tools, machinery, and buildings used to make other products. The tools used to construct your school building included bulldozers, trucks, hammers, saws, drills, and any other human-made instruments of production that were used during its construction.

Capital goods are unique in that they are the *result* of production. For example, we can’t find a hammer out in the forest like we can a tree—someone actually has to make a hammer for it to exist.

Economists differentiate capital goods from consumer goods. Consumer goods satisfy wants directly. Consumer goods are things like clothes, clocks, shoes, foods, bicycles, and radios. Capital goods satisfy wants indirectly by aiding production of consumer goods.

Capital Goods The trucking industry plays an important role in the nation’s economy. **Why are trucks considered a capital good?**



Computing GDP



Final Goods and Services	Quantity (in thousands)	Average Price	Value (in millions)
Goods:			
Automobiles	6,000	\$28,000	\$168,000
Books	15,000	25	375
Computers	1,300	1,700	2,210
.....
Zippers	1,000	2	2
Services:			
Advertising (minutes of)	1,050,000	\$1,000	\$1,050,000
Babysitting (hours of)	50,000	5	250
Car Washes (number of)	15,000	10	150
.....
Zodiac Readings (number of)	400	10	4
Gross Domestic Product:			\$10.2 trillion

Evaluating Charts

Gross Domestic Product is the dollar value of all final goods and services produced in the economy in one year. How do we calculate GDP?

Entrepreneurs

The fourth factor of production is the **entrepreneur**. These are individuals who start new businesses, introduce new products, and improve management techniques. Being an entrepreneur involves being innovative and willing to take risks in order to reap profits. Entrepreneurs are often thought of as the driving force in the American economy because they use the factors of production to produce new products.

Reading Check Classifying Under what factor of production would you classify a bulldozer? Oil deposits?

Gross Domestic Product

People can measure their economic success by the amount of their incomes and their ability to provide for themselves and their families. The success of the overall economy is measured in a similar way. One measure of the economy's size is **Gross Domestic Product (GDP)**. This is the total value, in dollars, of all the *final* goods and services

produced in a country during a single year. The word *final* in the definition of GDP is important. A final good is a good, such as a loaf of bread, sold to its user. The intermediate goods that go into making a loaf of bread—flour or wheat, sugar, honey—are not counted in GDP. When computing GDP, economists count only final goods and services. If they counted both final and intermediate goods, they would be double-counting, or counting a good more than once.

In addition, secondhand sales—the sale of used goods—are not counted as part of GDP. When products already produced are transferred from one person or group to another, no new production is created. Although the sale of a used car, clothes, or compact disc player may give others cash that they can use on new purchases, only the original sale is included in GDP.

Measuring GDP

Remember that GDP is a monetary measure. A monetary measure is helpful if we are to compare the number of goods and services produced and get a meaningful idea





Student Web Activity Visit civ.glencoe.com and click on **Student Web Activities—Chapter 19** to learn more about measuring GDP.

of their relative worth. If the economy produces two computers and three dining room tables in year 1, and three computers and two tables in year 2, in which year is output greater? We cannot answer that question until prices are attached to these products as indicators of society’s evaluation of their worth.

The chart on page 426 shows a simple version of GDP. In the first column, we list all of the final goods and services that are produced in the country. In the next column, we list the number of each that is produced, and in the third column we list the average price for each good or service. To compute GDP, first multiply the number of items produced by the average price of the item; then add up everything. What else does GDP tell us? If the new GDP is higher than the previous one, then the economy is expanding. If it is lower, the economy is declining. Economists study GDP figures regularly to analyze business cycle patterns.

GDP is an important measure of **standard of living**, the quality of life based on the possession of necessities and luxuries that make life easier. Whenever GDP grows faster than the population, there are more goods and services, on average, for

each of us to enjoy. GDP is a reasonably accurate and useful measure of economic performance. It is not a measure of society’s overall well-being, though. Many things could make a country better off without necessarily raising GDP, such as a reduction of crime, greater equality of opportunity, and reductions of drug and alcohol abuse.

Quantity vs. Quality

Remember that GDP measures *quantity*. It does not accurately reflect improvements in the *quality* of products. There is a great difference between a \$3,000 computer purchased today and a computer costing the same amount just a few years ago. Because of this, economists must take great care to account for quality improvement. Greater production of goods and services is only one of the many factors that contribute to raising the standard of living.

Reading Check **Describing** What does Gross Domestic Product measure?

SECTION ASSESSMENT

Checking for Understanding

- Key Terms** Write a paragraph in which you use these key terms: **goods, services, factors of production, natural resources, labor, capital, entrepreneur, Gross Domestic Product (GDP), standard of living.**

Reviewing Main Ideas

- Describe** How do economists define natural resources?
- Explain** What are the major functions of the entrepreneur?

Critical Thinking

- Making Comparisons** Is a pizza oven a capital good or a consumer good? Explain.
- Organizing Information** Create a chart like the one below. Then list the four factors of production and provide two examples of each.

Factor of Production		
Example 1		
Example 2		

Analyzing Visuals

- Interpret** Study the table on page 426. What is the Gross Domestic Product for that particular economy?

★ BE AN ACTIVE CITIZEN ★

- Organize** Search your local newspaper to find a story about a business in your community. Organize the facts under the categories of *Natural Resources, Labor, Capital, and Entrepreneurs.*

Economic Activity and Productivity

GUIDE TO READING

Main Idea

The circular flow model provides an overview of the operation of the market economy.

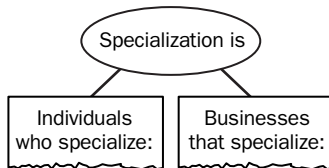
Key Terms

factor market, product market, productivity, specialization, division of labor, economic interdependence

Reading Strategy

Categorizing Information

As you read the section, complete a diagram like the one below by defining *specialization*. Then, identify at least two specialists in the categories.



Read to Learn

- What are factor markets and product markets?
- How does specialization increase production?



Americans in Action

High school and college students now have a new resource for finding jobs thanks to two students from Kansas City, Missouri. Michael and Ephren, both high school seniors, provide a service—a free online resource where students find employment opportunities. What kind of work will you do? What part do you play in the American market economy? You are a part of the system already. You buy things, so you are already a part of the consumer market. You might provide a service like Michael and Ephren. You might already have a part-time job. Part-time workers account for one of every five jobs in the U.S. economy. All of these activities are part of the market economy.



Part-time workers are part of a market economy.

Circular Flow of Economic Activity

To the economist, a market is a location or other situation that allows buyers and sellers to exchange a certain economic product. Markets may be local, regional, national, or global. In this section, you will learn about the major groups of decision makers and the major markets in the market system.

The Consumer Sector

Consumers make up one group of economic decision makers, but there are others—the business, government, and foreign sectors. The flow of resources, goods and services, and money in a market system between these groups is actually circular, as shown in the figure on page 429. Economists use this model, called a circular flow diagram, to illustrate how the market system works.

How does this circular flow operate? Consumers earn their income in **factor markets**—the markets where productive resources are bought and sold. Here, workers earn wages, salaries, and tips in exchange for their labor. People who own land may loan it in return for a type of income called rent. Finally, people who own capital exchange it for interest.

The Business Sector

When these individuals receive their incomes, they spend it in **product markets**—markets where producers offer goods and services for sale. The business sector receives payments in the product markets where they sell goods and services to consumers. Businesses use these payments to pay for natural resources, labor, and capital they use. These resources are then used to manufacture additional products that are sold in the product markets.

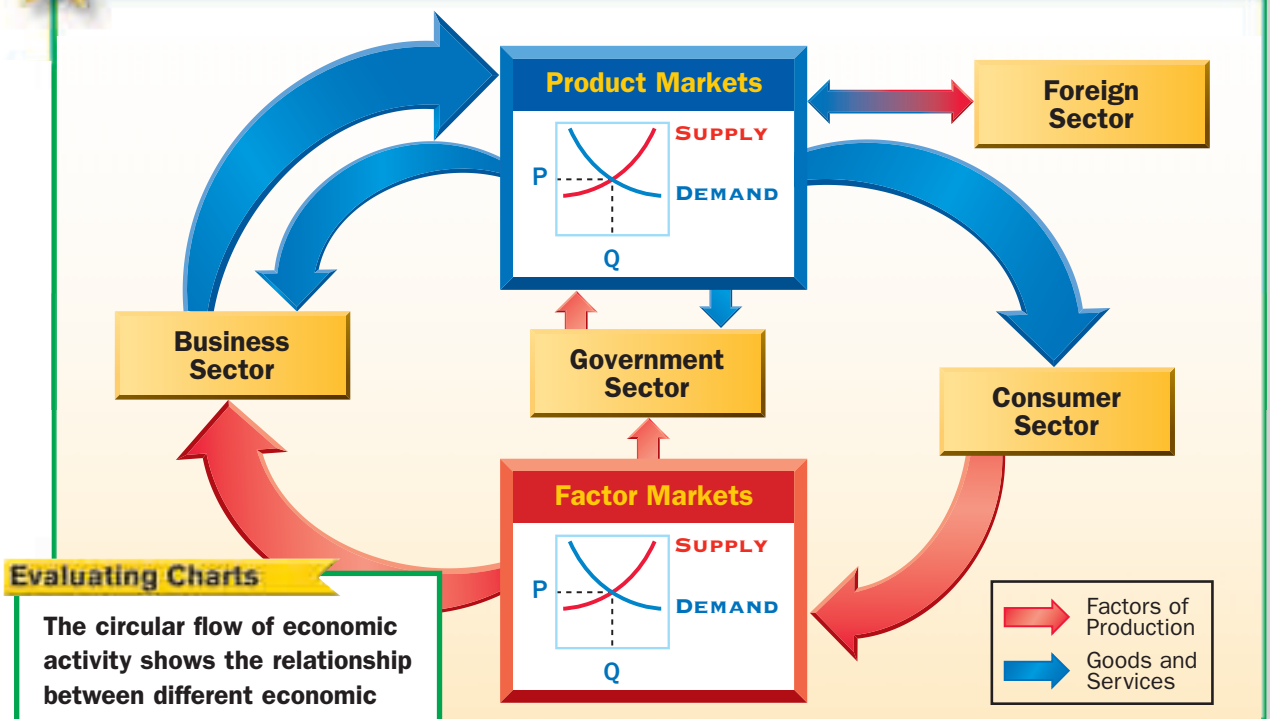
The diagram below shows that the business sector purchases some of the output it produces—primarily capital goods—so that it can continue to produce more goods and services. These purchases include things such as tools, factories, and other goods needed for current production. In actual practice, the business sector is much

smaller than the consumer sector. While the consumer sector purchases about two-thirds of all output, the business sector usually consumes about 15 to 20 percent of our GDP.

The Government Sector

The government sector shown on the diagram below is made of all three levels of government—federal, state, and local. Because the government sector also produces goods and services, like national defense, health, education, transportation, and housing, the government sector purchases productive inputs in the factor markets. The government receives revenue from the services it sells. For example, public universities charge tuition, public hospitals charge fees, and city buses charge fares. However, because the total cost of government services is seldom covered by fees

The Circular Flow of Economic Activity



alone, the government sector receives most of its revenues from taxes on businesses and individuals.

Government also uses its revenue to purchase final goods and services in the product markets. School systems, for example, purchase books and buses, while the military

purchases trucks, fighter planes, and ships. Historically, the government is the second-largest sector in our economy, purchasing approximately 20 percent of our GDP.

The Foreign Sector

The foreign sector in the diagram on page 429 represents all of the countries in the world. Notice that this sector is the only one with a line having an arrow at both ends. The reason for this is that we sell products to, as well as buy products from, other countries.

The value of the goods and services the United States purchases from other countries and the value of the goods and services it sells to other countries tend to offset one another. As a result, the foreign sector generally accounts for less than 4 percent of our nation's GDP.

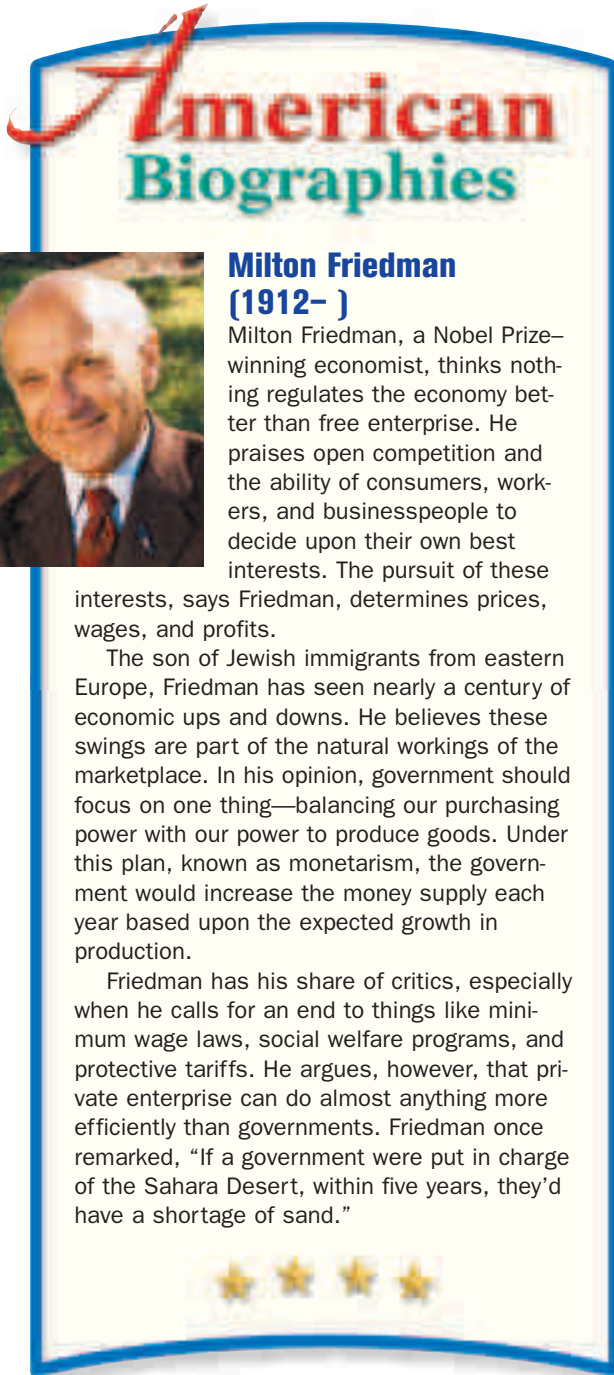
Reading Check **Identifying** What is a product market?

Productivity and Economic Growth

Growth in the economy occurs when a nation's total output of goods and services increases over time. This means that the circular flow becomes larger, with more factors of production, goods, and services flowing in one direction, and more payments flowing in the opposite direction. Economic growth is important because it increases people's standard of living.

Productivity

Everyone benefits when resources that are scarce are used efficiently. This is described by the term **productivity**, which is a measure of the amount of output produced by a given amount of inputs in a specific period of time. Productivity goes up whenever more output can be produced



American Biographies

Milton Friedman
(1912–)

Milton Friedman, a Nobel Prize-winning economist, thinks nothing regulates the economy better than free enterprise. He praises open competition and the ability of consumers, workers, and businesspeople to decide upon their own best interests. The pursuit of these interests, says Friedman, determines prices, wages, and profits.

The son of Jewish immigrants from eastern Europe, Friedman has seen nearly a century of economic ups and downs. He believes these swings are part of the natural workings of the marketplace. In his opinion, government should focus on one thing—balancing our purchasing power with our power to produce goods. Under this plan, known as monetarism, the government would increase the money supply each year based upon the expected growth in production.

Friedman has his share of critics, especially when he calls for an end to things like minimum wage laws, social welfare programs, and protective tariffs. He argues, however, that private enterprise can do almost anything more efficiently than governments. Friedman once remarked, “If a government were put in charge of the Sahara Desert, within five years, they’d have a shortage of sand.”

★★★★



Political Cartoons



and it seems to be diverted toward money and
Making the world a more convenient

Schneider, two men with little hope, of regaining
the company's

to be diverted
time

Analyzing Visuals

Economists note that consumers' purchasing decisions are often motivated by impulse as opposed to hard logic. According to the cartoonist, what is "the story behind the statistics"?

with the same amount of inputs in the same amount of time or when the same output can be produced with less input.

Productivity is often discussed in terms of labor, but it applies to all factors of production. For this reason, business owners try to buy the most efficient capital goods, and farmers try to use the most fertile land for their crops.

Specialization

Specialization takes place when people, businesses, regions, and even countries concentrate on goods or services that they can produce better than anyone else. As a result, nearly everyone depends upon others to produce many of the things that he or she consumes. Specialization is important because it improves productivity.

We specialize because we can earn more by doing the things that we do well. We also specialize because it is efficient to do so. Few individuals or households seriously consider producing their own food, shelter, and clothing. When people specialize, they are usually far more productive than if they

attempt to do many things. For example, Mary is a carpenter who wants to build a house. Even if Mary could build the entire house without any help, she could be better off hiring other workers who specialize in foundations, plumbing, and electrical wiring. Mary might even save money by first working for someone else and then using her earnings to hire specialized workers for her own project.

Division of Labor

The **division of labor** is the breaking down of a job into separate, smaller tasks, which are performed by different workers. The division of labor is a form of specialization that improves productivity.

Division of labor makes use of differences in skills and abilities. For example, you and your coworker each do the tasks you are best suited for. Even if your abilities are identical, specialization can be advantageous. By allocating all your time to a single task, you are more likely to discover improved techniques than by dividing your time among a number of different tasks.



Fact Fiction Folklore

Measuring Consumption

Every year, the United Nations Human Development Report looks for a new way to measure the lives of people. The report notes that the richest fifth of the world's population consumes 86% of all goods and services while the poorest fifth consumes just 1.3%. Indeed, the richest fifth consumes 58% of all energy used and owns 87% of all vehicles.

Human Capital

Productivity tends to increase when businesses invest in **human capital**—the sum of the skills, abilities, and motivation of people. Investments by government and businesses in training, health care, and employee motivation tend to increase the amount of production that takes place with a given amount of labor. Employers are usually rewarded with higher-quality products and increased profits. Workers often benefit from higher pay, better jobs, and more satisfaction with their work.

Economic Interdependence

Because of specialization, the American economy displays a remarkable degree of **economic interdependence**. This means that we rely on others, and others rely on us, to provide the goods and services that we consume.

Events in one part of the country or the world often have a dramatic impact elsewhere. For example, bad weather in a country where sugarcane is grown can affect sugar prices in the United States, which in turn can affect the price of snack foods and the demand for sugar substitutes elsewhere.

This does not mean that economic interdependence is necessarily bad. The gain in productivity and income that results from increased specialization usually offsets the cost associated with the loss of self-sufficiency. However, we need to understand how all the parts fit together, which is one of the many reasons we study economics.

Reading Check **Defining** What is specialization?

SECTION 2 ASSESSMENT

Checking for Understanding

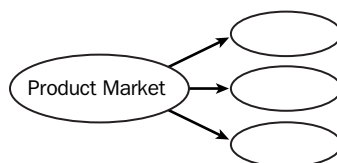
1. Key Terms Write a paragraph in which you use the following terms: **productivity, specialization, division of labor**. Then, write a second paragraph using these terms: **product market, factor market**.

Reviewing Main Ideas

- 2. Identify** Do consumers earn their income in the product market or the factor market?
- 3. Summarize** Name three things that government produces.

Critical Thinking

- 4. Drawing Inferences** In what industries or businesses does your community specialize? Why?
- 5. Organizing Information** Describe three different transactions that could take place in the product market. Use a diagram like the one below to help you organize your answer.



Analyzing Visuals

- 6. Interpret** Study the chart on page 429. As a consumer, what role do you play in the circular flow of economic activity?

★BE AN ACTIVE CITIZEN★

- 7. Research** Find out how either your local government or private groups protect consumer rights in your community. What ordinances protect consumers? How are complaints handled? What private organizations help consumers? Prepare a report for the class.



Landmark Supreme Court Case Studies

Gibbons v. Ogden



The steamer *Hartford* by Joseph B. Smith

Background of the Case

In the early 1800s, the state of New York licensed Robert Fulton and his partner to operate a steamboat monopoly along its waterway. The partners then used their license to grant Aaron Ogden a monopoly on ferryboat travel between New York City and Elizabethtown, New Jersey. Thomas Gibbons, however, had a federal license to run boats between New York and New Jersey.

Ogden wanted to shut down his competition. He sued to close down Gibbons's operation. It was up to the Supreme Court to decide which would prevail, Ogden's state license or Gibbons's federal license.

The Decision

John Marshall delivered the unanimous opinion on March 4, 1824. His decision rested on the power of Congress to "regulate commerce," as granted in Article I, Section 8, of the U.S. Constitution. Marshall interpreted *commerce* to mean "every species of commercial [interaction]," including navigation.

This power [to regulate commerce], like all others vested in Congress, is complete in itself, may be exercised to its utmost extent, and

In the early years of the nation, each state jealously guarded its own commerce. Trade barriers among the states restricted commerce and stood in the way of a strong national economy. What changed this situation?

acknowledges no limitations other than are prescribed in the Constitution. . . . [However, this rule does not apply to] . . . that commerce, which is completely internal, which is carried on between man and man in a state, or between different parts of the same State, and which does not extend to or affect other States.

The decision gave the federal government sole power to regulate all possible forms of commerce between states. It also affirmed Congress's right to regulate trade with foreign nations. States retained the right to regulate trade entirely inside their borders, and Ogden lost his license.

Why It Matters

The *Gibbons* decision took on more significance in later years than it did at the time. Marshall's broad interpretation of the commerce clause, in fact, helped pave the way for today's strong national government. It allowed Congress to prevent companies from fixing prices in 1905. In 1964, Congress was able to prohibit racial discrimination in businesses serving the public because such discrimination was seen as affecting interstate commerce.

Analyzing the Court Decision

1. How did Marshall define the commerce clause?
2. How did this Supreme Court ruling affect states' control of economic activities?



Capitalism and Free Enterprise

GUIDE TO READING

Main Idea

The United States has a free enterprise, or capitalist, system.

Key Terms

capitalism, free enterprise, consumer sovereignty, private property rights, competition, profit, profit motive, voluntary exchange

Reading Strategy

Organizing Information

As you read the section, complete a table like the one below by identifying the characteristics of a free enterprise economy. Then provide an example of each characteristic.

Characteristic	Example

Read to Learn

- What are the major features of free enterprise?
- What are some of the freedoms of free enterprise?



Americans in Action

Capitalism is an economic system in which individuals own most, if not all, resources and control their use. What are the benefits of capitalism and why has it spread to many countries? One writer noted that “capitalism has come to dominate the world’s economies because no other system has been able to generate long-term economic growth in the 200 years since the onset of the industrial revolution. Many others have been tried, but they have all failed.” In 1776 Adam Smith, a Scottish philosopher and economist, provided a philosophy for the capitalist system in his book, *The Wealth of Nations*. Smith wrote that individuals left on their own would work for their own self-interest. In doing so, they would be guided as if by an “invisible hand” to use resources efficiently and thus achieve the maximum good for society.



Economist
Adam Smith

Features of Capitalism

The economy of the United States is built largely on free markets and private ownership. It is known as **capitalism**, an economic system in which private citizens own and use the factors of production in order to seek a profit. **Free enterprise** is another term used to describe the American economy. In a free enterprise economy, competition is allowed to flourish with a minimum of government interference.

In *Americans in Action*, you read about one of the most remarkable characteristics of our nation’s economy: its ability to grow and accumulate wealth. No other economic system in the history of the world has been as successful. The unique features of this economic system combine to contribute to its success.

Markets

Markets are one important part of our economic system. Markets are the places where the prices of goods and services are determined as exchange takes place. However, markets do more than set prices; they are mechanisms that connect the

different sectors of the economy. To illustrate, the chart on page 429 shows that consumers and businesses interact primarily in the product and factor markets.

When you go to work, your labor is being sold in the factor markets. When you go shopping, the goods and services you buy are being purchased in product markets. Markets, then, are the main places where buyers and sellers meet to negotiate product prices.

Under our economic system, the consumer is especially important because businesses usually try to produce the products that people want most. Because of this, we use the term **consumer sovereignty** to describe the consumer as the “king,” or ruler, of the market, the one who determines what products will be produced.

Economic Freedom

In the United States, we place a high value on the freedom to make our own economic decisions. Choice is a key element of the free enterprise system. Specifically, each of us can choose the type of job or occupation we would like to have, and we can choose when and where we would like to work.

As consumers, we have the right to choose the products we will buy. Businesses have the right to choose the products they will produce and offer for sale. Along with this freedom come certain costs. In particular, individuals must normally accept the consequences of their decisions in our free enterprise system. If an entrepreneur starts a business that fails, the government usually won't help out.

Economic Freedom The freedom to own a business is one characteristic of a capitalist society. **What are other characteristics of capitalism?**

Private Property Rights

Another major feature of capitalism is **private property rights**. This means that we have the freedom to own and use, or dispose of, our own property as we choose as long as we do not interfere with the rights of others.

Private property rights give us the incentive to work, save, and invest, because we know we can keep any gains that we might earn. In addition, we tend to take better care of things if we actually own them so they tend to last longer. For example, someone who owns his or her own home often takes better care of it than does the person who rents property from someone else.

Competition

Capitalism thrives on **competition**—the struggle that goes on between buyers and sellers to get the best products at the lowest prices. The competition between sellers keeps the cost of production low and the quality of the goods higher than they would be otherwise. Buyers likewise compete among themselves to find the best products at the lowest prices.

Because of this, competition rewards the most efficient producers. Competition also forces the least efficient producers out





Consumer Sovereignty Consumers play an important role in the American free enterprise economy. **What is consumer sovereignty?**

of business or into other industries. The result is that competition makes for efficient production, higher-quality products, and more satisfied customers.

The Profit Motive

Under free enterprise and capitalism, people are free to risk their savings or any part of their wealth in a business venture. If the venture goes well, the people will earn rewards for their efforts. If things go poorly, they could lose part or even all of the investment. The possibility of financial gain, however, leads many to take risks in hopes of earning a profit.

Profit is the amount of money left over after all the costs of production have been

paid. Profit, then, is the extent to which persons or organizations are better off economically at the end of a period than they were at the beginning. The **profit motive**—the driving force that encourages individuals and organizations to improve their material well-being—is largely responsible for the growth of a free enterprise system based on capitalism.

Voluntary Exchange

Voluntary exchange is the act of buyers and sellers freely and willingly engaging in market transactions. Who benefits when you buy something—you or the seller? As long as the transaction involves a voluntary exchange, both you and the seller benefit—or the exchange would not have happened in the first place.

The buyer gives up money to obtain a product. The seller gives up the product to obtain money. Unless both parties believe they will be better off afterward than before, neither will make the exchange. When exchange takes place, it does so only because both parties feel they will make a profit. Voluntary exchange, then, is both a characteristic of capitalism and a way for us to improve our economic well-being.

Reading Check Summarizing What incentives does private property give people?

The Spread of Capitalism

No one person invented the idea of capitalism. It developed gradually from the economic and political changes in medieval and early modern Europe over hundreds of years. Two important concepts laid the foundation for the market system that is at the heart of capitalism. First is the idea that people could work for economic gain. Second is the idea that government should have a very limited role in the economy.

Major changes in the economic organization of Europe began with the opening of trade routes to the East in the 1200s. As trade increased, people began to invest money to make profits. By the 1700s, Europe had nation-states, a wealthy middle class familiar with money and markets, and a new attitude toward work and wealth. Included in this new attitude were the ideas of progress, invention, and the free market. The free market meant that buyers and sellers were free to make virtually unlimited economic decisions in the marketplace.

Adam Smith and Capitalism

Adam Smith was a Scottish economist and philosopher. His best known work, *The Wealth of Nations*, was published in 1776. Smith's book offered a detailed description of life and trade in English society. It also scientifically described the basic principles of economics for the first time.

Smith believed that individuals, seeking profit, end up benefiting society as a whole. From the writings of Smith and others came the basic idea of laissez-faire economics.

Laissez-faire, a French term, means “to let alone.” According to this philosophy, government should not interfere in the marketplace. In laissez-faire economics, the government's role is strictly limited to those few actions needed to ensure free competition in the marketplace.

Many of America's Founders read *The Wealth of Nations* and were influenced by it. James Madison read it, and Alexander Hamilton borrowed heavily from it in his “Report on Manufactures.” In a letter to Thomas Mann Randolph in 1790, Thomas Jefferson wrote, “. . . in political economy I think Smith's *Wealth of Nations* the best book extant [in existence] . . .”

Historically, communism and capitalism have been viewed as two opposing political and economic structures. The collapse of communism, however, did not mean that the transition to capitalism will be smooth. Despite problems, the rise of capitalism is one of the most remarkable phenomena of this era.

Reading Check Explaining What is laissez-faire economics?

SECTION 3 ASSESSMENT

Checking for Understanding

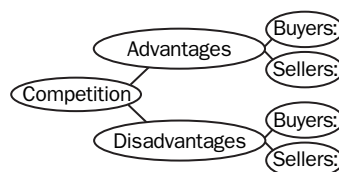
1. Key Terms Write a paragraph about free enterprise using all of the following terms: **consumer sovereignty, private property rights, competition, profit, voluntary exchange.**

Reviewing Main Ideas

- 2. Explain** What is a free enterprise economy? How does consumer sovereignty affect the free enterprise system?
- 3. Explain** What are the limits of private property rights?

Critical Thinking

- 4. Analyzing Information** What economic choices will you be free to make upon graduating from high school?
- 5. Making Comparisons** Create a diagram like the one below to list the advantages and disadvantages of competition to buyers and sellers.



Analyzing Visuals

- 6. Write** Create a caption for the photo on page 436. In your caption, indicate how the photo illustrates the characteristic of voluntary exchange.

★ BE AN ACTIVE CITIZEN ★

- 7. Interview** Survey five fellow students, friends, and neighbors to discover what the term “free enterprise” means to them. Review your findings and analyze why people might have different views of free enterprise.

The Economy and You

GUIDE TO READING

Main Idea

To make good economic decisions, we need to be aware of our rights and responsibilities as consumers.

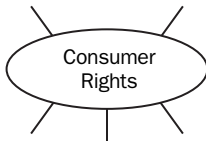
Key Terms

consumerism, warranty, ethical behavior, disposable income, discretionary income, saving, interest

Reading Strategy

Organizing Information

As you read the section, complete a diagram like the one below to list your rights as a consumer.



Read to Learn

- What private and federal help can you receive as a consumer?
- What considerations should govern your decision making as a consumer?



Americans in Action

Richard Hecker and Ruchit Shah met online and soon discovered that they shared an interest in business. The two high school students ultimately formed a multimillion-dollar company, called ClickZen.com. It is an advertising network that sells and serves banner space on a variety of Web sites.

According to a 2001 article from Rediff.com, Ruchit, a resident of Charlotte, North Carolina, from an early age “displayed an intense interest in the Internet and ways of doing business on the Net. Looking back, Shah credits his parents with his success: ‘A person can only be as remarkable as the people around him, which are my parents, my friends and my little brother Rishi. I couldn’t have done it without them. I really have to thank them and my teachers.’” For his part, Hecker discounts the idea that being so young is a liability in the business world. He says, “As long as we provide results, age doesn’t matter.”



Richard Hecker

Consumer Rights and Responsibilities

The American free enterprise system bestows numerous economic rights and protections on individuals like you, your teachers, your relatives, and your friends. You have the right to enter into just about any profession or enterprise you are interested in, just as Ruchit Shah and Richard Hecker did. You have the right to buy those products and brands that you like and to reject the others.

In earlier chapters, you discovered that with every right comes certain responsibilities. In the same way, our rights as consumers require some responsibility on our part. We should find out as much as we can about the products we buy so that we can recognize good quality. We should also find out where we can get the best value for our money. We cannot always rely on stores and businesses to protect us. We must take steps to protect ourselves.

Protecting Consumer Rights

Throughout much of history, consumer rights could be summed up in one Latin phrase: *caveat emptor*, or “let the buyer beware.” In this section, you will learn how **consumerism**, a movement to educate buyers about the purchases they make and to demand better and safer products from manufacturers, affects you personally.

Congress has passed a number of laws over the years that protect consumer rights. Many of these laws involve labeling. For example, the Fair Packaging and Labeling Act requires that every package have a label identifying its contents and how much it weighs. Other laws protect consumers’ health and safety. An early example is the Pure Food and Drug Act, passed in 1906. It requires manufacturers of foods, cosmetics, and drugs to prove their products are safe.

Many private groups and organizations have taken on the task of protecting individual consumers. One of the oldest of these consumer groups is the Better Business Bureau. There are about 145 better business bureaus in communities around the country. Surprisingly, business groups rather than consumers run these organizations. These businesspeople recognize that the key to success lies in earning the trust of their customers. They provide information about local businesses and warn consumers about dishonest business practices. They also investigate consumer complaints.

Consumer Bill of Rights

In the 1960s, a special effort was made to strengthen the consumers’ voice. President John F. Kennedy and, later, President Richard Nixon emphasized five major rights of consumers.

- Consumers have the *right to a safe product*—one that will not harm their health or lives.

- Consumers have the *right to be informed* for protection against fraudulent, deceitful, or grossly misleading information and to be given the facts needed to make informed choices.
- Consumers have the *right to choose*—to have available a variety of products and services at competitive prices.
- Consumers have the *right to be heard*—the guarantee that consumer interests will be listened to when laws are being written.
- Consumers have the *right to redress*—the ability to obtain from the manufacturers adequate payment if their product causes financial or physical damage.

Rights and Responsibilities When you buy something, you have a right to expect quality and a responsibility to recognize it. **What are other consumer rights and responsibilities?**



An Appearance in Small Claims Court

Javier purchased a radio/CD player. Ten days later it stopped working. The store refused to exchange it for another one, so Javier brought his complaint to small claims court. Javier has the receipt and the broken radio/CD player as evidence. The law requires that all new items

include an implied promise that they can do what they are supposed to do for a reasonable length of time. In small claims court, the proceedings went as follows:

Judge: “Both sides should be given an opportunity to present their case with the support of their witnesses. I will then make my decision.”



Witness Statements

Javier: “I really wanted a radio/CD player and the salesperson talked me into this model. When it didn’t work I went back to the store, but the salesperson would not take it back. I have the evidence and I want my money back!”

Ruby (Javier’s mother): “Javier was excited about his purchase and upset when it didn’t work. We thought the store would give us a credit so soon after the purchase. They must not have very good merchandise. Javier earned this money and deserves to have a good product.”

Tyrone (Salesperson): “I sold the radio/CD player and, of course, I thought it worked. Why wouldn’t it work if it was still in the original cardboard box—right from the factory? I think Javier broke it.”

Hattie (Store manager): “We haven’t had any complaints about this model. We accept returns within 5 days in the original box. Otherwise, we would have been happy to give him a credit—our customers are important to us.”

★ BE AN ACTIVE CITIZEN ★

How should the judge decide the case? In a brief report, make a decision on this case and give your reasons for it.

Consumer Responsibilities

Just as consumers have rights, they also have responsibilities. If a product or service is faulty, it is the consumer’s responsibility to begin the problem-solving process. If it happens to you, you should report the problem immediately. Do not try to fix a product yourself, because doing so may cancel the **warranty**, the promise made by a manufacturer or a seller to repair or replace a product within a certain time period if it is faulty. State the problem and suggest a fair solution. Keep an accurate record of your efforts to get the problem solved. If you need to contact the manufacturer in writing, type your letter or send an e-mail directly. Keep a copy of your letter.

Another responsibility of consumers is to exhibit **ethical behavior** by respecting the rights of producers and sellers. For example, a responsible consumer will not try to return a used item because it has been advertised elsewhere for a lower price.

Reading Check Summarizing What is the purpose of better business bureaus?

Your Role as a Consumer

Your role as a consumer depends on your available income and how much of it you choose to spend or save. Income can be both disposable and discretionary.

Uses of Income

Disposable income is the money income a person has left after all the taxes on it have been paid. People spend their disposable income on many kinds of goods and services. First, they generally buy the necessities of living: food, clothing, and housing. **Discretionary income** is money left over after paying for these necessities that can be used for satisfying wants, including luxury items or savings accounts.

Regardless of the size of a person's income, spending that income requires constant decision making. As a consumer, each person has a series of choices to make.

Decision Making

Virtually all of the steps in decision making involve an opportunity cost. Remember that opportunity cost is the value of your highest alternative choice that you did not make. Suppose a friend recently purchased athletic shoes. You like them, and you want to buy a pair for yourself. Before you do, however, ask yourself, "What can't I buy or do, if I buy the shoes?" In other words, you have to decide if the shoes are worth what you would give up to buy them.

What Are Your Goals?

It is also important to consider your goals when you make buying decisions. Suppose you work on weekends to save money for a new computer. You see many things that you would like to buy now—new clothes, magazines and books, and so on. If you buy these things, you will find it harder to accomplish your long-term goal. What option do you choose?

You could buy what you want now and reduce, or postpone, the chances of buying the computer or buy less of what you want now and increase the chances of buying the computer. Long-term goals often conflict with short-range spending decisions.

Saving for the Future

One way to help you reach your long-term purchasing goals is to save. **Saving** is to set aside a portion of income for a period of time so that it can be used later. It is that part of your income that you don't spend.

Saving money can be a difficult habit to establish. Some people feel they should enjoy every penny they earn. As a result,

they spend their money as quickly as it comes in. There are, however, many good reasons for saving. Most people cannot make major purchases, such as a car or a house, without putting aside money to help pay for them. Saving also comes in handy in emergencies.

When an individual saves, the economy as a whole benefits. Saving provides money for others to invest or spend. Saving also allows businesses to expand, which provides increased income for consumers and raises the standard of living.

Saving Regularly

To make it easier for people to save, most employers withhold a fixed amount from employees' paychecks. This money is automatically deposited into participating employees' savings accounts. Many people, however, handle the responsibility

A passbook savings account is a booklet in which deposits, withdrawals, and interest payments are recorded.



\$ Economics and You

Public Disclosure

The government helps citizens make informed purchases through the use of public disclosure—the requirement that businesses reveal certain information about their products or services to the public. The Food and Drug Administration, for example, requires food companies to put labels on cans and other containers. Pick a product that you use often. Report on any information or warnings on the labels or containers.

themselves. Each week or month, they budget a specific amount of money to put aside for savings.

Generally, when people think of saving they think of putting their funds in a savings bank or a similar financial institution where it will earn interest. **Interest** is the payment people receive when they lend money or allow someone else to use their money. A person receives interest at periodic intervals on his or her savings for as long as funds are in the account.

Deciding About Your Savings

Like every other activity, saving involves a trade-off. The more you save today, the more you can buy a year from now, 10 years from now, or 30 years from now. Saving increases a person’s future purchasing power. You will, however, have less to spend today. Deciding how much to save depends on your answer to several questions: How much do you spend on your everyday expenses? What are your primary reasons for saving? How much interest can you earn on your savings and, therefore, how fast will your savings grow? How much income do you think you will be earning in the future?

If you expect to make a much higher income tomorrow, you have less reason to save a large percentage of today’s income. When you are self-supporting and have more responsibilities, you will probably save for other reasons, such as having funds in case of emergencies and for your retirement. It is a good idea, however, to have some sort of savings plan.

Reading Check **Defining** What is discretionary income?

SECTION 4 ASSESSMENT

Checking for Understanding

1. Key Terms Use each of the following terms in a sentence that will help explain its meaning: **consumerism, warranty, ethical behavior, disposable income, discretionary income, saving, interest.**

Reviewing Main Ideas

- 2. Summarize** What private and federal help can you receive as a consumer?
- 3. Explain** What kinds of products are purchased with disposable income?

Critical Thinking

- 4. Making Generalizations** Why do some people buy brand-name products and other people buy generic products?
- 5. Synthesizing Information** On a chart like the one below, develop a checklist of three rules for making an important purchase.

My Checklist
1.
2.
3.

Analyzing Visuals

6. Interpret Look at the cartoon on page 431. Are the goods being purchased necessities (needs) or are they discretionary (wants)? Explain.

★ BE AN ACTIVE CITIZEN ★

7. Compare Select a product you use every day: toothpaste or a hair dryer, for example. Do some comparison shopping by finding at least three separate locations that sell this product. What were the differences in price for the product?



Critical Thinking SKILLBUILDER

Predicting Consequences

Why Learn This Skill?

What should I do? You answer this question every time you choose a course of action. Every time you act, you get results. These results are the consequences of your action. Of course, you want the consequences to be all that you had hoped for with no unpleasant surprises. The way to avoid unpleasant surprises is to predict the consequences before you act. Predicting consequences may prevent you from having to ask, “Why did I do that?”

Learning the Skill

To predict the consequences of an action, follow these steps:

- Clarify the issue or situation. Form a statement or a question that clearly states the decision that needs to be made.
- Identify the options and analyze patterns.
- Predict the possible consequences of each option.
- Make a prediction.

Practicing the Skill

On a separate sheet of paper, predict one or more possible consequences of the options listed below.

From his monthly job earnings of \$150, Joseph has saved \$575 toward the future purchase of a computer costing \$850. He wants a computer now, however, to do online research for two lengthy reports due in three weeks. What is the most satisfactory way for Joseph to acquire the use of a computer?

- Option 1.** Work nighttime hours stocking groceries for two months to earn the additional \$275 needed to buy the computer.



A job can help teens reach their goals.

- Option 2.** Use the \$575 as a down payment and make monthly credit payments of \$35 for the next 12 months.
- Option 3.** Spend \$500 for a rebuilt computer that carries no warranty.

Based on the consequences you have listed, which action would you choose? Explain.

Applying the Skill

Suppose you receive a gift of \$300 to save for your education after high school. How should you invest the money? List the options you might have. Beside each option, list the predicted consequences. Use your predictions to select the most suitable course of action.



Practice key skills with Glencoe's **Skillbuilder Interactive Workbook CD-ROM, Level 1.**

Assessment & Activities

Review to Learn

Section 1

- The four factors of production are natural resources, labor, capital, and entrepreneurs.
- The factors of production provide the means for a society to produce its goods and services.



Section 2

- Productivity relates to the efficient use of resources.
- Productivity tends to go up when workers specialize in the things they do best.

Section 3

- The economic system of the United States is based on capitalism and free enterprise.
- Important characteristics are markets, economic freedom, competition, private property rights, the profit motive, and voluntary exchange.



Section 4

- Consumer advocates promote the following consumer rights: the right to safety, to be informed, to choose, to be heard, and to redress.

FOLDABLES™
Study Organizer

Using Your Foldables Study Organizer

Use your completed foldable to explain, in a brief essay, how you fit into the circular flow of economic activity.

Reviewing Key Terms

Choose the key term from the chapter that best matches each clue below.

1. natural resources, labor, capital, and entrepreneurs used to produce goods and services
2. the amount of goods and services produced from a given level of inputs
3. a transaction in which a buyer and seller work out their own terms of exchange
4. role of consumer as ruler of the market when determining goods and services produced
5. the use of resources by an individual, a firm, a region, or a nation to produce one or a few goods and services

Reviewing Main Ideas

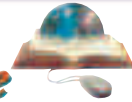
6. What factors of production are required to produce the things that people use?
7. What are goods?
8. What are services?
9. What is the difference between a final good and an intermediate good?
10. What is the term for breaking down a job into numerous, separate tasks?
11. What does the idea of consumer sovereignty express?
12. What is voluntary exchange?
13. What is the drive to improve your material well-being called?
14. What is a warranty?
15. What is the income after taxes used to buy the necessities of living called?
16. What is interest?

Critical Thinking

17. **Categorizing Information** Describe how either you or a relative of yours who has a job fits into the circular flow model. Be sure to discuss both the factor and product markets.

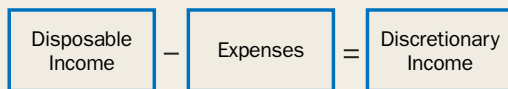
CLICK HERE

CIVICS
Online



Self-Check Quiz Visit the *Civics Today* Web site at civ.glencoe.com and click on **Self-Check Quizzes—Chapter 19** to prepare for the chapter test.

- 18. Understanding Cause and Effect** Define the meaning of the division of labor and explain how it improves the efficiency of production.
- 19. Understanding Cause and Effect** Copy the following diagram onto a separate sheet of paper. Use upward, downward, or horizontal arrows to show what would happen to the size of the boxes in situations A, B, and C.



- You receive a pay raise.
- You cut energy expenses.
- Wanting to graduate from college sooner rather than later, you leave your full-time job for a lower-paid, part-time position.

Practicing Skills

- 20. Predicting Consequences** Suppose that your government wanted to make health care more affordable for everyone. To do this, state legislators put a series of price controls in place that cut the cost of medical services in half. What would happen to the demand for medical services at the new, lower price? What would happen to the supply of medical services that doctors would be willing to provide at the new, lower price? Where do you think new doctors would prefer to set up practice? Explain the reasons for your answers.



Economics Activity

- 21.** Choose a product that you use frequently. Research to find the answers to these questions regarding how the product is produced.
- What natural resources were used?
 - What types of skills did the workers need?
 - What types of tools were used?
 - Is the firm that made the product large? What other products does it produce?

★ CITIZENSHIP COOPERATIVE ACTIVITY ★

- 22.** With a partner, find at least two examples of capital goods that are used in your school to provide the service of education. Would productivity go up or down if these capital goods were not available to your school? Explain why or why not.

Analyzing Visuals

- 23.** Study the chart on page 426. What does the figure show? What two categories of economic products are shown?



Technology Activity

- 24.** Using a search engine on the Internet, find and research an entrepreneur. Explain what benefits were brought to society by this person's risk taking.



Standardized Test Practice

Directions: Choose the *best* answer to the following question.

Which of the following statements about Gross Domestic Product is NOT true?

- It includes intermediate goods.
- It includes services as well as goods.
- It is based on dollar value.
- It includes final goods.

Test-Taking Tip

Read the question carefully. When a question uses the word *not* or *except*, you need to look for the answer that does not fit.