

# ***ECONOMICS / UNIT III***

*"The business of America is business" –Calvin Coolidge*

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## UNIT III / LESSON 1

# The Basic Economic Problem: The Mismatch of Unlimited Wants and Needs and Limited Economic Resources; an Introduction to Sustainability

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**Time Frame**  
1 day

**Standards**  
*NES: Economics – Describe the nature of economics and economic activity*  
*Explain how society uses scarce resources to produce and distribute goods and services*  
*NES: Skills – Follow directions*  
*Apply effective listening skills*  
*Make oral presentations*  
*Prepare written reports*

### Guiding Question

How is economics related to the problem of scarcity?

### Materials

Handouts III.1.A-C

### Objectives

*Students will be able to:*

- Define economics and explain how it relates to needs, wants, and scarcity.
- Explain and give examples to prove why everyone’s wants and needs cannot be satisfied.
- Discuss the importance of sustainability and how it relates to meeting people’s needs and wants.

### Teacher Background

Economics has been defined as how people and societies use limited resources (both natural and human) to meet their unlimited wants and needs. The problem of meeting these wants and needs is one which all people face, no matter how wealthy or poor they are. It is a problem that requires us to make choices as to how we will use the factors of production (i.e., land, labor, and management). To ensure that we will always be able to meet our most vital needs and wants, humankind is studying sustainability, the effort to preserve and ration natural and human resources.

The lesson begins with a discussion of how humankind’s needs and wants are surpassing our limited resources. This concept is addressed in Handout III.1.A, in which students are asked to explain the illustration focusing on the concept of scarcity, the basis for the study of economics. In Handout III.1.B, students will read an explanation of scarcity, after which they will be asked to answer questions about how scarcity has affected their lives. Finally, Handout III.1.C presents an editorial about sustainability, which the class will be asked to analyze.

## Teaching Strategies/Supporting Activities

- Write the following on the board:  
"Needs and Wants." Ask students to explain their answers to the following questions:
  - What do these terms mean to you?
  - How would you identify your most important needs and wants?
  - Why do some say that people's needs and wants are unlimited?
  - Explain some of the problems that arise when people try to meet their unlimited needs and wants.
- Distribute Handout III.1.A, "Illustration." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What do we learn from this handout?
  - Why does "A" outweigh "B"?
  - Why don't the scales balance?
  - Based on this cartoon, how would you describe the problem of scarcity? Can you give a real-life example to show that we have only limited resources to meet our unlimited needs and wants?
  - Why is this central problem so significant?
  - How does the fact that all your needs and wants cannot be met affect your life?
- Distribute Handout III.1.B, "Scarcity." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn about scarcity from this reading?
  - What does the reading mean when it says that resources like land, labor, and capital are scarce?
  - Which of the following suggestions serves as the best way for dealing with the problem of scarcity?
    - 1) The government should determine who gets the scarce resources.
    - 2) Scarce resources should be given to those people with the greatest needs.
    - 3) Scarce resources should be given to people who have the money to pay for them.
  - In our economy, people who have the money get the scarce resources; is this the best way to deal with the problem of scarcity?

- Distribute Handout III.1.C, "The Importance of Sustainability." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you identify as the major opinion stated in this editorial?
  - What arguments did you find to support the opinion stated in this editorial?
  - To what extent do you agree with the editorial writer about the importance of sustainability?
  - How necessary do you think it is that we preserve resources today for future generations?
  - What are some of the problems we face in trying to support the concept of sustainability in today's resource-thirsty world?

### Summary/Assessment

Ask students to explain their answers to the following question:

How should we deal with the fact that we cannot have all the things we need and want?

### Follow-Up

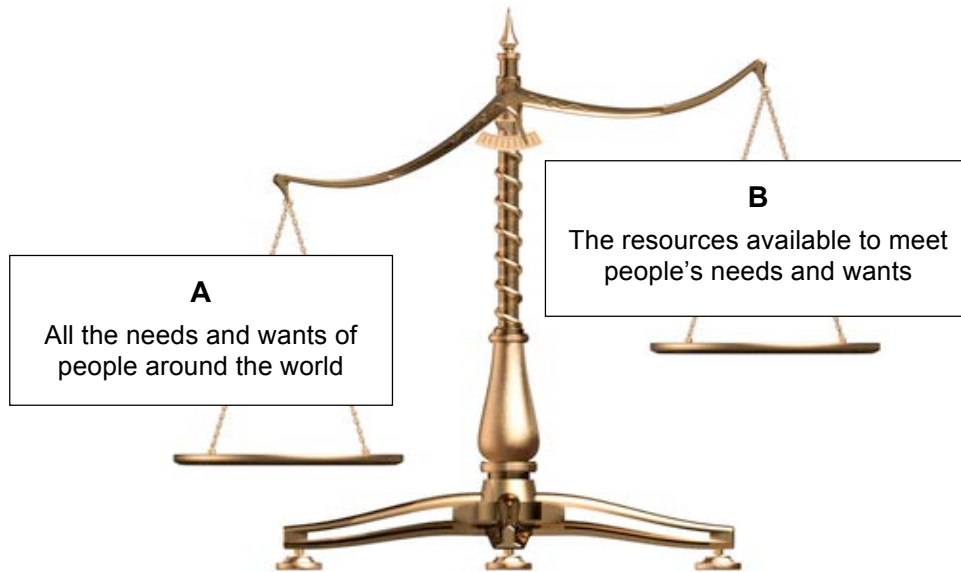
Ask students to research the topic of sustainability. Have students bring to class an effective idea based on that research related to sustaining our precious natural and human resources. As part of the class discussion, ask students to explain their answers to the following questions:

- What is one effective idea related to sustainability?
- Why do you think this idea is so effective?
- Are we doing enough today to promote sustainability?
- What additional things can we do to promote sustainability?

### Handout III.1.A, “Illustration”

**Directions:** Study the illustration below, including the title and caption, and answer the questions in the exercise.

## Scarcity: The Central Problem of Economics



“The scales do not balance.”

**Exercise:**

1. What is the title of this illustration? \_\_\_\_\_
2. What does the caption under the illustration say? \_\_\_\_\_
3. Why does “A” outweigh “B?” \_\_\_\_\_
4. Why don't the scales balance? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
5. Based on the illustration, explain “scarcity.” \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

## Handout III.1.B, "Scarcity"

**Directions:** Read the Q&A below and complete the exercise at the bottom of the page.

**Q. What does economics have to do with scarcity?**

**A.** Economics is all about scarcity, a problem that has existed ever since the beginning of humankind, a problem faced by rich and poor, and a problem confronting both individuals and societies.

**Q. What is scarcity?**

**A.** Scarcity, in general terms, is basically a lack of supply or a shortage. According to economics, scarcity refers to the shortage of resources available to meet the unlimited needs and wants of the entire population. In other words, scarcity can be defined as the excess of human wants over what can actually be produced.

**Q. Are all resources scarce?**

**A.** The scarce resources we are talking about are the factors of production. Among the most important are:  
Labor – the workers available to produce goods and services.  
Land & Raw Materials – the raw materials, etc., used to produce goods and services.  
Capital – the amount of money available for investing.

In spite of all the above-mentioned resources, there are some resources that are considered to be unlimited and they are known as "free goods." Air and water are considered to be "free goods." This is because they are freely available to the population. However, it should be said that even though air and water are considered to be free goods, for some nations air and water are considered to be scarce. This is because the air and water around them are polluted, and in order to produce purified air and water they basically have to use resources. For those countries, air and water are no longer free goods but instead considered to be economic goods because they are scarce.

**Q. Why is scarcity called the central problem of economics?**

**A.** If all the resources were unlimited or, in other words, if there were sufficient amount of resources to fulfill all of the ever-changing demands of the people, then of course the people would have fulfilled their needs and wants without any problem. But in reality this is not the case. That's why scarcity has become a problem, thus paving way for all of the economic issues faced by the world today.

*Adapted from: <http://www.articlesbase.com/management-articles/economics-understanding-the-problem-of-scarcity-2181754.html>*

**Exercise:** In the space below, suggest a question about scarcity that you would like to ask.

**Q:** \_\_\_\_\_



### Handout III.1.C, "The Importance of Sustainability"

**Directions:** An editorial is an essay expressing an opinion. Read the editorial below and complete the exercise that follows.

In the past, the entire human population was small and civilizations had very few needs. At that time, natural resources seemed limitless because the capacity of nature to regenerate was much higher than the rate at which human beings used up resources. Today, our needs are much greater—some would say our needs are unlimited—and we are painfully beginning to learn that environmental resources to meet those needs are limited and are quite sensitive to everything that we do. We are starting to experience the effects of the actions of generations that came before us.

To make sure that future generations will not experience a situation worse than ours, we need to be aware of the ideals and requirements of sustainability. Sustainability is the ability to maintain a certain status or process in existing systems. Sustainability is important because all the choices we pursue and all the actions that we make today will affect everything in the future.

For example, if we continue wasting water and polluting the dwindling supply of fresh water that we have today, we leave future generations with no other choice than to desalinate saltwater or treat contaminated water for their consumption and daily use. We can also be assured that, if that happens, all life that depends on clean fresh water will become extinct.

The same goes with the supply of soil that we currently have. Without proper care, our soils can easily lose quality enough that they will no longer be able to encourage growth and sustain life. If that happens, future civilizations will be void of crop and other natural sources of food. They will then have no other choice but to create man-made sources for nourishment and sustenance.

The two examples described above may seem frightening but, in fact, those are not the worst circumstances we can leave the future of mankind. If clean water and good soil become scarce enough, all life on Earth can become extinct. Keep in mind that this does not just apply to soil and water. The fact is that all resources, including human resources, are becoming scarce and being outweighed by our unlimited needs and wants.

As we become aware, we need to put what we learn into action, as that is the only way we can allow nature to catch up with the rate at which our requirements grow. This does not mean having to stifle human development. On the contrary, it means sustaining the supply of resources so that we can, in turn, sustain human development.

We need to make sound decisions at present in order to avoid limiting the choices of generations to come. Understanding and valuing sustainability will help us make those sound decisions.

**Handout III.1.C, "The Importance of Sustainability" (continued)**

**Exercise:** In the space below, identify one, major opinion stated in this editorial. Then, list two arguments offered in the editorial to support the opinion you identified.

Opinion stated in the editorial:

Argument #1 supporting the opinion stated in the editorial:

Argument #2 supporting the opinion stated in the editorial:

## UNIT III / LESSON 2

# Different Economic Systems

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**Time Frame**  
2 days

**Standards**  
*NES: **Economics** – Explain the types of economic systems (market, traditional, command, and mixed economies)  
Describe how society uses scarce resources to produce and distribute goods and services*  
*NES: **Skills** – Follow directions  
Apply effective listening skills  
Make oral presentations*

### Guiding Question

How do the different economic systems answer the fundamental economic questions?

### Materials

Handouts III.2.A-C

### Objectives

*Students will be able to:*

- Define and give examples of the different economic systems.
- Identify the fundamental questions confronting all economies.
- Draw conclusions as to why the United States is identified as having a “mixed” economy.
- Draw conclusions and give examples to prove why different economic systems answer the fundamental economic questions differently.

### Teacher Background

Every economic system deals with three fundamental questions: What should be produced, how should it be produced, and who should get what is produced? These questions are answered differently by the three predominant types of economic systems: the traditional economy (in which decisions are made based on tradition), the market economy (in which decisions are made by businesses and consumers acting according to individual needs and wants), and the command economy (in which decisions are based upon government dictates).

In Handout III.2.A, the class will learn about the three fundamental decisions facing societies. Handout III.2.B presents the three different economic systems and asks students to explain how each system answers the three fundamental questions. Finally, the class will examine the characteristics of a mixed economy such as the one that exists in the U.S. today.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.2.A, "The Shipwreck." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - How would you have answered the three questions posed in the exercise on the handout?
  - Why are three questions mentioned in the handout considered the fundamental economic questions that all societies must answer?
  - Which of these three questions is the most important for a society to answer? Which question would cause the greatest dispute?
- Distribute Handout III.2.B, "Economic Systems." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - In your own words, how would you describe how the following economic systems differ: traditional, market, and command economies?
  - What do you see as the greatest strength of each of the economic systems?
  - What do you see as the greatest weakness of each of the economic systems?
  - Which one of the three economic systems has more advantages than the other two?
- Distribute Handout III.2.C, "Mixed Economy." Have students complete the exercise on the handout; then have them explain their answers to the following questions:
  - What are some of the characteristics of a mixed economy that are described on this handout?
  - Which feature of a mixed economy listed in this reading can be found in the U.S. today?
  - What did you identify as the greatest strength of the mixed economy?
  - What did you identify as the greatest weakness of the mixed economy?
  - Would the U.S. be better off as a mixed or purely capitalist economy?

## Summary/Assessment

Ask students to explain their answers to the following question:

If you were the president of a newly independent nation, what is one element of traditional economies, one element of capitalistic economies, and one element of command economies that you would like to bring to your nation?

**Follow-Up**

Organize a debate among advocates of traditional, capitalist, and command economies, focusing on the following resolution: "Resolved: The traditional/capitalist/command economy best meets the needs and wants of people who live under it." Each group of advocates will have three team members. The debate would proceed according to the following agenda:

1. Opening statements – 2 minutes for each team
2. Main arguments: Traditional economy – 3 minutes
3. Rebuttal: Command economy – 1 minute
4. Rebuttal: Capitalist economy – 1 minute
5. Main arguments: Command economy – 3 minutes
6. Rebuttal: Capitalist economy – 1 minute
7. Rebuttal: Traditional economy – 1 minute
8. Main arguments: Capitalist economy – 3 minutes
9. Rebuttal: Traditional economy – 1 minute
10. Rebuttal: Command economy – 1 minute
11. Closing statements – 2 minutes for each team

## Handout III.2.A, "The Shipwreck"

**Directions:** Read the story below and complete the exercise that follows.

One day 20 people, including the paying customers and crew, set sail on a fishing expedition. After a few hours of peaceful sailing, the ship encountered a terrible storm. As a result of the storm, the fishing boat sank. Luckily, all 20 people survived, making their way to a small deserted island. Unfortunately, all the communication equipment went down with the ship so there was no way to signal for help.

Once settled on the island, the captain of the fishing boat called the survivors together and said the following.

Here are the facts about our situation as I see them:

- For better or worse, the 20 of us will be spending days, weeks, or maybe years together.
- We all have different needs and wants.
- In order to survive, we have to depend on each other, even though some of us are smarter, some have more money, and some are more skilled than the others in the group.
- Finally, and most important, there are three fundamental questions we have to answer to determine how we will meet the various needs and wants each of us has. The three questions are:
  1. What goods and services should we produce?
  2. How should they be produced?
  3. Who should receive the goods and services produced?

**Handout III.2.A, "The Shipwreck" (continued)**

**Exercise:** Assume you are one of the 20 people on this island. Write how you would answer each of these questions in the space provided on the chart below. If you cannot answer any of the questions, indicate what additional information you would need to answer that question.

Questions	Answers	Additional Information Needed
1. What goods and services should we produce and how will we decide what goods/services to make: by vote, by who has the most money, or by who is the strongest?		
2. How should these goods and services be produced and who should make these goods, who will gather the resources to make them, and who will be the manager?		
3. Who will receive the goods/services produced: the person who needs it most, the wealthiest person, the strongest person, or whoever gets a majority vote?		

### Handout III.2.B, "Economic Systems"

**Directions:** Economic systems are divided up into three basic types: Traditional, Market, and Command. These different economic systems are described below by people who live under those systems. After reading the descriptions, complete the exercise that follows.

#### Traditional Economic System

"I live in country which has a traditional economy, in which people's economic roles are the same as those of their parents and grandparents. Societies that produce goods and services in traditional ways are found today in some parts of South America, Asia, and Africa. People living in an agricultural village, such as mine, still plant and harvest their own food on their own land. And the ways we produce clothing and shelter are almost exactly the same as those used in the past. Tradition decides what our people do for a living and how our work is performed."

#### Market Economic System

"I live in a country which has a market economy, in which economic decisions are the result of individual decisions by buyers and sellers in the marketplace. Countries like the U.S and other developed nations have many elements of a market economic system. In my country, when I graduate from school, I can go to work where I choose, if a job is open. I am also free to go into business if I want and have the money to do so. If I decide to open a business, I must take a risk with the money that I invest in the business, recognizing I could lose it all. The prices that businesses charge for goods or services in a market system will be influenced by the prices charged by competitors (other businesses selling the same items). The success that businesses have will depend on the demand by consumers for their goods or services. In such a business you may do well. But if people do not want what you are selling, you will go out of business."

#### Command Economic System

"I live in a command economy, similar to the one that existed in Russia before the fall of communism. In a command economic system, the main decision maker is the government. No person may independently decide to open and run any kind of business. The government decides what goods and services are to be produced. And the government sells these goods and services. The government also decides how the talents and skills of its workers are to be used."



**Handout III.2.B, “Economic Systems” (continued)**

**Exercise:** Based on the descriptions you read, write an explanation of how the three fundamental economic questions appearing on Handout III.2.A, are answered in traditional, market, and command economies.

Questions	Traditional Economy	Market Economy	Command Economy
1. What goods/ services should be produced?			
2. How should goods/services be produced?			
3. Who will receive the goods/services produced?			

### Handout III.2.C, "Mixed Economy"

**Directions:** Few economies are purely traditional, command, or market systems. Rather they could be most accurately described as mixed, having elements of capitalism, socialism, command economies, etc. Read about the features of a mixed economy below and complete the exercise that follows.

A mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and socialist economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects.

The basic plan of the mixed economy is that the means of production are mainly under private ownership, that markets remain the dominant form of economic coordination, and that profit-seeking enterprises and the accumulation of capital would remain the fundamental driving force behind economic activity. However, the government would wield considerable indirect influence over the economy through fiscal and monetary policies designed to counteract economic downturns and capitalism's tendency toward financial crises and unemployment, along with playing a role in interventions that promote social welfare. Subsequently, some mixed economies have expanded in scope to include a role for indicative economic planning and/or large public enterprise sectors.

There is not one single definition for a mixed economy, but the definitions always involve a degree of private economic freedom mixed with a degree of government regulation of markets. The relative strength or weakness of each component in the national economy can vary greatly between countries. Economies ranging from the United States to Cuba have been termed mixed economies. The term is also used to describe the economies of countries that are referred to as welfare states, such as Norway and Sweden. Governments in mixed economies often provide environmental protection, maintenance of employment standards, a standardized welfare system, and maintenance of competition.

Supporters view mixed economies as a compromise between state socialism and laissez-faire capitalism, superior in net effect to a pure version either of those two.

**Exercise:** Based on the reading above, indicate the greatest strength and greatest weakness of a mixed economy.

<http://www.answers.com/topic/mixed-economy#ixzz1njINz0pv>

Greatest Strength of a Mixed Economy	Greatest Weakness of a Mixed Economy

## UNIT III / LESSON 3

# The Factors of Economic Production

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**Time Frame**

*2 days*

**Standards**

*NES: Economics – Describe how society uses scarce resources to produce and distribute goods and services*

*NES: Skills – Follow directions*

*Apply effective listening skills*

*Make oral presentations*

*Prepare written reports*

### Guiding Question

How are the factors of economic production brought together to produce goods and services?

### Materials

Handouts III.3.A-D

### Objectives

*Students will be able to:*

- Define and give examples of the different factors of production.
- Draw conclusions as to how the production of goods and services depends on bringing together the various factors of production.
- Determine the role of management in bringing together the factors of production.
- Explain how the issue of sustainability impacts the use of the factors of production.

### Teacher Background

According to some economists there are three factors of production: labor (human resources), land (both natural and cultivated), and capital (the means of production). Some people believe there is a fourth factor of production, entrepreneurship, or management, the factor that brings together the three other factors of production.

Handout III.3.A asks students to select a product or service and identify the factors of production that go into creating it. Handout III.3.B is a cooperative learning activity in which each group explains a different one of the four factors of production. In Handout III.3.C, the class applies what they learned about the factors of production in an exercise asking them to decide how to allocate the factors of production in a hot dog business. Handout III.3.D presents a reading dealing with the relationship between sustainability and the factors of production, including an exercise in which students suggest a title for the reading.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.3.A, "Chart." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - Discuss the product / service you listed on your chart and explain the role that land, labor, and capital played in bringing the product / service you listed to customers.
  - Why do you think that land, labor, and capital are called the factors of production?
  - Some people say entrepreneurship should be considered the fourth factor of production. Do you agree?
- Divide the class into eight groups, with approximately four students in each group. Distribute Handout III.3.B, "Group Work." Assign two groups each to study a different one of the four factors of production appearing on the handout. Explain to the class the directions for the exercise as stated on the handout. After the groups have completed the exercise, call on four groups each to make a presentation about a different one of the four factors of production. After the last group has completed its presentation, as part of the class discussion, have students explain their answers to the following questions:
  - What did you learn from the presentation about land as a factor of production?
  - What did you learn from the presentation about labor as a factor of production?
  - What did you learn from the presentation about capital as a factor of production?
  - What did you learn from the presentation about entrepreneurship as a factor of production?
  - Which of these should be considered the most essential factor of production?
- Distribute Handout III.3.C, "Application." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - How would you describe in your own words the business situation presented in "Another Day in the Hot Dog Business"?
  - Based on the situation presented in "Another Day in the Hot Dog Business," what were the most important decisions you had to make to increase profits?
  - In which factor(s) of production did you decide to invest additional money?
  - In which factor(s) of production did you decide not to increase or to cut investments?

## Summary/Assessment

Ask students to explain their answers to the following question:

How do the four factors of production work together in the creation of goods and services?

**Follow-Up**

Distribute Handout III.3.D, “Sustainability and the Factors of Production.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:

- What is this reading about?
- What do we learn about sustainability and the factors of production from this reading?
- If you were in business, how much importance would you place on sustainability in making your product or delivering your service?

**Handout III.3.A, “Chart”**

**Directions:** Using the chart in the exercise section below, write the name of a product or service you use regularly (bar of soap, candy bar, pen, haircutter, dentist, etc.). Under the words “Land,” “Labor,” and “Capital,” write an explanation of the part played by each of these factors in making the product/service. For example, if the product you chose was a pencil, your chart might look like this:

<b>PRODUCT: PENCIL</b>		
<p><b>Land:</b></p> <ol style="list-style-type: none"> <li>1. Trees are needed to obtain the wood used to manufacture pencils.</li> <li>2. Lead comes from graphite found in rocks.</li> </ol>	<p><b>Labor:</b></p> <ol style="list-style-type: none"> <li>1. Workers must locate and cut down trees to provide the wood for pencil.</li> <li>2. Miners must extract graphite from rocks that is turned into lead for use in pencils.</li> </ol>	<p><b>Capital:</b></p> <ol style="list-style-type: none"> <li>1. Money must be raised by the pencil producing company.</li> <li>2. Equipment must be purchased to manufacture pencils.</li> <li>3. Trucks, trains, and/or boats must be purchased/leased to transport the pencils once they are produced.</li> </ol>

**Exercise:**

<b>NAME A PRODUCT / SERVICE YOU USE REGULARLY:</b>		
<p><b>Land</b> – Not just real estate. Land includes resources such as plants, other living things, and materials taken from mines.</p>	<p><b>Labor</b> – Not just the work performed by humans. Labor includes the planning, research, and creative talents of the people involved.</p>	<p><b>Capital</b> – More than the money invested. Capital includes the machinery, trucks, and other equipment involved in creating product and transporting it.</p>

### Handout III.3.B, "Group Work"

**Directions:** In order to produce any good or service, the following three factors of production must be brought together by management: land, labor and capital. Some people have suggested that entrepreneurship is a fourth factor of production.

The class will be divided into groups. Study the factor of production, below, that has been assigned to your group. Your task will be to make a 1-2 minute presentation to the class in which you: 1) describe, in your own words, the factor of production you read about; 2) give an example of how your factor of production is used to create a good or service; 3) describe the relationship of your factor to the other three factors of production.

#### Land

"Land," as a factor of production, refers to the physical ground and natural resources, such as minerals, used in the production of goods. It also refers to anything that is not man-made and can be used to produce goods. Natural resources, such as minerals and fossil fuels, are the backbone to many giant mining companies. Soil is also a natural factor that supports economic activities such as farming. Land is a scarce resource and requires good management.

#### Labor

"Labor" refers to the work and production activities provided by humans for monetary compensation. This consists of various abilities and skills that human beings apply to enhance production of goods and services and ensures that business is up and running. Companies invest in labor by training employees to operate different machines for the production of goods (e.g., operating a machine to package products). The ability to apply mental talents to innovatively perform errands and discover new products is also counted as labor. Entrepreneurship, however, is not categorized as labor.

#### Capital

"Capital" refers to the use of wealth to create more wealth by enhancing the production of goods. Apart from money, capital also refers to tools, machinery, and infrastructure made to produce other goods. For example, in producing crops or livestock, a farmer will need to include farming equipment and other machinery as capital. Factories, machinery, and office structures used for the production of goods are referred to as fixed capital, while social capital refers to government's investment in learning institutions and infrastructure to facilitate production. Finished and unfinished products produced for consumption or turned into consumer goods in the future are referred to as "working capital."

#### Entrepreneurship

"Entrepreneurship" refers to individuals with an economic motivation who attempt to make money from an idea. Entrepreneurs are innovators ready to take risks to push their ideas to set up businesses. Economists have had debates over entrepreneurship as a factor of production. Some categorize it under labor while other economists view it as an independent factor. It takes an entrepreneur to develop business concepts and take risks to ensure that the idea conceives successful businesses.

### Handout III.3.C, "Application "

**Directions:** Read the paragraph below and complete the exercise that follows.

#### Another Day in the Hot Dog Business

You and your friends have been doing a good business at the hot dog stand you have been operating on weekends in a local parking lot. Sales are brisk! You have decided to invest the profits to expand your business and—you hope—bring in even more profit. You have been selling 200 hot dogs each weekend at \$1.00 each. Supplies cost you \$100, and rent for your space in the parking lot was \$25. You and a friend each spent five hours working at the stand. That means you have \$75 left to divide between your wages, and money to invest in expanding your business. The more wages you pay yourself and your helper, the less you will have to invest.

**Exercise:** Now that you have some understanding about the four factors of production, write up a plan for investing your hot-dog profits. In this plan, try to estimate, as best you can:

1. What additional investments, if any, you should make in land and what should that investment be.
2. What additional investments, if any, you should make in labor and what should that investment be.
3. What additional investments, if any, you should make in capital and what should that investment be.
4. In addition, estimate how many additional hot dogs each option will allow you to sell, and how much profit the investment will bring in.

*Taken from: <http://www.landandfreedom.org/econ/econ2act.htm>*



### Handout III.3.D, "Sustainability and the Factors of Production"

**Directions:** Below is an advertisement from Company X that appeared on the Internet. The ad describes the relationship between sustainability and the factors of production. Suggest an attention-grabbing headline for the advertisement and write it on the line below.

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(headline)

The factors of production are land (i.e., natural resources, including water and the proportion of the planet given over to agriculture-producing raw materials), labor (i.e., the human effort involved in production), capital (i.e., the money invested in business including equipment purchases), and enterprise (i.e., the process of bringing the above factors together to make a profit).

Any production process involves the use of all factors of production. The efficient and sustainable use of factors of production has long been tackled by Company X working with its agricultural suppliers. Company X helps suppliers in developing countries to increase their output. For example, in Pakistan, sales of milk per farmer have doubled in the last three years as a result of the support our company provided to more than 115,000 farmers.

Despite consuming only a tiny proportion of water, Company X still seeks to minimize water use. Seventy percent of water usage is by agriculture, and agricultural raw materials provide the basis of our company's finished products. It is important that the environment in which raw materials are grown is safeguarded and protected in a sustainable manner. Company X does not own farms but encourages sustainable agricultural practices among its suppliers. The company invests over \$60 million per year in environmental protection, amounting to three percent of total capital expenditure on top of regular capital-investment projects that incorporate environmental components and factory environmental operating costs. Also, in certain parts of the world, Company X has invested in water education programs and community initiatives to develop sustainable and safe water supplies.

Finally, our company uses water in manufacturing (e.g., to wash raw materials). It limits the use of water in its various operations and, where this is not possible, re-uses or re-cycles waste water.

*Adapted from: <http://businesscasestudies.co.uk/nestle/sustainability-and-water/factors-of-production.html#ixzz1k28ljzRf>*

## UNIT III / LESSON 4

# Principles of the U.S. Economic System

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**Time Frame**  
*2 days*

**Standards**  
*NES: Economics – Describe how society uses scarce resources to produce and distribute goods and services*  
*NES: Skills – Follow directions*  
*Apply effective listening skills*  
*Make oral presentations*  
*Prepare written reports*

### Guiding Question

What are the basic principles on which the U.S. economy operates?

### Materials

Handouts III.4.A-D

### Objectives

*Students will be able to:*

- Identify and give examples of the principles of the U.S. economic system.
- Draw conclusions as to how the economic principles of the U.S. shape economic decisions.
- Explain how and why economic principles can come into conflict with each other.

### Teacher Background

Free enterprise is an economic system that provides individuals with the opportunity to make their own economic decisions, free of government constraints, and as private profit-potential businesses. The system allows for the privilege of individual ownership of property and the means of production. The key ingredient of the free enterprise system is the right of consumers to make their own choices in the purchase of goods, the selling of their products and their labor, and their participation in business structure. Five basic principles are at the core of the free enterprise system: private enterprise, private property rights, consumer sovereignty, the profit motive, and competition.

In Handout III.4.A, students are asked to interpret an illustration portraying the five basic principles of the American free enterprise system. Handout III.4.B presents an in-depth explanation of the five basic principles, asking students to give examples of situations where the principles can conflict with each other. The building blocks of the free enterprise appear in Handout III.4.C. Finally, the class will confront and evaluate criticisms of the free enterprise system in Handout III.4.D.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.4.A, "Drawing." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What do you see in this drawing?
  - What is this drawing telling us about the U.S. free enterprise system?
  - To what extent does this drawing present an accurate picture of the free enterprise system?
  - Can you suggest something about the U.S. free enterprise system that should be included in this drawing but is not?
- Distribute Handout III.4.B, "Principles." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - How would you summarize, in your own words, each of the five principles of the U.S. free enterprise system?
  - Why do you think the U.S. economy is called a "free enterprise system"? Is this an accurate description of our economy?
  - Which of these five is the most important principle?
  - What examples did you create in which two of the basic principles are in conflict? In these cases, which principle do you think should prevail?
- Distribute Handout III.4.C, "Building Blocks." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - Why are the four items mentioned on this handout referred to as the "building blocks of the free enterprise system"?
  - Where did you place the building blocks in the illustration featured in the exercise at the bottom of the handout?
  - In the building block dealing with businesses, what does the author mean by "Profit fuels the engine of business"?
  - In building block dealing with government, what does the author mean by saying "Government provides the umbrella under which the free enterprise system operates"?
  - Which of these building blocks is most crucial to the operation of the free market enterprise system?

- Distribute Handout III.4.D, "Critics." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What is the Occupy Wall Street movement all about?
  - What are some of the more important demands made by the protesters?
  - Which of these demands is most justified?
  - Which of these demands is least justified?

### Summary/Assessment

Ask students to explain their answers to the following question:

To what extent have the five principles appearing in the drawing discussed at the beginning of the lesson made the U.S. a more/less desirable place for the average American to live, work, and or do business??

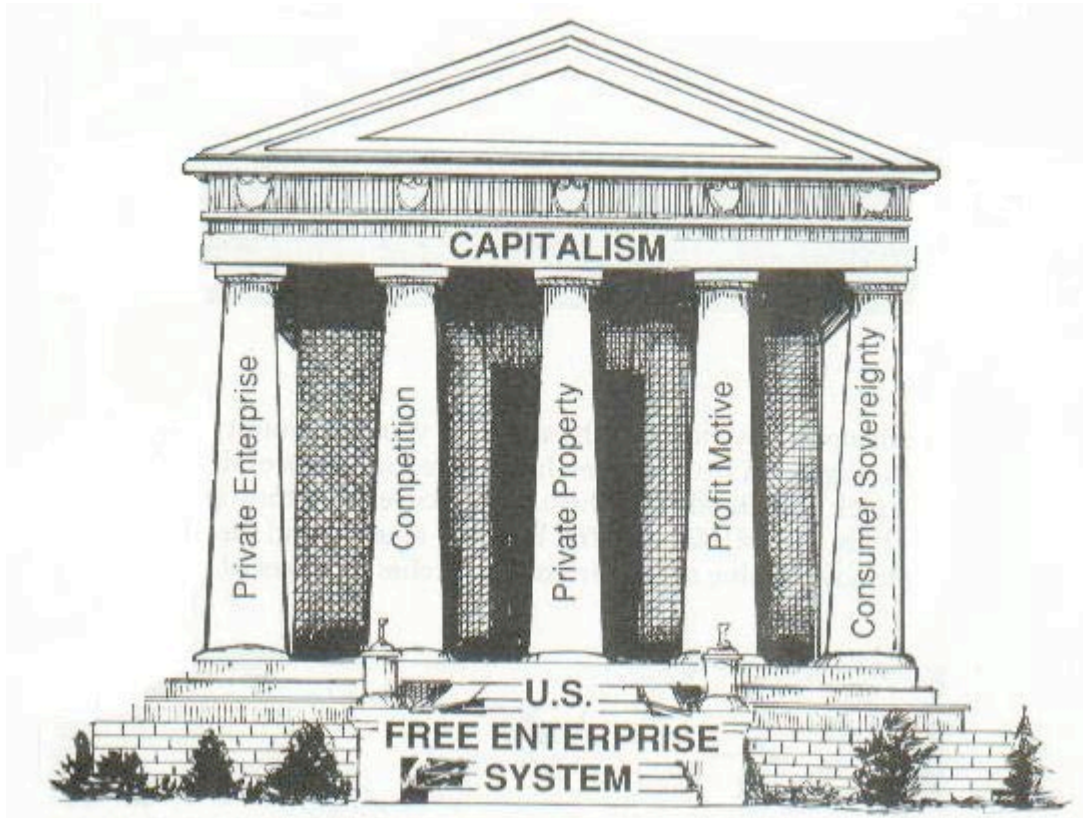
### Follow-Up

Assume you were addressing a group of Occupy Wall Street protesters. Write a speech in which you discuss their criticisms of the U.S. free enterprise system The speech should specifically tell them:

- Which of their ideas you agree with most.
- Which of their ideas you disagree with most.
- What the best course of actions would be for the protesters to take that would lead to a higher standard of living for the people who are suffering most in the free enterprise system.

### Handout III.4.A, “Drawing”

**Directions:** Study the drawing below of the five basic economic principles on which the U.S. operates and complete the exercise that follows.



[http://www.socialstudieshelp.com/Eco\\_Free\\_Enterprise.htm](http://www.socialstudieshelp.com/Eco_Free_Enterprise.htm)

**Exercise:** In two or three sentences, explain the message that the drawing is looking to convey.

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### Handout III.4.B, "Principles"

**Directions:** The five basic principles of the U.S. economic system appear below. For each principle, underline one sentence that contains the most important idea related to that principle. Then complete the exercise below.

**1. Freedom to Choose Your Businesses (Free Enterprise)**

In this country, the decision about what kind of business to go into is basically yours alone to make. You will decide what fees to charge and what hours to work. Certain laws prohibit you from cheating or harming your customers or other people. But, in general, you will be left alone to run your business as you see fit.

**2. Right to Private Property**

Private property is a piece of land, a home, or a car owned by an individual, a family, or a group. It differs from a public building, or public property, such as the city hall, a park, or a highway, all of which provide a government service for all citizens. In the U.S. economic system, people's right to buy and sell private property is guaranteed by law. People must use the property in safe and reasonable ways, of course, and respecting the personal rights or property of other people.

**3. Profit Motive**

The main reason why a person organizes a business is to make money. You do this by earning more money than you spend. The amount of money left over after subtracting your business expenses from your business income is known as your profit. In the free enterprise system, business firms try hard to keep costs down and increase their income from sales. The better they succeed at this, the higher are their profits. Economists describe the efforts by business firms to earn the greatest profits as the profit motive.

**4. Competition**

Just as you are free to start the business of your choice, so is everyone else. The rivalry between sellers in the same field for consumers' dollars is called competition. If your business is profitable, it is likely that others will enter the same business hoping to be as successful as you are. They will be competing with you for the same customers. To win a share of the computer business, other sellers may try to offer more and better services, or services at lower prices. Because of the pressure of competition, business firms must constantly try to provide the best services and create the best products at the lowest possible prices.

**5. Consumer Sovereignty**

In the end, it is the customers, or consumers, who determine whether any business succeeds or fails. In the U.S. free enterprise economy, consumers are said to have sovereignty-the power or freedom to have final say. Consumers are free to spend their money for Product X or for Product Y. If they prefer Y over X, then the company making X may lose money, go out of business, or decide to manufacture something else (perhaps Product Z). Thus, how consumers choose to spend their dollars causes business firms of all kinds to produce certain goods and services and not others.

**Handout III.4.B, "Principles" (continued)**

**Exercise:** Describe a situation in which two of the basic economic principles come into conflict with each other. (For example, when a consumer's right to choose a product at the right price—consumer sovereignty—is denied due to a businessperson's desire to make a greater profit—profit motive.)

### Handout III.4.C, "Building Blocks"

**Directions:** Read about the building blocks of free enterprise system below and complete the exercise that follows.

Households, businesses, markets, and governments make up the building blocks of a free enterprise system. They are described below.

**Households—the Owners.** In a free enterprise system, households—not the government—own most of the country's economic resources and decide how to use them. One of the resources that households possess is their labor, which they sell to existing firms or use to form new businesses. In addition to selling their resources where they can get the highest price or largest profit, households also act as consumers. The wages and salaries of households purchase about two-thirds of all the production in the United States. Consumers vote with their dollars, thereby directing production toward the goods and services they want businesses to provide. This is called consumer sovereignty.

**Businesses—the Organizers.** Businesses organize economic resources to produce a good or service. The people who start businesses are the organizers and innovators, constantly discovering new and better ways to bring resources together in the hopes of making a profit. Profit fuels the engine of business. Entrepreneurs, lured by the potential for profits, create new businesses to satisfy consumers' needs and desires. The inability to make profits signals businesses to close or to reorganize their resources more efficiently. Efficiency means that resources are being used to produce the goods and services that society most desires at the lowest economic cost. In a competitive industry, the presence or absence of profits sends an important signal about the industry's economic efficiency.

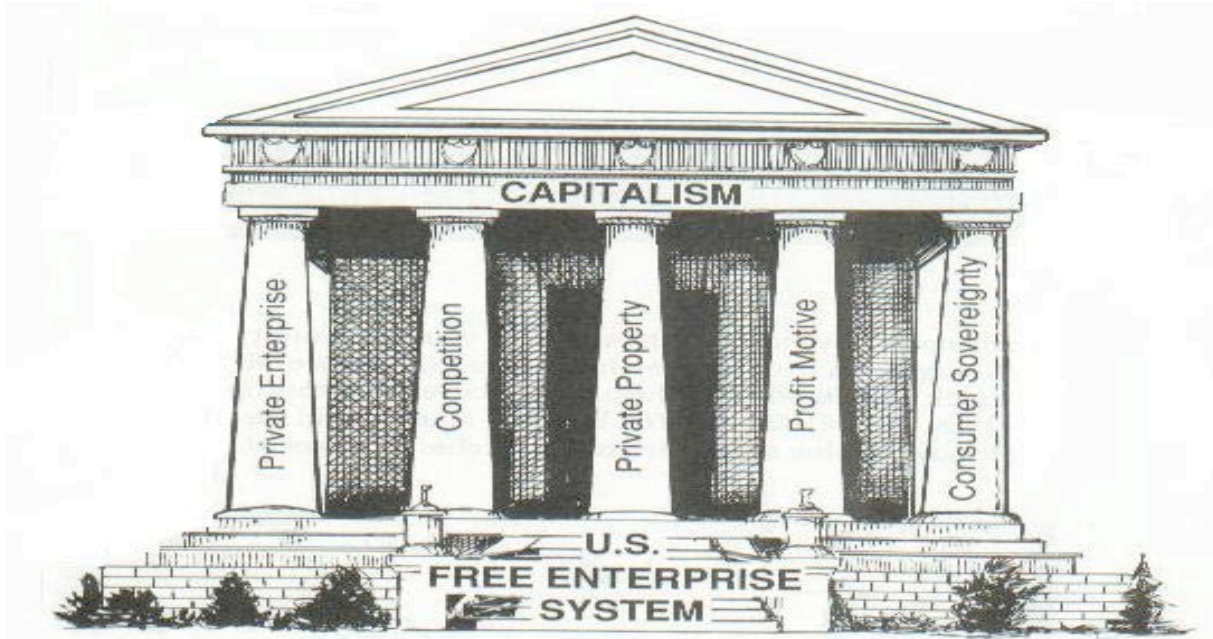
**Markets—the Brokers.** How and where do buying and selling activities take place? The answer is in markets. Although markets are not necessarily people, they act as agents—something like a stockbroker or a real estate agent—to bring buyers and sellers together. Over time, markets have become increasingly complex. Now, buying and selling can occur 24 hours a day from anywhere in the world via the Internet. A market is any place or any way that buyers and sellers can exchange goods, services, resources or money. There are three categories of markets in a free enterprise society: resource markets, product markets, and financial markets. Households go through resource markets to sell their labor to businesses. Businesses go through product markets to sell goods and services to households. And both households and businesses use financial markets to borrow and save money. Typically, businesses borrow money that households save, using financial institutions as the intermediary.

**Governments—the Protectors.** The cornerstone of a truly free enterprise economy is the absence of government interference in economic matters. However, the government still plays an important role in any free enterprise system. This is because unlimited freedom is impossible: one person's freedom may sometimes conflict with another's. The main role of government in a free society, then, is to define and enforce the rules of society. Government has the coercive power to maintain law and order, protect people's right to own property and enforce voluntary contracts people enter into. In essence, government provides the umbrella under which the free enterprise system operates. Governments also provide goods, such as national defense, that the private market alone would have a hard time producing.



Handout III.4.C, "Building Blocks" (continued)

Exercise: Draw in the four building blocks described above where they best fit in the illustration below.



### Handout III.4.D, "Critics"

**Directions:** In September 2011, a group of protesters called Occupy Wall Street, began a protest involving a number of criticisms that the group has of current government policies, laws, and practices as well as what it sees as a lack of responsibility at major financial institutions. Identify three of these criticisms mentioned in the reading below and underline them.

## What "Occupy Wall Street" Demands of Our Leaders

Occupy Wall Street began in mid-September with a group of 1,000 protestors marching through the streets of New York City. It has now grown into a global movement in search of sanity in our economic system. Many in the group, unemployed and disheartened, are quietly demanding a new breed of leaders in Washington and on Wall Street—leaders measurably committed to the average individual struggling to make ends meet. The overarching demand of Occupy Wall Street is for greater equality in our free enterprise system.

And that is where both Wall Street and Washington have failed miserably in the eyes of the unemployed or underemployed protestors. In the various divisions of the movement sprouting up around the world, the cry is for hope, for economic opportunity, for soul in our business, and for promise that the American dream will not be denied to today's young people.

Occupy Wall Street is looking to our leaders in Washington to enact legislation that focuses more on the needs of the struggling middle class. To the participants in Occupy Wall Street, business and political leaders have lost their footing. They have detoured the country away from the basic tenets of our government: life, liberty, equality, and the pursuit of happiness.

While Occupy Wall Street is a fledgling movement, it should remind all of us that we have a say in what happens in our economy. More than that, we have a responsibility to hold our leaders accountable.

While Occupy Wall Street is not advocating one set of unified demands types of demands. Here are some of the demands most often issued by the protesters:

- An end to taxpayer bailouts of big corporations, banks, and other finance companies.
- An end to corporate governance structures that allow the positions of CEO and president of the board to be held by the same individual.
- A reduction in CEO pay. (Back in 1965, CEO pay was 24 times greater than the average employee's pay; today it is 300 times greater.)
- Stiff penalties for offshore jobs creation while unemployment festers in the United States.
- Raising the minimum wage.
- A moratorium on all home foreclosures and layoffs immediately.
- A negative income tax, and a tax of up to 90 percent on the income of the very rich.

Protestors may not yet have a unifying goal, but they are not confused about the fact that living conditions for the average American are rapidly deteriorating. And, what's more, no one appears to be listening.

## UNIT III / LESSON 5

# Supply and Demand

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**Time Frame**  
*2 days*

**Standards**  
*NES: Economics – Explain the principles of supply and demand  
Explain how supply and demand interact to determine prices*  
*NES: Skills – Follow directions  
Apply effective listening skills  
Make oral presentations  
Prepare written reports*

### Guiding Question

How does supply and demand explain the prices we pay for goods and services?

### Materials

Handouts III.5.A-E

### Objectives

*Students will be able to:*

- Define supply, demand, elasticity.
- Explain and give examples of the laws of supply and demand.
- Draw conclusions as to why there are shortages of some goods and services and surpluses of others.
- Illustrate the principles of elasticity of supply and demand.

### Teacher Background

The two most crucial factors in determining prices of goods and services are supply and demand. We learn from the law of demand that: 1) people will buy more of a product at a lower price than at a higher price; and 2) at a lower price, more people can afford to buy more goods than they can at a higher price. From the law of supply we learn that 1) at higher prices, producers are willing to offer more products for sale than at lower prices; and 2) the supply of goods and services increases as prices increase and decreases as prices decrease.

Handout III.5.A is writing exercise in which students explain the role that supply and demand play in setting prices. In Handout III.5.B, the class learns the definitions and the laws of supply and demand. Handouts III.5.C and III.5.D explain in greater depth the Law of Supply and the Law of Demand, providing some examples of each. Finally, students will encounter an explanation of the elasticity of demand and supply in Handout III.5.E.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.5.A, "Q&A." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - How would you summarize in your own words the information presented in the "Question" here?
  - (Call on at least five volunteers here.) What is the answer you wrote to this 8<sup>th</sup> grader?
- Distribute Handout III.5.B, "Definitions." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - How did you answer the exercise on the handout?
  - In your own words, how would you explain the concept of "demand" to someone who had never heard the term "demand" before?
  - In your own words, how would you explain the concept of "supply" to someone who had never heard the term "demand" before?
  - How does the law of supply and demand explain why the diamond written about in the Q&A letter cost so much more than the t-shirt?
- Distribute Handout III.5.C, "Law of Demand." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - If you were Mary, what is one conclusion you would draw about the amount of donuts you could sell at the different prices?
  - Based on the graph, what conclusion would you draw about the relationship between the price of an item and the demand for that item?
  - Why is it important for a businessperson to know about the law of demand?
  - What other factors beside demand play a role in determining the price of an item?
  - How does the law of demand help explain why there are shortages of some goods and surpluses of others?
- Distribute Handout III.5.D, "Law of Supply." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn about supply from this handout?
  - According to the data on the chart and graph, how would you explain the law of supply to someone who knew nothing about it?
  - As a businessperson, how would you use the law of supply to your advantage?
  - How does the law of supply help explain why there are shortages of some goods and surpluses of others?

### **Summary/Assessment**

Ask students to explain their answers to the following question:

How do supply and demand play a role in determining the prices we pay for goods and services?

### **Follow-Up**

Distribute Handout III.5.E, "Elasticity of Demand and Supply." Have students complete the exercise on the handout, then have them explain their answers to the following questions:

- How did you complete the exercise on elasticity of demand? Elasticity of supply?
- What do we learn about elasticity of demand and supply from this handout?
- To what extent is it important for an entrepreneur to know something about the elasticity of supply and demand in running a business?

**Handout III.5.A, “Q&A”**

**Directions:** Assume you write a column in which you answer questions from children about economics. Answer the question below, writing a one-paragraph answer.

*Question:* I am in the 8<sup>th</sup> grade. Recently, I went shopping with my parents to a department store. They bought me a t-shirt for school that cost \$30. In the store we passed through the jewelry department. There, I noticed a diamond in one of the display cases. The diamond had a price tag of \$6,000. I asked my parents why the diamond cost so much more than my t-shirt. They said that most prices are explained by supply and demand. Can you tell me how “supply and demand” explains why the diamond costs so much more than my t-shirt? Thanks.

*Answer:* You parents are correct. The prices of the diamond and t-shirt have a lot to do with supply and demand. Here is the explanation.

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### Handout III.5.B, "Definitions"

**Directions:** To understand how prices are set in an economy like the U.S., it is important to know about concepts like supply, demand, and the law of supply and demand. The definitions of these concepts appear in Column B below. However, the terms that go with the definitions have been omitted. Enter the correct term (supply, demand, and law of supply and demand) in Column A that matches the definition that appears in Column B.

Column A – Term	Column B – Definition
	As the price of a good or service <b>increases</b> , the demand <b>decreases</b> and vice-versa. As the price of a good or service <b>increases</b> , the supply of goods or services offered by producers <b>increases</b> and vice-versa.
	The willingness and ability of the people to purchase particular amounts of goods or services at a variety of alternative prices.
	The total amount of a good or service available for purchase.

Adapted from: [http://www.thirteen.org/edonline/lessons/supply\\_and\\_demand/b.html](http://www.thirteen.org/edonline/lessons/supply_and_demand/b.html)

**Handout III.5.C, "Law of Demand"**

**Directions:** Read Parts One and Two below and complete the exercises that follow each part.

**Part One**

Mary recently opened a donut shop in the school cafeteria. To help her determine what price to charge for a donut, she tried the following experiment: During first week after opening, she charged \$.20 per donut, and during the second week she charged \$.10 per donut. The chart below shows the results of Mary's experiment.

**DONUT PRICE EXPERIMENT**

	Price per donut	Number of donuts sold	Total Revenue
<b>Week 1</b>	20¢	50	\$10
<b>Week 2</b>	10¢	500	\$50

**Exercise 1**

What is one conclusion you would draw about the price per donut and the amount sold from looking at the chart above?

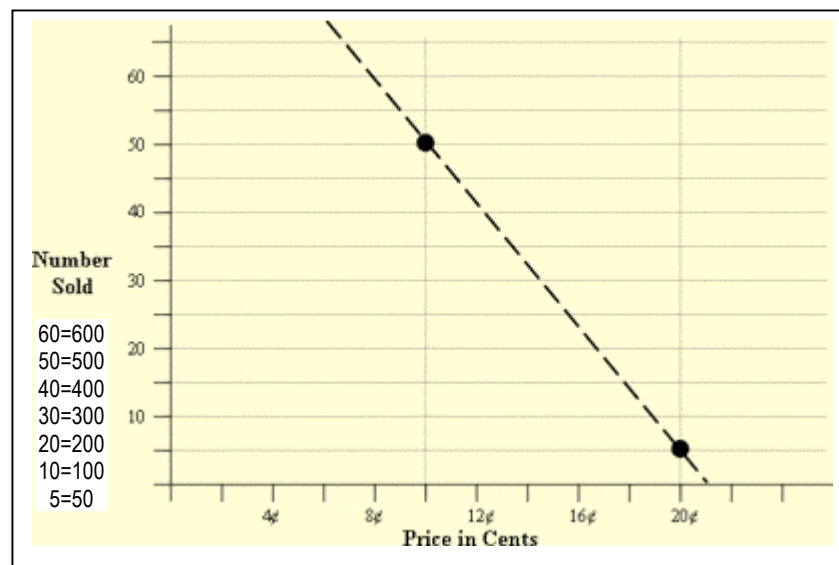
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**Handout III.5.C, "Law of Demand" (continued)****Part Two**

Mary mentioned the results of her experiment to Mr. Jones, her Business Education teacher. Mr. Jones said that the finding from her experiment demonstrates one of the most important concepts in economics: the Law of Demand. He suggested that she plot the results of her experiment on a graph. Mr. Jones said such a graph measuring the amount of donuts sold at the two different prices is called a Demand Curve. Here's what the graph looked like.

**Demand Curve Graph**

Adapted from: [http://www.thirteen.org/edonline/lessons/supply\\_and\\_demand/b.html](http://www.thirteen.org/edonline/lessons/supply_and_demand/b.html)

**Exercise 2**

Based on the graph, fill in the blanks below to describe the relationship between the price for an item and the demand for that item.

All else equal, as the price of a product \_\_\_\_\_, the quantity demanded will \_\_\_\_\_.

**Handout III.5.D, “Law of Supply”**

**Directions:** Read the passage below and complete the exercise that follows.

Fred owned a wholesale bakery in which he sold various baked goods to stores in the community. One of the goods Fred sold was cookies. During the first month in business, he found that the stores would pay him \$.10 a cookie. As a result, he sold 100 cookies, from which he made a decent profit. His cookies were an instant hit. Each month, the stores to which he sold cookies offered to pay him pay more than the month before for each cookie: \$.40 a cookie after six months and \$.70 a cookie after one year. As a result, he also increased the number of cookies he made, realizing he could sell them at the higher price point. The chart and graph below indicate how many cookies Fred made and sold at prices ranging from \$.10 per cookie to \$.70 per cookie

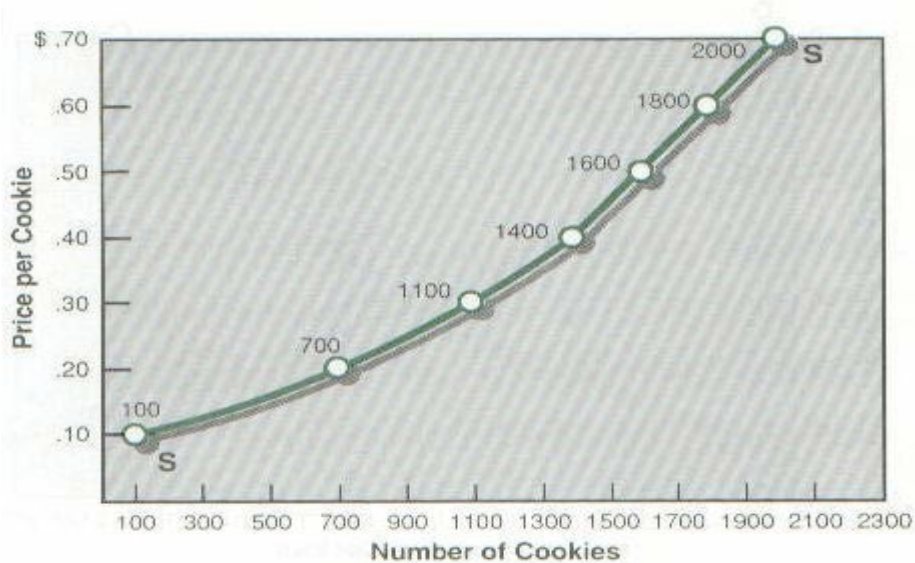
**A. Chart**

**Supply Schedule for Fred’s Cookies**

	The price Fred charges per cookie	The number of cookies Fred has available for sale
After 1 year	.70 cents	2,000 cookies
	.60	1,800
	.50	1,000
After 6 months	.40	1,000
	.30	1,100
	.20	700
After 1 month	.10	100

**B. Graph**

**Supply Curve**



**Handout III.5.D, "Law of Supply" (continued)**

**Exercise:** Fill in the blank spaces below with the correct word.

The chart and graph above reveal an economic concept known as the "law of supply," which states:

"As the price of a good increases, the \_\_\_\_\_ also increases."

Another way to say this is: "As the price of a good decreases, the \_\_\_\_\_ also decreases."

### Handout III.5.E, "Elasticity of Demand and Supply"

**Directions:** The degree to which the demand or supply of a good or a service varies with its price is referred to as elasticity. Part One below discusses elasticity of demand and Part Two discusses supply. In both Parts One and Two below, circle the underlined words, after 1 and 2, that you think best belongs in the definition.

#### Part One

##### Elasticity of Demand

Elasticity of demand refers to the degree to which demand for a good or service varies with its price. Normally, sales increase with a drop in prices and decrease with a rise in prices. As a general rule, appliances, cars, candy, haircuts, and other non-essential goods and services show: 1. more / less elasticity of demand than other types of goods or services. On the other hand, most necessities (food, medicine, basic clothing) show: 2. more / less elasticity of demand.

*http://www.businessdictionary.com/definition/elasticity-of-demand.html#ixzz1kh62Weza*

Give one example of a good or service that you purchase or use that has:

1. Great elasticity of demand \_\_\_\_\_
2. Little elasticity of demand \_\_\_\_\_

#### Part Two

##### Elasticity of Supply

Elasticity of supply refers to the responsiveness of producers to changes in the price of their goods or services. As a general rule, if prices rise, so does the supply. High elasticity indicates the supply is sensitive to changes in prices, low elasticity indicates little sensitivity to price changes, and no elasticity means no relationship with price. The supply of paintings by a world famous artist who died hundreds of years ago would be considered: 1. elastic / inelastic, whereas the supply of cookies offered at various prices would be considered 2. elastic / inelastic.

*Read more: http://www.businessdictionary.com/definition/elasticity-of-supply.html#ixzz1khDRabSS*

Give an example of another kind of good or service that has:

1. Elasticity of supply \_\_\_\_\_
2. Inelasticity of supply \_\_\_\_\_

## UNIT III / LESSON 6

### Market Structure and Prices

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**Time Frame**  
2 days

**Standards**  
*NES: Economics – Describe the concept of price and how prices send signals and provide incentives to buyers and sellers  
Describe the types of market structures (perfect competition, pure monopoly, monopolistic competition, oligopoly)*  
*NES: Skills – Follow directions  
Apply effective listening skills  
Make oral presentations  
Prepare written reports*

#### Guiding Question

How does the degree of competition impact the way prices are determined?

#### Materials

Handouts III.6.A-E

#### Objectives

*Students will be able to:*

- Explain some of the advantages and disadvantages of competition in business for consumers and businesses.
- Define and give examples of the various degrees of competition that can exist in different market structures.
- Draw conclusions as to how prices are determined in a pure market economy.

#### Teacher Background

While all markets are made up of buyers and sellers, significant differences exist between market structures. These differences include the numbers of buyers and sellers and the degree to which the specific market can control prices. This lesson focuses on market structures, ranging from pure competition (with lots of buyers and sellers) to a monopoly (with one provider of a specific good or service). Other market structures that will be discussed in this lesson are monopolistic competition and oligopolies.

This lesson begins with a discussion of the advantages and disadvantages of economic competition. Handout III.6.A asks students to compare and contrast the following market structures: perfect competition, monopolistic competition, oligopolies, and monopolies. In Handout III.6.B, the class writes an editorial, giving their opinion on economic competition, the subject of handout. In the next activity, using Handouts III.6.C, III.6.D, and III.6.E, the students are divided into three sections. Students in each section will read about the advantages and disadvantages of one of the following: monopolistic competition, monopolies, or oligopolies.

## Teaching Strategies/Supporting Activities

- Write the word “competition” on the board. Have students explain their answers to the following questions:
  - What does the word “competition” mean to you?
  - What are some examples of competition you see among sellers of different goods and services you purchase?
  - To what extent is competition among sellers of goods and services a good thing?
  - To what extent is competition among sellers of goods and services a bad thing?
- Distribute Handout III.6.A, “Competition.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What is this handout about?
  - Based on what you read, what is the greatest advantage of competition?
  - What was the greatest disadvantage of competition mentioned in the handout?
  - What did you write in your editorials about competition?
- Distribute Handout III.6.B, “Different Market Structures.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn about the different market structures from this handout?
  - In what ways are perfectly competitive markets, monopolistically competitive markets, oligopolies, and monopolies different from each other?
  - How are the ways prices determined different in each type of market structure?
  - What are the greatest strengths and weaknesses of each market structure for consumers? For businesses?
- Divide the class into three sections. Distribute: Handout III.6.C, “Advantages and Disadvantages of Monopolies” to Section One; Handout III.6.D, “Advantages and Disadvantages of Monopolistic Competition,” to Section Two; and Handout III.6.E, “Oligopolies” to Section Three. Ask each group to complete the exercise described on the handout they received. Then, as part of the whole discussion, have students explain their answers to the following questions:
  - What are greatest advantages and disadvantages of monopolies to businesses and consumers?
  - What are the greatest advantages and disadvantages of monopolistic competition to businesses and consumers?
  - What are the greatest advantages and disadvantages of oligopolies to businesses and consumers?

## Summary/Assessment

Ask students to explain their answers to the following questions:

- As consumers are we better off living under a more or less competitive market structure, or does it depend more on the product we are buying?
- Are small businesses better off operating under a more or less competitive market structure or does it depend more on the product they are selling?

## Follow-Up

Ask students to select one of the four market structures (perfect competition, monopoly, monopolistic competitive, oligopoly) they learned about in this lesson and prepare a five-minute presentation to explain that market structure to the class. The presentation should be accompanied by at least three PowerPoint slides and include a description of the market structure, some existing examples of that market structure, and the positive and negative attributes of that market structure for consumers and businesses.

## Handout III.6.A, "Competition"

**Directions:** In most economic markets, competition determines how industries operate. While there are obvious advantages that competition brings to consumers and producers, significant disadvantages also result. The advantages and disadvantages of competition are addressed below. After reading the handout complete the exercise that follows.

### Advantages of Competition

Competition among companies is what gives consumers choice, allowing them to select products that fit their budgets and needs. In addition, economic competition forces companies and countries to increase their efficiency and continually seek ways to improve their production process for maximum efficacy. New business problems and consumer problems are created every day, providing opportunities for companies to create innovative products that solve these problems. Healthy economic competition, when free of monopolies, can also attract investments from other countries, thereby increasing a nation's gross domestic product. A final key advantage of economic competition is that it allows anyone with a specialized skill set to create something better than what the market currently offers and clean up. Many of the large brands with which we are familiar today were started by a small team dedicated to solving a customer problem.

### Disadvantages of Competition

Unfortunately, economic competition comes with significant disadvantages. Foremost, investment wealth can be disproportionately allocated into what earns the highest profit, leaving less money for social services, such as police departments, public schools and emergency aid. Countries that outsource their production to companies overseas may partner with suppliers who provide poor working conditions and low wages, exploiting workers and offering inadequate incentives. Some politically minded economists would also argue that a key disadvantage of economic competition is that it reduces the amount of human labor required to produce goods, as machinery replaces assembly jobs once filled by human workers.

[http://www.ehow.com/print/info\\_8455003\\_advantages-disadvantages-economic-competition.html](http://www.ehow.com/print/info_8455003_advantages-disadvantages-economic-competition.html)

**Exercise:** In your notebook, write a two-paragraph editorial under the title "Economic Competition: A Good/Bad Thing." In the editorial, give your opinion about competition, making sure to address some of the arguments advocating the opposing points view that appear above.



## Handout III.6.B, "Different Market Structures"

**Directions:** The degree of competition differentiates the four types of market structures. After reading the descriptions of each, complete the exercise that follows.

### PERFECT COMPETITION

Perfect competition is a model that does not actually exist in the real world. Economists developed it to explain how markets are supposed to work in a capitalist economy. The model helps us understand the free market as well as other market structures that do exist. Perfect competition describes a market in which: 1) the product sold by any one seller is identical to the product sold by any other seller; 2) there are many buyers and sellers, so that no one buyer or seller can affect the market price—instead, all buyers and sellers must accept the market price; and 3) resources move to the most profitable industry. With perfect competition, consumers receive fair treatment because the price they pay for any good or service is equal to the cost paid to produce the good or deliver the service.

### MONOPOLISTIC COMPETITION

The market structure that comes closest to perfect competition is monopolistic competition. It is a market characterized by many sellers. Unlike perfect competition, the sellers under monopolistic competition differentiate competitive products. Product differentiation is accomplished by changing the physical composition, using special packaging, or simply claiming to have a superior products based on brand images and/or advertising. In addition to the existence of a large number of firms and product differentiation, relative ease of entry into the industry is considered another important requirement of a monopolistically competitive market. With the large number of firms that monopolistic competition requires, collusion (e.g., price fixing) is generally difficult. As with perfect competition, a firm produces the quantity of product that maximizes its profit. But unlike perfect competition, a firm under monopolistic competition has some control over the price it charges, as the firm differentiates its products from those of others. However, the price-making power of a monopolistically competitive firm is rather small, since there are a large number of other firms in the industry with somewhat similar products. An important consequence of the price-making power of a monopolistically competitive firm is that when such a firm reduces its price, it can attract customers buying other "brands" of the product. The opposite is also true when the firm increases the price it charges for its product. Apparel retail stores (with many stores and differentiated products) provide examples of monopolistic competition.

### OLIGOPOLY

An oligopoly is a market controlled by a small number of sellers. An important characteristic of an oligopolistic market structure is the interdependence of firms in the industry. The interdependence, actual or perceived, arises from the small number of firms in the industry. However, unlike monopolistic competition, if an oligopolistic firm changes its price or output, it has a significant effect on the sales and profits of its competitors. Thus, an oligopolistic firm always considers the reactions of its rivals in setting its prices or making output decisions. There are huge, though not insurmountable, barriers to entering an oligopolistic market. These barriers can involve large financial requirements, availability of raw materials, access to the relevant technology, or simply patent rights of the firms currently in the industry. It is hard to make concrete statements regarding price charged and quantity produced under oligopoly. However, from the point of view of the society, one can say that an oligopolistic market structure provides a fair degree of competition in the market place if the oligopolies in the market do not collude. Collusion occurs if firms in the industry agree to set price and/or quantity. In the U. S., both the steel and auto industries are examples of oligopolies.

*continued*

**Handout III.6.B, "Different Market Structures" (continued)****MONOPOLY**

Monopoly is the opposite of perfect competition. It is a market form in which there is only one seller. There are many factors that give rise to a monopoly. For example, a monopoly can exist in an industry because an inventor obtained a patent for his product, or a company owns the entire supply of a necessary material needed to produce a product, or it can be legally created by a government agency when it sells a market franchise a particular product or service. Finally, a monopoly may arise due to declining costs of production for a particular product. In such a case the average cost of production falls and reaches a minimum at an output level that is sufficient to satisfy the entire market. In such an industry, rival firms will be eliminated until only the strongest firm is left in the market. Generally speaking, price and output decisions of a monopolist are similar to those of a monopolistically competitive firm, with the major distinction of a large number of firms under monopolistic competition and only one firm under monopoly. Thus, one may technically say that there is no competition under monopoly. Like monopolistic competition, a monopolistic firm also maximizes its profits by producing up to the point where marginal revenue equals marginal cost. As the monopolist is a price maker and can increase the amount of sales by lowering the price, a monopolist does not lure consumers away from rivals, rather he or she induces them to buy more. An example of a monopoly is the local electric company in your community.

*Adapted from: <http://www.referenceforbusiness.com/encyclopedia/Clo-Con/Competition.html>*

*continued*

**Handout III.6.B, "Different Market Structures" (continued)**

**Exercise:** Complete the chart below by describing how characteristics (a), (b), (c), and (d) are different for market structures 2-4. (The section on perfect competition has been filled in to give you an example of what to write in each column.)

Market Structure	Characteristics of the Market Structure			
	(a) number of firms in the market	(b) control over the price of the relevant product	(c) type of the product sold in the market	(d) factors stopping new firms from entering the market
<b>1. Perfect competition</b>	Many firms participate in the market	No one buyer or seller can control prices because so many buyers and sellers exist.	The type of product sold by every seller is identical to the product sold by other sellers.	Other than costs involved, there are no factors stopping new firms from entering the market
<b>2. Monopolistic competition</b>				
<b>3. Oligopoly</b>				
<b>4. Monopoly</b>				

## Handout III.6.C, "Advantages & Disadvantages of Monopolies"

**Directions:** Circle the most significant advantage and disadvantage of the monopoly market structure.

A monopoly is a market structure having only one producer or seller of a product or service. Some of the negative aspects of a monopoly include the single business being able to control pricing and charge relatively high prices, exceptional power over the market, and a lack of new products being introduced into the market.

### Advantages

#### 1. Research and Development

In a monopoly market, products or services that require large scale capital benefit when only one firm produces these goods or services. A monopolist will have more resources to invest in research and development of the product. Monopolies in their own way encourage economies of scale, meaning increased output and decreased unit cost for those goods produced by a monopoly. Monopoly of a particular product or service encourages research and development for the production of better products because the resources are available.

#### 2. Domestic Monopoly but International Competition

When a company wields considerable domestic monopoly power, it is in a very strong position to charge prices as it sees fit to increase profits of the firm. However, when the same company faces intensive international competition, market power is reduced; this competition helps to keep the prices down for customers. For example, U.S. Steel Corporation controls over half the steel production in the country, but faces intensive competition in international markets from the U.K., Japan, China, and India.

### Disadvantages

#### 3. Poor Quality of Products

Monopoly markets may produce a poor quality of product because of lower levels of output than would normally exist if there were competitive companies producing the same products. The company with the monopoly is free to buy cheap materials to reduce the cost of producing the products. Because of the lack of substitute products, consumers are forced to buy the products offered by the monopoly company, giving it the freedom to sell sub-standard products.

#### 4. Unfair Treatment Towards Employees

In a monopoly, employees often suffer unfair treatment at the hands of the company management. Because the company has a monopoly in a certain industry area, employees may be forced to accept low wages, lack of proper benefits, and zero motivation in their jobs. The management can dictate the terms of the salary package, leaving little room for negotiation for the employees. This is done because the company knows that the employees have no choice but to accept its terms.

## Handout III.6.D, "Advantages & Disadvantages of Monopolistic Competition"

Circle the most significant advantage and disadvantage of the monopolistic competition market structure.

### Advantages

#### 1. Competition

Monopolistic competition is characterized by few barriers to market entry; it is easy for new firms to enter and leave such markets without facing the many barriers in pure monopoly markets; this allows creativity and an active business environment with ample competitors. The less restrictive market structure ensures that no one firm plays as a monopoly and consumers get a variety of products or services from which to choose. Businesses running in this market structure make business decisions based on various economic factors such as cost of production, the market, and the type of products they are offering.

#### 2. Informed Consumers

Monopolistic competition requires consumers to become more informed about the products and services available in the market. Businesses entering a monopolistic competition market often engage in advertising to make their presence known and differentiate themselves from other local businesses offering the same products. Due to competition, firms under this market structure have to enhance their visibility in the market through aggressive advertising and marketing. In return, consumers are fed information concerning unique aspects of products such as pricing, packaging, and other special services through advertising channels like radio and local newspapers. Consumers in monopolistic competition environments can therefore become well informed about products and services in their market and can make informed choices based on their knowledge.

#### 3. Differentiated Products

Companies functioning in monopolistic competition market have to differentiate their products from those of their competitors. Differentiated products ensure that consumers can choose a product from a company, for example, for its unique qualities such as the color of the packaging, size, or price. Due to the competitive nature of the market, companies strive to find a distinctive feature to differentiate its products from those of its competitors offering the same type of product. For example, a company selling detergent often differentiates its product through easily recognizable packaging.

*continued*

## Handout III.6.D, "Advantages & Disadvantages of Monopolistic Competition" (continued)

### Disadvantages

#### 4. High Costs

Most local companies under monopolistic competitive market enjoy some level of liberty. Though the market is free and open to other companies, a local company can often adjust prices upward without attracting competition. In addition, a local firm enjoys repeat business from local customers who remain loyal irrespective of price changes or the quality of services offered.

#### 5. High Expenses

Monopolistically competitive firms incur high expenses in marketing and advertising; advertising is expensive, and monopolistically competitive companies have to spend to make their presence in the market known. In monopolistic competition, firms make an extra effort to differentiate their products in the view of stiff competition using methods such as product packaging, unique marketing and distribution channels to differentiate their products. This becomes an additional cost, which makes operating costs high.

[http://www.ehow.com/info\\_8572321\\_advantages-disadvantages-monopolistic-competition.html](http://www.ehow.com/info_8572321_advantages-disadvantages-monopolistic-competition.html)

## Handout III.6.E, "Advantages & Disadvantages of Oligopolies"

**Direction:** Circle the most significant advantage and disadvantage of oligopolies.

### Advantages

#### 1. **Big Businesses Gain Massive Profits**

One of the greatest advantages for oligopolies is the degree to which they are in control of their businesses. Think about some of the major companies in the United States. You could probably point out five businesses that own the majority of other businesses. Sometimes, even products that appear to come from competing companies are actually results of the same larger establishment. Therefore, the main company is able to drive its own competition, yet it always wins that competition, since it has products on both sides. Additionally, the business is able to make massive amounts of money since that one company is in charge of so many different components.

#### 2. **Ability to Determine Prices**

Instead of having to keep up with the market, oligopolies essentially control the market. Of course, in times of economic hardship, many different types of venues are going to be affected-and these successful businesses can be hurt as well. However, once again, think about the major businesses in the United States and how they have managed to stay open during the current recession.

Since oligopolies have so much power, they are able to set prices for both goods that people want and goods that people need, thereby sustaining themselves. However, the practice of "setting" prices is illegal. Therefore, while it is a positive for the company, it is a negative for consumers in so many other ways.

#### 3. **Long-Term Profits**

These companies not only make massive profits, but they are able to retain them for the long haul. The way that the market is set up does not allow just any old business to come into a share of the power of the oligopoly.

### Disadvantages

#### 1. **Power in the Hands of a Wealthy Few**

When the wealth is concentrated in the hands of a few people and not more spread out, smaller businesses are not necessarily able to get their names out there and sell their products and services, unless they are absorbed by a larger business that is part of the oligopoly.

#### 2. **Creativity**

When the wealth is concentrated, it is difficult for new ideas to come into play. They either need to be absorbed by one of the controlling businesses in the oligopoly, or they are never able to reach fruition. For the individual, stifling creativity is suffocating. A great idea might be all ready to come into existence, but it is unable to be introduced because of the oligopoly's power in the marketplace.

#### 3. **Setting Prices**

These big businesses have the power to set prices, which is negative for the society and for other types of businesses, in addition to being illegal. The whole idea of competitive pricing is thrown out the window when these businesses go about their pricing practices.

As you can probably see, oligopolies appear to be beneficial for the successful businesses in them, but not so great for the other people in the society.

## UNIT III / LESSON 7

# The Circular Flow of Economic Activities

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**Time Frame**

*2 days*

**Standards**

*NES: Economics – Describe the nature of economics and economic activities  
Explain the circular flow movement of inputs and outputs  
among households, businesses, and governments  
Assess the impact of government actions on business ventures*

*NES: Skills – Follow directions  
Apply effective listening skills  
Make oral presentations  
Prepare written reports*

### Guiding Question

How do households, government, and business activities work together to make our economy run?

### Materials

Handouts III.7.A-F

### Objectives

*Students will be able to:*

- Draw conclusions as to how goods and services are distributed in the United States.
- Describe and illustrate what is meant by the circular flow of economic activity in the United States.
- Explain how the government has the power to alter the circular flow and under what circumstances the government will take actions to control or alter the flow of the economy.

### Teacher Background

The flow of payments in an economy is a circular flow involving households/consumers, businesses, and the different levels of government. This circular flow works as follows: Consumers work for businesses, rent their property (or their capital) to businesses, and/or manage and own the businesses. These activities generate incomes—which can be looked at as flows of payments from businesses to households. Households then spend their incomes—on consumption goods, which go to businesses, or pay taxes to governments. For its part, governments then spend the money they have received on goods and services, which go back to households and businesses.

Handouts III.7.A, III.7.B, and III.7.C ask students to interpret diagrams illustrating the role households, businesses, and government play in running the nation’s economy. In Handouts III.7.D, III.7.E, and III.7.F, the class will read more detailed information about the interrelated role played by the three sectors in the economy. For each of these handouts, students will be charged with asking a question about the information contained in the handouts.



## Teaching Strategies/Supporting Activities

- Write the words “consumers,” “businesses,” and “government” on the board. Ask students to write one sentence for each, to explain the role that that sector plays in making our economy run. Then have students explain their answers to the following questions:
  - What role did you say consumers play?
  - What role did you say businesses play?
  - What role did you say governments play?
  - Which of these three sectors plays the most important role in making the economy run?
- Distribute Handout III.7.A, “Diagram.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you see in this diagram?
  - What ideas about the Circular Flow of Money, Goods, and Services were expressed in the diagram? How do you explain the use of the term “circular flow” to describe the economic relationship between households and firms?
  - What did you learn from the diagram about the role households play in the circular flow of money, goods, and services? What did you learn about the role businesses play in the circular flow of money, goods, and services?
  - What is the most important thing about Circular Flow of Money, Goods, and Services that you learned from this diagram?
- Distribute Handout III.7.B, “Government and Public.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What do you learn from this handout about the interrelationships between the government and public in the economy?
  - To what extent would you say that households are dependent on government?
  - To what extent would say the government is dependent on households?
- Distribute: Handout III.7.C, “Flow of Economic Activity.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What information do you get from studying this chart?
  - Based on this chart, how would you explain the role households play in the nation’s economic activities?
  - Based on this chart, how would you explain the role businesses play in the nation’s economic activities?
  - Based on this chart how would you explain the role governments play in the nation’s economic activities?
  - Which sector plays the most indispensable role?

- Distribute: Handout III.7.D, "Households." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn from this reading about the role households play that you did not get from looking at the diagram on Handout III.7.C?
  - What question about households would you have asked of the person who wrote the note on the handout?
- Distribute: Handout III.7.E, "Businesses." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn from this reading about the role businesses play that you did not get from looking at the diagram on Handout III.7.C?
  - What question about businesses would you have asked of the person who wrote the note on the handout?
- Distribute: Handout III.7.F, "Governments." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn from this reading about the role governments play that you did not get from looking at the diagram on Handout III.7.C?
  - What question about governments would you have asked of the person who wrote the note on the handout?

### Summary/Assessment

Ask students to explain their answers to the following question:

Based on what you learned in this lesson, how do households, government, and business activities work together to make our economy run?

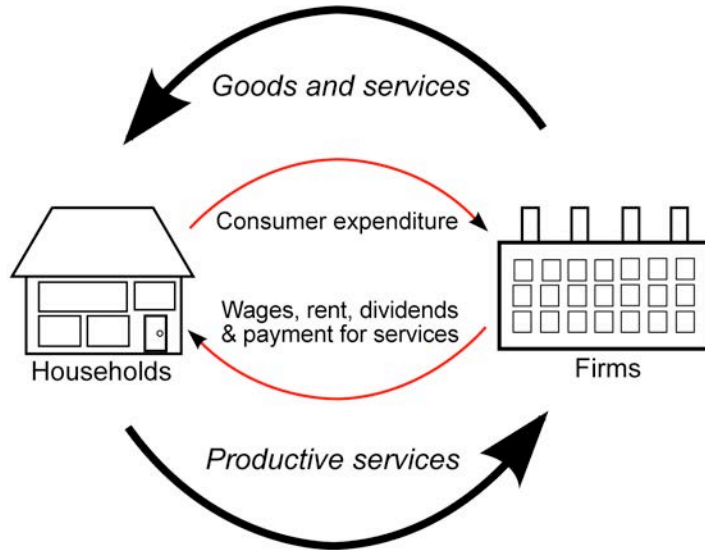
### Follow-Up

Ask students to create three PowerPoint slides consisting of an image and no more than three lines of text, picturing the roles that households, businesses, and governments play in conducting the nation's economic activities.

### Handout III.7.A, “Diagram”

**Directions:** Diagrams helps us to understand an idea by presenting a picture of that idea. Study the diagram below and complete the exercise that follows.

**Circular Flow of Money, Goods, and Services**



Taken from <http://ingrimayne.com/econ/TheFirm/CircularFlow.html>  
<http://www.enotes.com/circular-flow-reference/circular-flow>

**Exercise:** Write a paragraph of 3-4 sentences explaining the most important ideas continued in the diagram.

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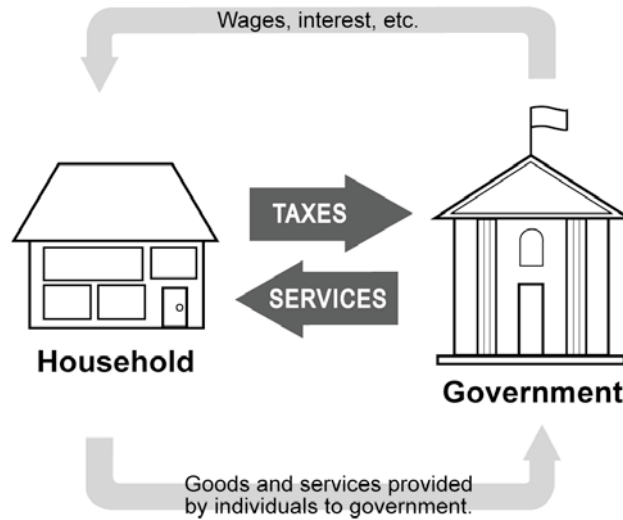
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### Handout III.7.B, “Government and the Public”

**Directions:** Government’s role in the flow of economic activities is an important one, particularly its relationship with households. Study the diagram below and complete the exercise that follows.

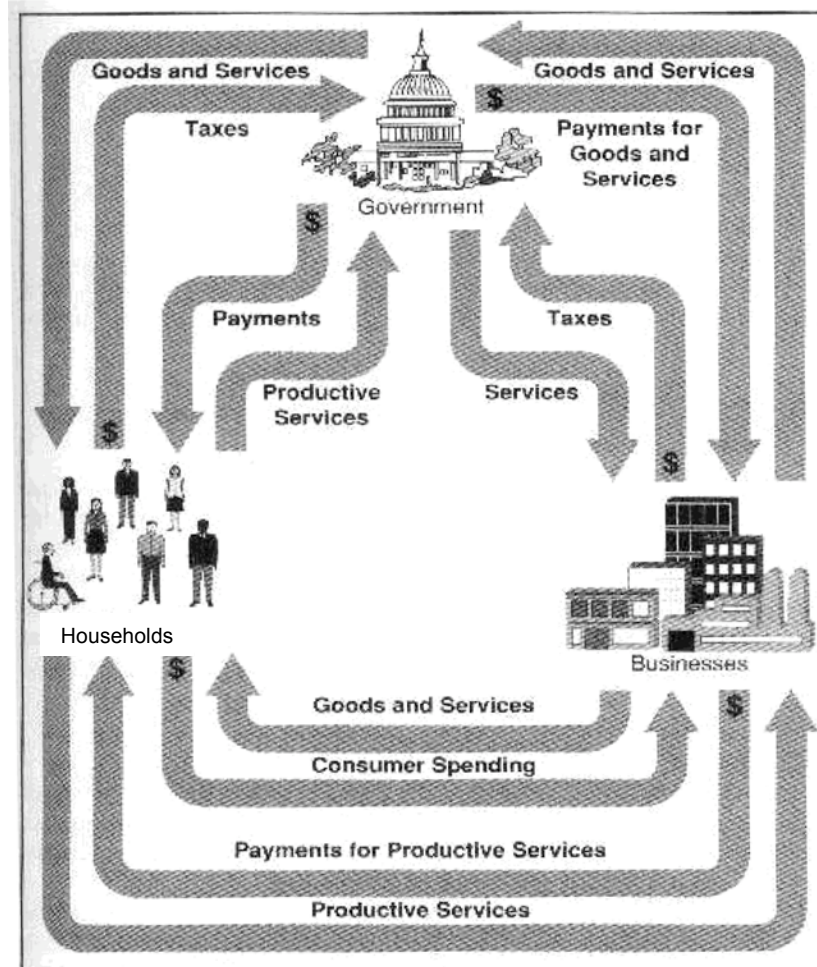


**Exercise:** In the chart below, give two examples of taxes paid by households to government and two examples of services performed by government for households.

Examples of taxes paid by households to government	Examples of services performed by government for households
1.	1.
2.	2.

### Handout III.7.C, "Flow of Economic Activity"

**Directions:** Study the diagram below, which gives a complete description of the interrelated role played by households, businesses, and government in the economic activities of the U.S. Then complete the exercise that follows.



*Adapted from, Economics: Practices and Principles, Gerson Antell, Amsco: 1997, p33*

**Exercise:** Based on the information provided in the diagram above, explain, in one or two sentences for each, the role that the household, business, and government sectors play in the economic activities of the U.S.

1. Households
2. Businesses
3. Government

### Handout III.7.D, "The Households"

**Directions:** Assume you could write to a representative of the household sector, asking that person to explain more about the role of the household sector plays in the economy than was pictured in Handout III.7.C. The letter below contains a possible response to your question. Complete the exercise that follows.

Dear Sir/Madam:

As the household sector, our spending drives the economy, accounting for about 70 percent of all economic activity in the U.S. Here's how it works. We get the money to spend from a variety of sources, including businesses and government—some of it is earned (e.g., wages and salaries, interest, rent and dividends). Individuals may also receive income—called transfer payments such as veterans' benefits, welfare payments, and retirement or pension benefits.

Household income, along with borrowings from financial markets, goes to another sector of the economy, businesses, in the form of spending on goods, such as automobiles and food, and services, such as education and entertainment. While the bulk of our income is spent, households, like the other sectors, often borrow to purchase goods and services the cost of which may be beyond the reach of our current incomes. Examples of items for which we typically borrow to pay for are automobiles, homes and education. Of course, consumers may, as a matter of convenience, borrow when they use credit or charge cards to purchase relatively less expensive times such as food in restaurants or clothing.

Finally, individuals pay taxes on the basis of their income, on the things they purchase, or on the property they own. The taxes collected represent the principal source of income to the government sector. The portion of household income that is neither spent nor taxed is saved.

*Adapted from: <http://ecedweb.unomaha.edu/ve/library/cirf.pdf>*

**Exercise:** Write one question you would ask the person who wrote this letter about the household sector's role in the economic activity of the nation.

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### Handout III.7.E, "Businesses"

**Directions:** Assume you could write to a representative of the business sector, asking that person to explain more about the role that the business sector plays in the economy than was pictured in the diagram on Handout III.7.C. The letter below contains a possible response to your question. Complete the exercise that follows.

Dear Sir/Madam:

The principal economic activity of the business sector is to produce consumer and capital goods and services, mostly for households (consumers) but for the government as well. Consumer goods and services include anything—for example, television sets, clothing, health care—that is bought for immediate use. Capital goods are goods—such as trucks, tools, and equipment—which, while not directly consumed, are used to produce either additional consumer goods and services or other goods. By producing we mean not only goods you can see, like steel, but also services, which are also part of the production activities of business firms. For example, the shipment of an automobile from an assembly plant to a dealer's showroom involves the use of transportation services.

As businesses, we compete with each other for resources around the world, as well as human talent, such as designers, workers, and managers. We get this human talent primarily from the household sector. The cost of acquiring resources such as labor is a source of income (namely, wages) for households, who are the labor resource suppliers.

A firm's net income or profit is the difference between its revenue from selling output and the costs or expenses associated with producing it. These profits are an important internal source of funds firms use to finance their expenditures for new capital resources or to place in financial institutions (e.g., banks) for use by the public. In addition to undistributed profits, the funds we borrow are also used to finance business expenditures.

Business investment spending is affected by a variety of factors including the current and expected state of the economy, interest rates, and taxes. An economic slowdown that is expected to continue for some time may result in business firms trimming their capital spending plans. A sluggish economy, high business taxes and rising interest rates normally weaken the rate of business investment spending and, in turn, the economy's capacity to grow and produce goods and services. In contrast, an expanding economy, along with a favorable tax and interest rate environment, will cause the circular flows of economic and financial activity to expand, as well.

*Adapted from: <http://ecedweb.unomaha.edu/ve/library/cirf.pdf>*

**Exercise:** Write one question you would ask the person who wrote this letter about the business sector's role in the economic activity of the nation.

### Handout III.7.F, "Government"

**Directions:** Assume you could write to a representative of the government sector, asking that person to explain more about the role that the government sector plays in the economy than was pictured in the diagram on Handout III.7.C. The letter below contains a possible response to your question. Complete the exercise that follows.

Dear Sir/Madam:

Lumped together in our sector are more than 80,000 separate units, made up of all levels of government—federal, state, municipal, and local. Generally, we spend your tax dollars on goods and services, produced by private sector business firms. For example, the federal government provides national defense using aircraft carriers made by and purchased from the private sector. In addition to spending to purchase them, we sometimes produce goods and services ourselves. As a rule, the government sector provides the private sector with goods and services that businesses generally does not or cannot provide. For example, private business firms generally will not provide goods and services to customers who do not pay, yet benefit from their availability. If such goods and services are provided at all, it is generally done by the public sector. They are called public or collective goods and services because individuals "collectively" benefit from their availability whether or not they pay. Some examples are public schools, national defense goods like tanks and missiles, and interstate highways.

The principal source of income for the federal government comes from taxes levied on the earnings of households and businesses. State and local governments, however, rely to a large extent on sales and real estate taxes. A tax on the flow of income affects the amount households and business firms devote to saving as well as to spending on services and consumer and business capital investment goods. For example, an increase in the personal income tax rate would tend to lower after-tax or disposable income and, in turn, the amount of income households allocate to spending and saving. With higher taxes discouraging consumer spending, business firms will generally cut back on production rather than being stuck with unsold inventories of output. A slowing in production will decrease business demand for productive resources and, in turn, will increase resource unemployment and lower resource income, further reducing the general demand for goods and services, which was initially triggered by the income tax increase.

A change in the level of government spending affects the economy's flows. If the government sector were to increase spending on goods and services produced by businesses, the tempo of economic activity would rise and the following is also likely to increase: a) the levels of employment; b) household and business income, spending and saving; and c) tax receipts, as households and businesses pay more taxes on higher incomes. Similarly, a slowing or reduction in government spending (or an increase in taxes) would tend to slow the economy's flows, as well.

*Adapted from: <http://ecedweb.unomaha.edu/ve/library/cirf.pdf>*

**Exercise:** Write one question you would ask the person who wrote this letter about the government's role in the economic activity of the nation.



## UNIT III / LESSON 8

### Measuring Economic Activity

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**Time Frame**

*2 days*

**Standards**

*NES: Economics – Macroeconomic concepts  
Explain measures used to analyze economic conditions*

*Explain the concept of Gross Domestic Product*

*Explain the concept of Consumer Price Index*

*NES: Skills – Follow directions*

*Apply effective listening skills*

*Make oral presentations*

*Prepare written reports*

### Guiding Question

How do economists measure the health of an economy?

### Materials

Handouts III.8.A-E

### Objectives

*Students will be able to:*

- Describe their concept of healthy economy.
- Discuss some of indicators economists use to evaluate the economy (e.g., GDP, CPI, Employment data) and the flaws in these measures.
- Make judgments as to which economic indicators give us the clearest picture of the health of the economy.

### Teacher Background

Economic indicators appear regularly in the news reports. These indicators provide important information to economists, government officials, and business leaders because they allow analysis of economic performance and predictions of future performance. At times, the various indicators paint a clear picture of an economy going in one direction. At other times, the various indicators seem to be going in different directions. Some indicators are called leading (e.g., stock market prices) because they change before the economy as a whole changes. Others indicators are called coincident (e.g., personal income), because they change at approximately the same time as the whole economy. And still others are called lagging indicators (e.g., the unemployment rate), because they change after the economy as a whole does. This lesson examines some of the more prominent indicators, examining what information they provide and how reliable they are.

Handout III.8.A asks students to suggest measures that a non-economist would look at to determine whether or not an economy is healthy. Students will read a beginner's guide to economic indicators in Handout III.8.B to learn some basic information on the subject and identify three important ideas they gained from the reading. The class is exposed to some of the more important economic indicators in Handout III.8.C. In the related exercise they are expected to point to those indicators that present the most vital information about the economic health of the nation. Handout III.8.D calls upon students to apply what they learn about indicators to a chart and story about one of the most important indicators, Gross Domestic Product.

### Teaching Strategies/Supporting Activities

- Distribute Handout III.8.A, "Doctor." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - When you go to the doctor, what kinds of things does he or she look at to determine your health?
  - What do things like a person's temperature, blood pressure, and blood tests tell us about a person's health?"
  - What kinds of things would you, as a non-economist, look at to determine how healthy our economy is?
  - If you had to make a determination about the health of the U.S. economy today, would you say it is: a) very healthy, b) somewhat healthy, c) more unhealthy than healthy, or d) unhealthy?
- Distribute Handout III.8.B, "Guide to Indicators." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - In what ways are economic indicators important to: 1) economists, 2) business people, and 3) government officials?
  - What are the major differences between lagging, leading, and coincident indicators? Why might an entrepreneur be interested in looking at a leading, a lagging, and a coincident indicator?
  - What is the most important information you learned about indicators from this handout?
- Distribute: Handout III.8.C, "Important Indicators." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What information did you get from this handout about economic indicators?
  - What are some of the important differences in the indicators in these three categories?
    - I) Total Output, Income, Prices, and Spending
    - II) Employment, Unemployment, and Wages
    - III) Production and Business Activity

- Some people believe the most important statistics about the economy come from the Category II Employment, Unemployment, and Wages. How can you explain that belief?
- In your opinion, which of the three categories of information is most crucial to understanding the current health of the economy?
- Distribute: Handout III.8.D, "Application." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - How did you fill in the six blanks on the handout?
  - What information did you learn about GDP from this handout?
  - Based on this report, to what extent is GDP a good measure of the nation's overall economic activity? To what extent should GDP be described as an incomplete measure of the nation's economic health?
- Distribute Handout III.8.E, "Flaws." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn about some of the flaws in each of the major economic indicators from this reading?
  - What are the most serious flaws in each of the following: GDP, CPI, and the unemployment rate?
  - Based on what you learned about these flaws, to what extent should we rely on the GDP, CPI, and unemployment rate when attempting to determine the health of the economy?

### Summary/Assessment

Ask students to explain their answers to the following question:

What did you learn in this lesson about the indicators used to measure the health of the U.S. economy?

### Follow-Up

Ask students to write a three-page paper entitled "Problems with Economic Indicators." The paper should address some of the shortcomings related to economic indicators that are used to measure the economic health of the nation. Students should address this question in their conclusions: "To what extent can we rely on economic indicators to determine the nation's economic health?"

### Handout III.8.A, "Doctor"

**Directions:** On the chart, list three things you would look at to determine the health of a nation's economy.



*dreamstime.com*

## Handout III.8.B, "Beginner's Guide to Economic Indicators"

**Directions:** Underline three important pieces of information from this beginner's guide to economic indicators.

**Q:** *I'm constantly hearing about economic indicators in the news, but I'm never sure what they're talking about. What are economic indicators and why are they important?*

**A:** An economic indicator is simply any economic statistic, such as the unemployment rate, Gross Domestic Product, or the inflation rate, which inform us about how well the economy is doing now and which direction it is going in the future. To understand economic indicators, we must understand the ways in which economic indicators differ. There are three major attributes each economic indicator has:

### Three Attributes of Economic Indicators

#### 1. Relation to the Business Cycle / Economy

Economic Indicators are related to the business cycle in one of these two ways:

- a. A pro-cyclical economic indicator is one that moves in the same direction as the economy. So if the economy is doing well, this number is usually increasing, whereas if the economy is doing poorly, this indicator is decreasing. The Gross Domestic Product (GDP) is an example of a pro cyclical economic indicator.
- b. A countercyclical economic indicator is one that moves in the opposite direction as the economy. The unemployment rate gets larger as the economy gets worse, so it is a countercyclical economic indicator. As the economy gets better, the unemployment rate goes down.

#### 2. Frequency of the Data

Some indicators are released every three months (e.g., Gross Domestic Product), some monthly (e.g., unemployment rate), and still others are available immediately and change minute-by-minute (e.g., the Dow Jones Index).

#### 3. Timing

Economic Indicators can be leading, lagging, or coincident, which indicates the timing of their changes relative to how the economy as a whole changes.

#### Three Timing Types of Economic Indicators:

- a. **Leading:** Leading economic indicators are indicators that change before the economy changes. Stock market returns are a leading indicator, as the stock market usually begins to decline before the economy declines and they improve before the economy begins to pull out of a recession. Leading economic indicators are the most important type for investors, as they help predict what the economy will be like in the future.
- b. **Lagging:** A lagging economic indicator is one that does not change direction until a few quarters after the economy does. The unemployment rate is a lagging economic indicator, as unemployment still tends to increase for 2 or 3 quarters after the economy starts to improve.
- c. **Coincident:** A coincident economic indicator is one that simply moves at the same time the economy does. The Gross Domestic Product is a coincident indicator.

### Handout III.8.C, "Important Indicators"

**Directions:** This handout lists three categories of important economic indicators and how frequently they are released to the public (this information appears in brackets). Circle the one category of the three that you think contains the most important indicators.

Each of these indicators helps create a picture of the performance of the economy and how the economy is likely to do in the future.

#### I. Total Output, Income, Prices and Spending

These tend to be the broadest measures of economic performance and include such statistics as:

- Gross Domestic Product (GDP) [quarterly]
- Real GDP [quarterly]
- Personal Consumption (PCE) Expenditure Deflator [quarterly]
- Business Output [quarterly]
- Consumer Price Index (CPI) [monthly]
- National Income [quarterly]
- Consumption Expenditure [quarterly]
- Corporate Profits [quarterly]
- Real Gross Private Domestic Investment [quarterly]

**Comment:** *The Gross Domestic Product measures the total dollar value of goods and services produced by a nation's economy over a certain period of time. It is a coincident economic indicator. The Consumer Price Index is a measure of the general level of prices and therefore provides important information about periods of inflation or deflation. It tends to be a lagging indicator, as it reflects an economic change (e.g., a rise in inflation) after it has already occurred.*

#### II. Employment, Unemployment, and Wages

These statistics cover how strong the labor market is and they include the following:

- Unemployment Rate [monthly]
- Level of Civilian Employment [monthly]
- Average Weekly Hours, Hourly Earnings, and Weekly Earnings [monthly]
- Labor Productivity [quarterly]

**Comment:** *The unemployment rate measures the number of people looking for jobs who cannot find them. It is a lagging indicator. The level of civilian employment measures how many people are working and is a coincident economic indicator.*

#### III. Production and Business Activity

These statistics measure production by businesses and the level of new construction in the economy:

- Industrial Production and Capacity Utilization [monthly]
- New Construction [monthly]
- New Private Housing and Vacancy Rates [monthly]
- Business Sales and Inventories [monthly]
- Manufacturers' Shipments, Inventories, and Orders [monthly]

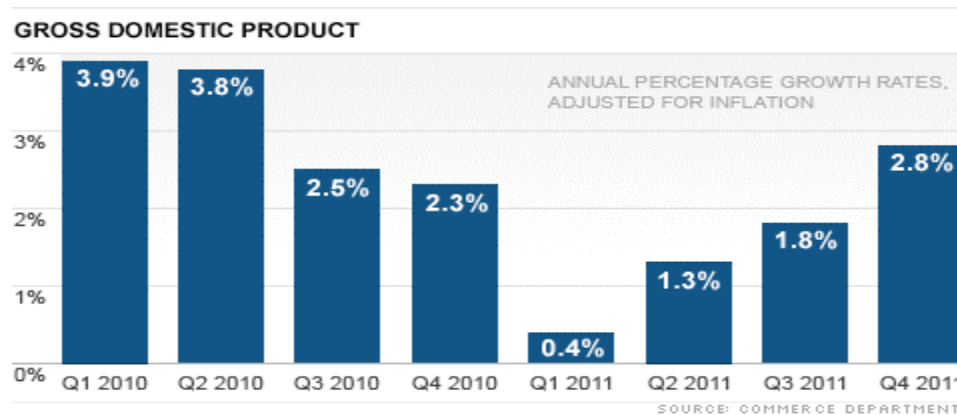
**Comment:** *Changes in business inventories is an important leading economic indicator as it indicates changes in consumer demand. New construction including new home construction is another leading indicator watched closely by investors. A slowdown in the housing market during a boom often indicates that a recession is coming, whereas a rise in the new housing market during a recession usually means that there are better times ahead.*

### Handout III.8.D, "Application"

**Directions:** Below is a news story about a report on the Gross Domestic Product (GDP), one of the most important indicators studied by economists. Based on what you learned about indicators, and looking at the chart below, fill in the underlined six spaces with words that you think fit best.

## U.S. economy is 1) \_\_\_\_\_, but still struggling

@CNMoney January 27, 2012: 10:11 AM ET



NEW YORK (CNMoney) – The United States economy 2) \_\_\_\_\_ at the end of 2011 as businesses substantially built up their inventories and consumers increased their spending.

Gross domestic product, announced every 3) \_\_\_\_\_ month(s) is a measure of 4) \_\_\_\_\_. In Q4 2011, it grew at an annual rate of 5) \_\_\_\_\_ % in the last three months of the year, the Commerce Department said. GDP is considered a 6) \_\_\_\_\_ indicator, because it moves at the same time the economy does.

While that's a major improvement from 1.8% in the prior quarter, and the fastest since the second quarter of 2010, it still fell short of economists' expectations of 3.2% and sent stock futures falling.

#### Signs of weakness

While the number appeared to come in strong, there were still signs of overall weakness, and economists remain cautious about the outlook for the economy.

One reason is that the bulk of the growth came from just one area: businesses building up their stock of goods. Private businesses increased inventories \$56 billion in the fourth quarter, following a decrease of \$2 billion in the third quarter.

An increase on that front can be seen as a double-edged sword. On the one hand, it can be a sign of confidence in the economy. When firms predict greater purchases in the future, they build up their inventories.

### Handout III.8.E, "Flaws"

**Directions:** Economists and other market watchers look to major market indicators such as the Gross Domestic Product (GDP), the Consumer Price Index (CPI), and the unemployment rate for guidance on the state of the economy. However, there are many potential flaws in the story these indicators are telling. Some of the flaws in these three major indicators are described below. For each of the three indicators mentioned, underline the most serious flaw.

#### 1. Gross Domestic Product

Gross domestic product (GDP), defined as the monetary value of all the finished goods and services produced within a country's borders, is commonly used as an indicator of a country's economic health, as well as a gauge of the country's standard of living. Critics of this indicator correctly point out that the GDP does not take into account the so-called underground economy, including those people who produce goods and services but do not report these activities to avoid paying taxes. All transactions that, for whatever reason, are not reported to the government are simply left out of the GDP calculation. For example, household production (the value of a housewife) counts for nothing while the services of a maid add to the gross domestic product. Other examples of underground production include the time you spend working in your garden or fixing your car.

#### 2. Consumer Price Index

The Consumer Price Index (CPI) is a series of measures that reflect the weighted average of prices of a basket of consumer's goods and services. The goods are weighted in the index according to their share of total consumer expenditures. Changes in the CPI are used to measure inflation. While tracking inflation is important in that it can help consumers understand changes associated with the cost of living, understanding CPI is not a simple matter. The Core CPI, an important part of the CPI, does not measure food and energy because those prices go up and down so frequently. Of course, food and energy costs have a significant impact on one's spending budget and generally have a hard-to-avoid impact on consumers. Any measure that does not capture them is unlikely to reflect the experiences of the majority of the population. The CPI measures are filled with criticism. For one, the basket of goods changes infrequently and, therefore, may not always reflect items that provide an accurate accounting of the consumer experience. For another, some critics argue that CPI overestimates inflation, while others argue the reverse.

#### 3. Unemployment Rate

The U.S. government's Bureau of Labor Statistics (BLS) headline unemployment number, frequently cited by the press in the headlines, is the narrowest, most sugarcoated measure of U.S. joblessness for these reasons:

- It excludes workers seeking full-time jobs, failing to find them, and then accepting part-time work that almost invariably pays far less.
- It excludes discouraged workers who have given up looking for jobs because they can't find any.
- And, as if that wasn't enough, the BLS has been consistently and grossly understating the current unemployment numbers, not revising them until months later, when fewer people are paying attention.

*Adapted from:*

<http://www.investopedia.com/articles/economics/11/flaws-in-market-indicators.asp?partner=thebull#axzz1fll4iMC>  
and <http://www.marketoracle.co.uk/Article9960.html>



## UNIT III/LESSON 9

### Business Cycle

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**Time Frame:**  
*2 days*

**Standards**

*NES: Economics – Macroeconomic concepts  
Describe the impact of business cycles on business activities  
Explain measures used to analyze economic conditions  
NES: Skills – Follow directions  
Apply effective listening skills  
Make oral presentations  
Prepare written reports*

### Guiding Question

How does the business cycle help us understand what's going on in the economy?

### Materials

Handouts III.9.A-D

### Objectives

*Students will be able to:*

- Discuss the concept of the business cycle.
- Describe the different phases of the business cycle.
- Explain the causes of the business cycle.

### Teacher Background

The business cycle is defined as the tendency of an economy to experience periodic upturns and slowdowns in production. During these periods, people gain or lose jobs, the demand for goods increases or declines, and businesses expand or close. Sometimes called the "boom/bust" cycle, the business cycle has been a recurring phenomenon since the mid-nineteenth century. This phenomenon is characterized by four phases of economic activity: the peak (the highest point of economy activity, prior to the downturn), the contraction or recession (an economic downturn characterized by negative growth), the trough (the lowest point of economic activity, leading to a transition upward), and the expansion (a period during which the economy improves, leading to the peak).

Students will interpret a chart of the business cycle in Handout III.9.A. They will next role-play an interview about the business cycle with an economist in Handout III.9.B. Handout III.9.C explains in greater depth the four phases of the business cycle. In the exercise for this handout, the class will plot the business cycle, in terms of GDP growth, for the 2008-2009 period. Handout III.9.D asks the class to pose a question about the causes of the business cycle based on a letter that students read.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.9.A, "Chart." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - What did you learn about the business cycle from this chart?
  - Why do you think the chart is titled "The Business Cycle"?
  - After studying this chart, what is one question about the business cycle that you would want answered?
- Distribute Handout III.9.B, "Interview." Assign six students to the following roles: Interviewer #1 (I-1); Interviewer #2 (I-2); Interviewer #3 (I-3); Interviewer #4 (I-4); Interviewer #5 (I-5); and Economist (E). Have the six students act out the interview, according to the script on the handout. Have the remainder of the class complete the exercise at the end of the handout; then have them explain their answers to the following questions:
  - What was this interview about?
  - What are some of the important things you learned about the business cycle from the interview?
  - What question would you have asked of the economist about the business cycle after watching the performance of the interview?
- Distribute Handout III.9.C, "Phases." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - What did you learn about the phases of the business cycle from this handout?
  - What are the major differences among the peak, trough, expansion, and contraction phases?
  - Based on the graph you created for the exercise on this handout, what phase(s) of the business cycle was our economy in between the first quarter of 2008 and fourth quarter of 2009?
  - To what extent is it necessary for an entrepreneur to have an understanding about the different phases of the business cycle in running his or her business?
- Distribute Handout III.9.D, "Causes." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - According to this letter, what are the causes of the business cycle?
  - How can an economy that's growing too fast lead to an economic downturn?
  - Based on what you learned about the business cycle from this reading, why does the government have so much trouble in taking the proper action to prevent economic downturns?
  - What question would you have posed about the causes of the business cycle to the economist who wrote this letter?

## Summary/Assessment

Ask students to explain their answers to the following question:

What should an entrepreneur opening his or her first business know about the business cycle?

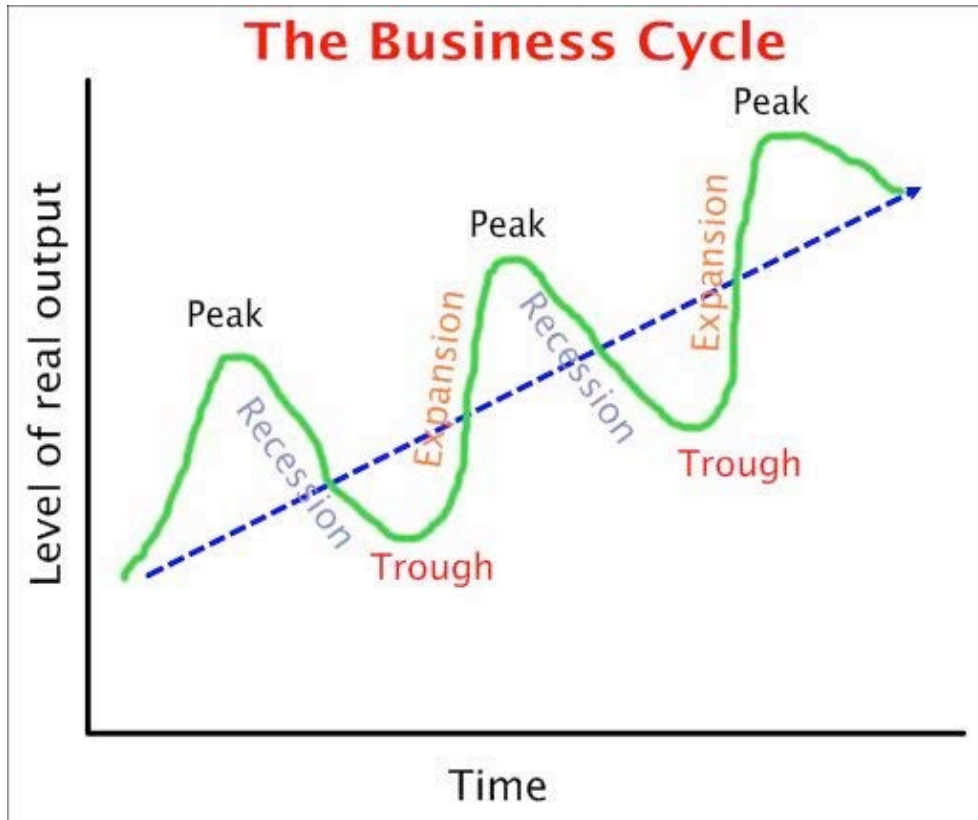
## Follow-Up

For homework, ask students to write a one-page paper on the business cycle and what it means to entrepreneurs. The paper should include the following:

1. The student's assessment of a) what phase of the business cycle are we in now (expansion, trough, contraction, or peak) and b) what part of that phase we are in (beginning, middle, or end).
2. Three pieces of evidence to support the student's assessment stated in "1."
3. An interview with one businessperson who works in the community where the student lives. In the interview, the students should ask: a) Based on how well your business is doing, in what phase of the business cycle do you think we are in now? b) How would you operate your business differently if we were in one of these phases: peak, trough, expansion, or contraction? (c) What actions, if any, should the government be taking at the present time with regard to the phase of the business cycle we are now in?

**Handout III.9.A, “Chart”**

**Directions:** This chart below portrays an economic concept known as the business cycle. After studying the chart, complete the exercise that follows.



<http://monevator.com/2009/05/21/investment-clocks/>

**Exercise:** In the space provided, write one thing you learned about the business cycle from this chart.

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### Handout III.9.B, "Interview"

**Directions:** After the play below is performed, write a question that you would have asked the economist about the business cycle.

**I-1: Thanks for coming to our class today. We are looking to learn something about the business cycle, a topic we are studying in our entrepreneurship class.**

E: Thanks for having me. The business cycle is a very important concept, both to entrepreneurs and economists.

**I-2: Can you tell us, in the simplest terms, what the business cycle is?**

E: Parkin and Bade's textbook *Economics* gives the following definition of the business cycle: "The periodic but irregular up-and-down movements in economic activity, measured by fluctuations in real GDP and other macroeconomic variables."

**I-3: We saw a diagram of the business cycle on Handout III.9.A of this lesson. Is there anything important about the business cycle that does not appear in the diagram?**

E: There is one important feature about the business cycle that the diagram does not show.

**I-4: What is that?**

E: A business cycle is not a regular, predictable, or repeating event like the swing of the pendulum of a clock.

**I-5: I guess Handout III.9.A makes the swings in the business cycle, between peak and trough, seem like they occur at regular time intervals.**

E: That's just not the case. The timing of the business cycle is random and, to a large degree, unpredictable.

**I-1: I also remember that the business cycle on Handout III.9.A had terms like "peak" and "trough" on it. What's that about?**

E: Peaks and troughs are two of the four sequenced phases of the business cycle.

**I-2: What are those phases?**

E: Let's begin with the two phases you asked about—peaks and troughs. A peak in the business cycle represents the highest level of economic activity of that cycle. The peak is the upper turning point of that cycle, meaning after the peak economic activity starts slowing down.

**I-3: Okay, so what's the trough?**

E: The trough is just the opposite of the peak—it is the lower turn point of business cycle—the beginning of the time when the economy starts to get better.

**I-4: So what happens in between the peaks and trough?**

E: After the trough, economic activity increases and conditions improve as we move into the next phase of the business cycle, called "expansion," when economic activity speeds up and the economy takes off. Finally, let's talk about the "contraction" phase of the business cycle, which follows the peak. During a contraction, economic activity slows down to the point where the economy stops growing. Handout III.9.A identifies the phase in the economy when a slowdown takes place, a recession.

**I-5: I never realized that there was so much to learn about the business cycle.**

E: There's a good deal more you should know about the business cycle. However, I think I'll stop now.

**Your Question:** \_\_\_\_\_

## Handout III.9.C, "Phases"

**Directions:** Read the "Entrepreneur's Brief: The Business Cycle" below and complete the exercise that follows.

# ***entrepreneur's brief***

## **phases of the business cycle**

*(entrepreneur's brief is the place business people go to learn about the economy)*

### **The Stages of the Business Cycle**

There are four stages that make up the business cycle. At any point in time, the business cycle is in one of these stages:

1. Contraction – When the economy starts slowing down.
2. Trough – When the economy hits bottom, usually in a recession.
3. Expansion – When the economy starts growing again.
4. Peak – When the economy hits its highest point, in terms of growth, before heading lower.

### **Who Determines the Business Cycle Stages?**

The National Bureau of Economic Research (NBER), a private, nonprofit, nonpartisan research organization dedicated to promoting a greater understanding of how the economy works, analyzes economic indicators to determine the phases of the business cycle. The Business Cycle Dating Committee uses quarterly GDP growth rates as the primary indicator of economic activity. In its analysis of economic conditions, the NBER also uses monthly statistics, such as employment reports, real personal income, industrial production, and retail sales.

### **What GDP Can You Expect in Each Business Cycle Phase?**

#### **1. Contraction Phase**

In the contraction phase, GDP growth rates, as measured as annual rate usually slow to the 1%-2% level before actually turning negative. The 2008 recession was so nasty because the economy immediately shrank 1.8% in the first quarter 2008, grew just 1.3% in the second quarter, before falling another 3.9% in the third quarter, and then *plummeting a whopping 8.9%* in the fourth quarter. The economy received another wallop in the first quarter of 2009, when the economy contracted a brutal 6.9%.

#### **2. Trough Phase**

In the trough phase, GDP growth may still be negative, but it's not as bad as during a contraction. It's clear that the economy has turned a corner. According to the NBER, this occurred in the second quarter 2009, when GDP contracted a mere .7%.

*continued*

As the trough turns into the Expansion phase, GDP growth turns positive again. In the 2008 recession, this wasn't until the third quarter of 2009, when the GDP grew 2.2%. In the fourth quarter of 2009, GDP rose an unexpected 5.7% from the third quarter.

#### **3. Expansion Phase**

As the expansion phase of the business cycle continued in 2010, GDP fluctuated between a 3.9% growth rate in Quarter 1 and a 2.3% growth rate in Quarter 4. It is hoped the GDP growth rate for the life of the expansion phase will be in the healthy 2-3% growth range. If the economy is managed well, it can stay in the expansion phase for years.

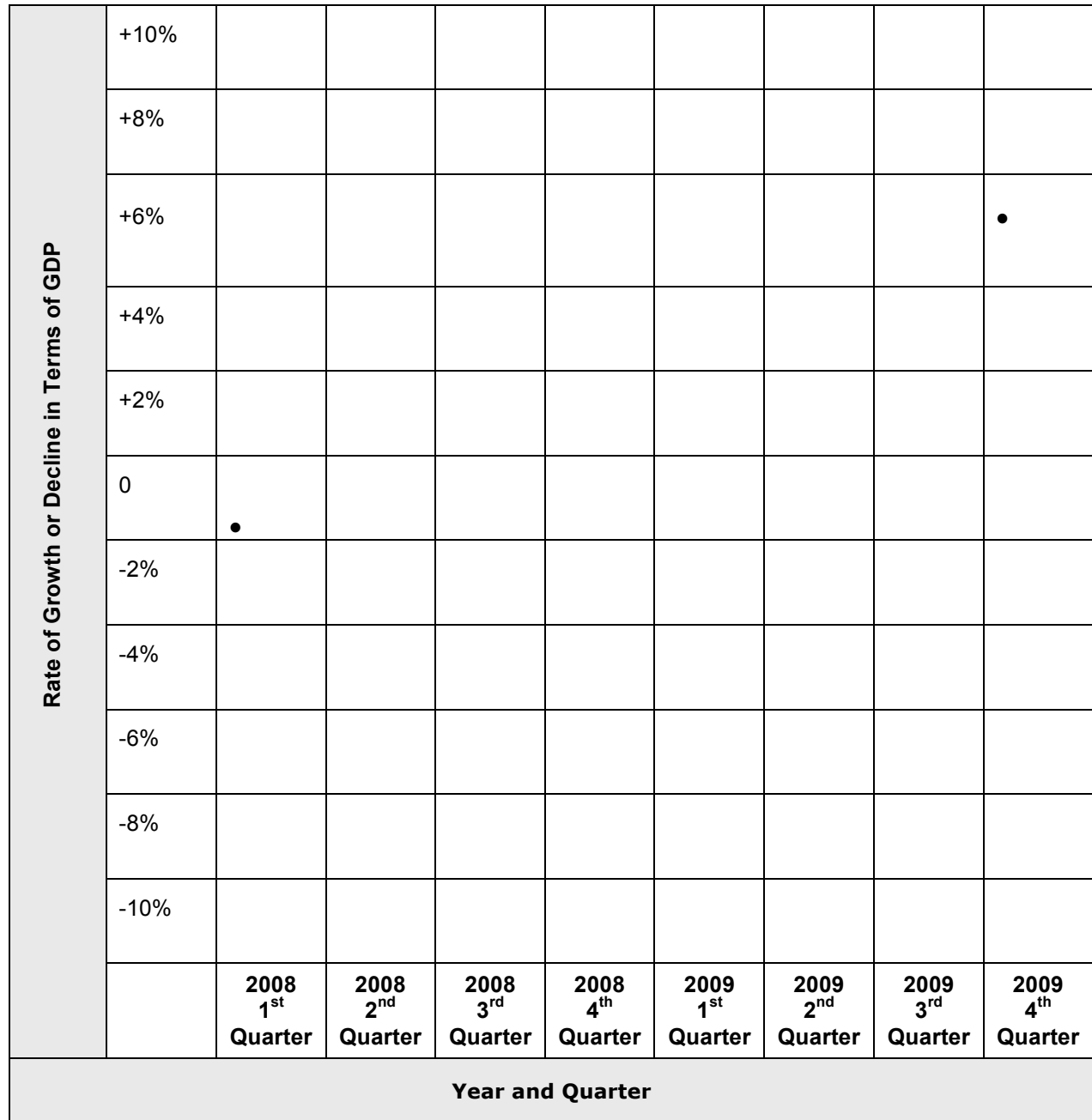
#### **4. Peak Phase**

The peak phase is when the economy's expansion slows. It is usually the last healthy growth quarter before the recession starts. You usually don't know you are in the peak phase until it is too late. However, if the GDP growth rate is 4% or higher for two or more quarters in a row, you can bet the peak is not far off. In the 2008 recession, the peak occurred in the fourth quarter 2007, when the GDP growth rate was 1.9%.

continued

**Handout III.9.C, “Phases” (continued)**

**Exercise:** Based on the information provided above in the section titled “**What GDP Can You Expect in Each Business Cycle Phase?**” make a graph of the business cycle for 2008-2009 by plotting the rates of decline and growth of GDP for as many quarters as there is information. To help you get started with this exercise, GDP for both the 1<sup>st</sup> Quarter of 2008 and 4<sup>th</sup> Quarter of 2009 have been plotted for you. (See the two • on the graph below.)



### Handout III.9.D, "Causes"

**Directions:** If you wrote a letter to an economist asking the question "What causes the business cycle?" he or she might write a response like the one below.

Dear Student:

You wrote to ask me "What Causes the Business Cycle?" I'll try to answer as briefly as possible. The business cycle is affected by the forces of supply and demand. When consumers are confident, they buy now, knowing there will be income in the future from better jobs, higher home values, and increasing stock prices. Even a little healthy inflation can trigger demand by spurring shoppers to buy now before prices go up. As demand increases, businesses hire new workers, which further stimulates more demand. This is the Expansion phase.

If demand outstrips supply, then the economy can overheat, leading to inflation—an economic occurrence when the general level of prices rise and our money loses its value. Overheating created the housing asset bubble in 2005. Even with inflation, we may still be in the expansion phase, but if demand isn't cooled down with higher taxes (fiscal policy) or higher interest rates (monetary policy), then the Peak is not far off.

In the Contraction phase, confidence is replaced by fear or even panic. Consumers sell their homes, and stop buying. Businesses lay off workers and hoard cash. Confidence must be restored to before the Trough can be hit, and the economy re-enters a new Expansion phase.

In addition to demand, the business cycle is also heavily dependent on the availability of capital. This is known as liquidity, which is dependent upon interest rates. Too much capital will turn a healthy expansion into a Peak, at which point greed will bid up the price of assets, often causing inflation. At this point, a stock market correction may indicate that assets are overvalued, creating fear and a Contraction. The Federal Reserve lowers interest rates to spur the economy into Expansion during a Trough. It raises interest rates during an expansion to avoid too much of a Peak.

A Trough usually is accompanied by a recession and a bear market, while an expansion is usually signaled by a bull market and inflation.

*Adapted from: [http://useconomy.about.com/od/glossary/g/business\\_cycle.htm?p=1](http://useconomy.about.com/od/glossary/g/business_cycle.htm?p=1) (Updated October 28, 2011)*

**Exercise:** After reading this letter, suggest a question you would like to ask the economist based on what he/she wrote about "What Causes the Business Cycle?"

**QUESTION TO THE ECONOMIST:**



## UNIT III/LESSON 10

# The Economic Role of Government

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**Time Frame**

*2 days*

**Standards**

*NES: Economics – Describe the relationship between government and business  
Assess the impact of government actions on business ventures*

*NES: Skills – Follow directions*

*Apply effective listening skills*

*Make oral presentations*

*Prepare written reports*

### Guiding Question

Are the American people better off with more or less government involvement in the economy?

### Materials

Handouts III.10.A-D

### Objectives

*Students will be able to:*

- Draw conclusions as to what is meant by the term “laissez-faire” and how it relates to the U.S. economy.
- Assess the arguments favoring more government involvement in the economy.
- Assess the arguments favoring less government involvement in the economy.

### Teacher Background

“Laissez-faire,” meaning to leave business alone, is a phrase often associated with free-market capitalism. However, no economy can function properly without some government involvement in the economy. Since the founding of the U.S., the issue of how much government involvement is appropriate has vexed our national leaders. Today it is at the heart of the debate between the two political parties.

In Handout III.10.A, students will respond to poll questions about the appropriate role of government in the economy today. The class will have the opportunity to examine the four major roles played by government today. Handout III.10.B, presents some basic ideas differentiating laissez-faire and progressivism. Here students are asked to identify key differences in the two schools of thought. Finally, the class is presented with a study of the different views that Americans have today about the appropriate role for government. Students are given the task of presenting evidence provided by individuals who hold opposing views on the issue.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.10.A, "Student Poll." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - What kinds of things did you say that the federal government is doing that it should not be doing?
  - What kinds of things did you say that the federal government is not doing that it should be doing?
  - To what extent do you believe that we are all better off if the government is involved in a major way in the economy?
  - To what extent do you believe that we are all better off if the government is not involved or minimally involved in the economy?
- Distribute Handout III.10.B, "Government Programs." Have students complete the exercise at the end of the handout, then have them explain their answers to the following questions:
  - How would you describe the four areas of government involvement identified on this handout?
  - In what ways are each of these areas important to the well-being of all Americans?
  - Which of these areas represents the most necessary role of government? Which of these areas is the least necessary role of government?
- Distribute: Handout III.10.C, "Laissez-faire vs. Progressivism." Have students complete the exercise at the end of the handout, then have them explain their answers to the following questions:
  - What did you learn about the concept of laissez-faire from this handout?
  - What did you learn about the concept of progressivism from this handout?
  - How would you describe the most significant differences between the two ideas?
  - Would it be in the best interests of the U.S. today to follow laissez-faire or progressive policies?
- Distribute Handout III.10.D, "Debate." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - In your own words, how would you summarize the most important ideas appearing in this story?
  - What are three pieces of evidence from the handout that support the view that Americans want the government more involved in the economy?
  - What are three pieces of evidence from the handout that support the view that Americans want the government less involved in the economy?
  - With which of the following arguments did you find yourself in most agreement: the size of government is too small, too big, or just about right?
  - To pay for the things that government needs to do, which you would prefer: raising taxes, cutting spending, or not sure?

### **Summary/Assessment**

Ask students to explain their answers to the following question:

Are the American people as a whole better off with more or less government involvement in the economy?

### **Follow-Up**

Assign students to bring to class two news articles dealing with the issue of how much a role the government should play in the economy. During the class discussion, call on students who have articles favoring each point of view. After the students discuss their articles, hold a class debate on the issue of the appropriate role of government in the U.S. today.

**Handout III.10.A, "Student Poll"**

**Directions:** Record your responses to the two poll questions below by placing a check next to those answers you agree with. You can place as many checks as you would like as responses to the two questions.

1) What is something the federal government is doing at the present time that it should NOT be doing?

Passing health care legislation for those who cannot afford it

Spending too much money on too many things

Raising taxes

Bailing out large corporations

2) What's something the federal government is NOT doing at the present time that it should be doing?

Creating jobs and reducing unemployment

Improving the economy

Balancing the budget/ limiting its own spending

Stopping foreclosures on people's homes

### Handout III.10.B, "Government Programs"

**Directions:** The government exercises its influence over the U.S. economy through four types of programs. These programs are described below. In front of each of the types of programs listed, place one of the following letters to indicate how necessary you think they are: AN = absolutely necessary, N = somewhat necessary, and U = unnecessary.

\_\_\_ **1. Stabilization and Growth.** The federal government guides the overall pace of economic activity, attempting to maintain steady growth, high levels of employment, and price stability. By adjusting spending and tax rates (fiscal policy) or managing the money supply and controlling the use of credit (monetary policy), it can slow down or speed up the economy's rate of growth and, in the process, affect the level of prices and employment.

\_\_\_ **2. Regulation and Control.** Regulation of the private sector falls into two general categories: economic regulation and social goals. Economic regulation seeks, either directly or indirectly, to control prices. Traditionally, the government has sought to prevent monopolies such as electric utilities and other businesses from raising prices beyond the level that would ensure them reasonable profits. Another form of economic regulation, antitrust law, has been used to prohibit practices or mergers that would unduly limit competition. Government also exercises control over private companies to achieve social goals, such as protecting the public's health and safety or maintaining a clean and healthy environment. The U.S. Food and Drug Administration bans harmful drugs, for example; the Occupational Safety and Health Administration protects workers from hazards they may encounter in their jobs; and the Environmental Protection Agency seeks to control water and air pollution.

\_\_\_ **3a. Direct Services.** Each level of government provides many direct services. The federal government, for example, is responsible for national defense, backs research that often leads to the development of new products, conducts space exploration, and runs numerous programs designed to help workers develop workplace skills and find jobs. Government spending has a significant effect on local and regional economies -- and even on the overall pace of economic activity. State governments, meanwhile, are responsible for the construction and maintenance of most highways. State, county, or city governments play the leading role in financing and operating public schools. Local governments are primarily responsible for police and fire protection. Overall, federal, state, and local spending accounts for a significant part of the annual GDP.

\_\_\_ **3b. Direct Assistance.** Government also provides many kinds of help to businesses and individuals. It offers low-interest loans and technical assistance to small businesses and it provides loans to help students attend college. Government actions encourage home lending. Government also actively promotes exports and seeks to prevent foreign countries from maintaining trade barriers that restrict imports. Government supports individuals who cannot adequately care for themselves. Social Security, which is financed by a tax on employers and employees, accounts for the largest portion of Americans' retirement income. The Medicare program pays for many of the medical costs of the elderly. The Medicaid program finances medical care for low-income families. In many states, government maintains institutions for the mentally ill or people with severe disabilities.

**Handout III.10.B, "Government Programs" (continued)**

**4. Anti-Poverty Programs.** Among the programs in this group are Food Stamps to help poor families obtain food, health and wellness initiatives, and public housing efforts. However, advocates for the poor point out that these programs rarely cover all of a family's food or health care needs and that there is a shortage of public housing. Besides the above, federal and state governments jointly provide welfare grants to support low-income parents with children.

*Adapted from: <http://economics.about.com/od/howtheconomyworks/a/government.htm?p=1>*

### Handout III.10.C, "Laissez-faire vs. Progressivism"

**Directions:** Laissez-faire and progressivism represent two competing ideas about how much government involvement serves the best interests of the American people. Some of the important differences between the two ideas appear on this handout. Read the handout below and complete the exercise that follows.

#### 1. History of Laissez-faire

While the phrase "*laissez-faire*" is often associated with the Scottish economist Adam Smith, ideas about individualism and limited government were present in Greek, Roman, and Renaissance times. Early laissez-faire ideas revolved around the accumulation and protection of property rights as a means to fulfillment in society. John Stuart Mill, John Locke, and Thomas Jefferson all thought and wrote about the role of limited government. According to Smith, a government that leaves people alone to live their lives according to their own judgment serves the best interests of rich and poor alike.

#### 2. History of the Progressive Movement

The Progressive movement traces its roots from collectivism in the Scottish Enlightenment, but American Progressivism really emerged in the 19th and early 20th century to champion an involved government taking all necessary actions to create a more egalitarian society, including wealth redistribution (e.g., welfare) to varying degrees and social programs (e.g., Medicare and Social Security). American presidents identified with the Progressive movement include Theodore Roosevelt, Woodrow Wilson, Franklin Delano Roosevelt, and Lyndon B. Johnson.

#### 3. Features of Laissez-faire

Laissez-faire places emphasis upon the rights of the individual in society and a very limited role for government. Economically, these rights include the right to property and to free enterprise. Laissez-faire thinking judges people upon their accomplishments, and holds that all are able to succeed, though not to the same level, according to their merits and work.

#### 4. Features of Progressivism

The Progressive movement tends to favor government policies that enforce egalitarianism. Progressive thought tends to emphasize equality above individual achievement. Thinkers in the Progressive tradition recognize that cultural and natural barriers prevent some people from achieving according to their work or merits, and thus uses government's authority to equalize the foundation for the whole of society.

#### 5. Liberty

Perhaps the starkest contrast between the ideas of the Progressive and Laissez-faire movements deals with issues of equality and individual liberty. Laissez-faire supporter tend to emphasize freedom from government controls. In contrast, Progressives emphasize the importance of equality for all through government controls.

**Handout III.10.C, "Laissez-faire vs. Progressivism" (continued)**

**Exercise:** Complete the chart below by indicating three major differences between laissez-faire and progressivism.

Laissez-faire	Progressivism
1.	
2.	
3.	



### Handout III.10.D, "Debate"

**Directions:** In many ways Americans are strongly divided on the question of "how big should the government be? Read the article below and underline the opinion on this question that you agree with most. Then complete the exercise that follows.

Six in 10 Americans say the government has too much power, and nearly half agree with this alarming statement: "The federal government poses an immediate threat to the rights and freedom of ordinary citizens." So what size and scope of government do Americans want? That issue has fueled the Tea Party movement and defined recent national and local elections.

USA TODAY and Gallup are trying to understand the underlying attitudes driving this debate with a national survey and an analysis that charts four groups of public opinion. They range from the 22% of Americans at one end who want government out of their lives—among them many Tea Party supporters—to the 20% at the other end who endorse an expansive government that protects its citizens from life's problems and challenges. No political issue is more fundamental, and no other question divides the electorate more sharply.

Rhonda Bryner, 44, of Newark, Ohio, is a small-business owner whose views put her in the midpoint of the USA TODAY analysis. "They've overstepped their authority," she says of the government. "For sure they've forgotten about the Constitution and what our forefathers set up."

Like Bryner, 58% of those surveyed say the government is doing too many things that should be left to individuals and businesses. That's the highest percentage who say the government is doing too much in more than a decade.

Thirty-six percent say the government should do more to solve the country's problems.

The analysis reveals a complicated landscape of beliefs: Most Americans endorse government activism on a range of issues—not only national defense but also the environment, civil rights, and consumer protection—but doubt the competence of government to deliver results effectively and efficiently. Brian Pyle, 45, a truck driver and Teamsters Union member from Battle Creek, Mich., struggles to describe where he stands. "It's too big, the federal government, and too involved in regulation as far as businesses are concerned, because that tends to stifle economic growth," he begins. "But it's kind of a Catch-22 situation, in my mind. I think unregulated business to some degree can be a bad thing, too. That's what got us into this recession in the first place."

Here are some of the warning flags for politicians when Americans consider the subject of how big should the government be:

- The government-is-the-problem refrain of conservatives draws only about one in five voters. There is a broad consensus that the government ought to build transportation systems, protect consumers from unsafe products, preserve the environment, and combat discrimination.
- Nearly six in 10 say the government should make sure all Americans have adequate health care, despite qualms about the health care overhaul President Obama signed into law in 2010.
- "They aren't doing enough for the right people, for the poor," says Yvette Chappell, 47, a mother of three from Hawthorne, Calif., who falls in the bigger-is-better category of views toward government. She wants more public help for the homeless in her community, especially families with children.
- The government-is-the-solution message of liberals also draws only about one in five voters. Half of those surveyed say there's too much government regulation of business, a new high. Three in four say business can do things more efficiently than the government.
- Six in 10 even disagree with the notion that the government generally does things in a way that is fairer than business, a traditional reason for government activism.

(continued)

### Handout III.10.D, "Debate" (continued)

#### Looking for What Works

There's no question that there has been a backlash to steps the government took in 2008 and 2009 in the face of a possible financial meltdown—from the Wall Street bailout signed by President George W. Bush to the stimulus package and auto-rescue plan signed by Obama. Some voters fear billions of taxpayer dollars have been spent to little effect while their families still deal with hard times.

"This spending like a madman was just incredible to me," says Trace Oliver, 53, of Eagle, Idaho, a conservative who counts himself as a Tea Party sympathizer. His earnings as a salesman of high-end RVs has dropped by half since the recession hit. "We're Americans. We like the great country we live in but, damn it, you're giving it away."

#### A Deficit of Trust

"Americans historically have been skeptical of government and of concentrations of power generally... but there are two other more recent factors at work," says William Galston of the Brookings Institution, a White House adviser to President Clinton and co-author of *Democracy At Risk*. "Trust in government is at a very low ebb... and the perception that spending is out of control and is not achieving its intended purposes is the central feature of the political landscape right now. It absolutely trumps everything else."

"It's expanding too fast, and it's too large—the health care bill for one," Robert Durden, 68, a retired elementary-school principal from San Antonio, says of the government. "We are quickly moving into becoming a socialist state, and that's something I definitely do not want to see happen."

A USA TODAY analysis of polling data used responses about the government to divide Americans into these four groups with distinct points of view.

1. **Keep it small:** This cohesive group wants government to stay away from regulating the free market. They trust private enterprise over public institutions. Many support the Tea Party movement. They are the wealthiest, the most conservative, and the most predominantly white and male of any of the groups.
2. **The mushy middle:** Ninety-five percent of them end up somewhere in the middle when asked to place themselves on a five-point scale on the proper role of government — "1" meaning the government should provide only the most basic functions and "5" meaning the government should take active steps in every area it could.
3. **The liberals:** This group wants the government to take a big role in addressing economic disparities. It is the most suspicious of business: Six in 10 say business will harm society unless regulated by the government. They are the youngest group.
4. **The bigger the better:** The members of this group are the most likely of any to trust government and to endorse its involvement in addressing income inequality. This group is the most racially and ethnically diverse of any—45% of its members are Hispanic, African-American, or another racial minority—and has the lowest income levels. In their ranks, nine in 10 think the government should take a major role in ensuring adequate health care and a minimum standard of living for all Americans.

Most of those surveyed acknowledge a disconnect: 56% say most Americans demand more from the government than they are willing to pay for with taxes. More than three of four also see a day of reckoning approaching. They predict that the costs of entitlement programs will create major economic problems for the United States in the next 25 years if no changes are made. Recognizing the issue isn't the same as reconciling it, however. Raise taxes to address it? Fifty-six percent say no. Cut benefits instead? Sixty-six percent say no. Just 12% say both steps should be taken.

**Handout III.10.D, "Debate" (continued)**

**Exercise:** Based on the handout, list three pieces of evidence that Americans want the government to be more involved and three pieces of evidence that Americans want the government less involved in the economy.

More involvement in the economy	Less involvement in the economy
1.	
2.	
3.	

## UNIT III/LESSON 11

### Taxation

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#### Time Frame

*2 days*

#### Standards

*NES: Economics – Describe how the government’s use of taxation and spending affects the economy*

*NES: Skills – Follow directions*

*Apply effective listening skills*

*Make oral presentations*

*Prepare written reports*

#### Guiding Question

How well does our system of taxation work?

#### Materials

Handouts III.11.A-E

#### Objectives

*Students will be able to:*

- Identify, define, and give examples of the various types of taxes that exist in our country.
- Explain how a society can use taxes to both support government activities and to shape societal norms.
- Draw conclusions as to why taxes are considered a “necessary evil” in America.
- Differentiate between progressive and regressive taxes.

#### Teacher Background

One of the most controversial issues related to our economy is taxation. Some people contend that there are too many taxes imposed on citizens and that they take too much money from us. Others argue that such taxes are required to support necessary government-provided services and that taxes do not take enough from the affluent. Even those who support current levels of taxation question the fairness or progressiveness of the tax system.

Handout III.11.A calls for the students to interpret a cartoon about the tax issue. In Handout III.11.B, the class will read a passage providing some of the reasons for paying taxes. The related exercise has them examine some of the statements taken from the reading and determine which of those statements are facts and which are opinions. Next, in Handout III.11.C, the class will evaluate both sides of the argument about whether we pay too much or too little in taxes. Handout III.11.D calls for the class to differentiate between the following four tax kinds of taxes: income, corporate, property, and sales. Finally, in Handout III.11.E, students will identify the difference between progressive and regressive taxes.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.11.A, "Cartoon." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - What is happening in this cartoon?
  - What does the cartoonist mean when he has the character who is standing say to the other, "Comfy?"?
  - What is the opinion of the cartoonist about the tax system in the U.S.?
- Distribute Handout III.11.B, "Reasons for Taxes." Have students complete the exercise at the end of the handout, then have them explain their answers to the following questions:
  - What is this reading about?
  - In the exercise, which statements did you identify as facts? Which statements did you identify as opinions?
  - Which of the arguments explaining the necessity for taxes was most persuasive?
- Distribute: Handout III.11.C, "Too Much in Taxes." Have students complete the exercise at the end of the handout, then have them explain their answers to the following questions:
  - What is this reading about?
  - How does the author answer the question "Are taxes too high?" How does he answer the question "Are taxes too low?"
  - With which of the following opinions do you agree: taxes are too high, taxes are too low, or taxes are just about right?
- Distribute: Handout III.11.D, "Chart." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What are the major differences between the four taxes listed?
  - Which of these taxes are most justified?
  - If you were a taxpayer, which of these taxes would you be most in favor of eliminating?
- Distribute: Handout III.11.E, "Q&A." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What are the major differences between progressive and regressive taxes?
  - How did you answer the exercise at the end of the handout?
  - What arguments can you make for and against keeping progressive taxes?
  - What arguments can you make for and against keeping regressive taxes?

## Summary/Assessment

Ask students to explain their answers to the following question:

In light of what we learned about taxes from this lesson, how would you explain the cartoon on Handout III.11.A? Do you agree with the cartoonist's view point?

## Follow-Up

Conduct a debate in class on the following resolution: "Resolved: The taxation system in America works about as well as it can." Assign three debaters to the pro and three to the con side of the debate. After giving the debaters a sufficient number of days to research the topic and prepare their presentations, have students adhere to the following agenda on the day of the debate:

- Opening statements (1-2 minutes each, maximum)
  1. Pro side
  2. Con side
- Main arguments (5 minutes each, maximum)
  1. Pro side
  2. Con side
- Rebuttal (2 minutes each, maximum)
  1. Con side
  2. Pro side
- Closing statements (1-2 minutes each, maximum)
  1. Con side
  2. Pro side
- Questions from the class and general discussion (remainder of the class period)

**Handout III.11.A, "Cartoon"**

**Directions:** Study the cartoon below and complete the exercise that follows.



[http://www.graphicshunt.com/funny/images/tax\\_cartoon-12607.htm](http://www.graphicshunt.com/funny/images/tax_cartoon-12607.htm)

**Exercise:** Answer the questions below about the cartoon on this handout.

1. Who is the person tied to the sign supposed to represent? \_\_\_\_\_
2. Who does the other person, with the smiling face, in the cartoon represent?  
\_\_\_\_\_
3. What is the cartoonist saying about the tax system in the U.S.?  
\_\_\_\_\_

### Handout III.11.B, "Reasons for Taxes"

**Directions:** Read the article below and complete the exercise that follows.

## Some Reasons Why We Pay Taxes

NANCY CZERWINSKI, Yahoo! Contributor Network, Apr 15, 2009

As hard as it is to believe, there are good reasons for paying taxes. I thought now would be a good time to review them. Our libraries are priceless to most of us and they are the center of activities, whether in person or online, during the months that school is in session. Children receive assignments and sometimes they require research. What better place to go than where there's a learning atmosphere. Our libraries are safe, well-lighted, and the staff is always very knowledgeable. During the summer most libraries have reading programs. Children enjoy these programs but it does cost money to keep our libraries open. There are electric bills and gas bills and the wages of our librarians. They purchase new books when they become available. There's always a display of magazines for us to read and a daily newspaper. Libraries have videos, CDs, and e-books. This is where some of our hard-earned tax dollars go and I believe we definitely benefit from our libraries.

The roads we travel on each day must be kept up and repaired. When you see the orange barrels on the highway you will know our tax dollars are at work. Can you imagine the way our roads would be if they weren't repaired on a routine basis? If the road crews were not out working we'd be in a sad state of affairs. Our food is transported by the truckers and our groceries are delivered to our stores every week. If our food is not delivered the grocery store shelves will empty out fast. Our school buses need safe roads to transport our children from home to school and back again. We also need safe roads to go to work and to complete our errands. There are a lot of factors involved in transportation and the upkeep of our city streets and highways. When you think about paying taxes remember the amount of money it takes to keep our roads safe for our families.

Lastly I'd like to mention our schools. Education is very important for our children. Children are our future and they will need as much knowledge as we can give them. I cannot think of a better way to spend our tax dollars than on the children of America. We will have space programs, scientific studies, health advances, financial markets, and different languages to learn and to teach. This is just a small list of ways that we will advance into the future and our children must be prepared. It is our duty as American citizens to prepare our young adults for what the future holds. Can you think of a better way to spend our tax dollars?

When it's time to pay your taxes remember the highlights that I have pointed out in this article. I believe that although it may be a bit of a struggle sometimes we must do what is best for our country.

[http://www.associatedcontent.com/article/1637409/some\\_good\\_reasons\\_why\\_we\\_pay\\_taxes\\_pg2.html?cat=27](http://www.associatedcontent.com/article/1637409/some_good_reasons_why_we_pay_taxes_pg2.html?cat=27)

**Exercise:** Indicate which of statements taken from the reading are facts and which are opinions.

Statement	Fact	Opinion	Not Sure
As hard as it is to believe, there are good reasons for paying taxes.			
The roads we travel on each day must be kept up and repaired.			
I cannot think of a better way to spend our tax dollars than on the children of America.			



### Handout III.11.C, "Too Much in Taxes?"

**Directions:** Underline three arguments that the author uses in the reading below to answer the question: "Do we pay too much in taxes?"

## Do Americans Pay Too Much in Taxes?

By Mark Willen, May 31, 2010

Nobody likes paying taxes, but it's the only way to pay for those basic government services that everyone agrees are necessary, such as defense. There is no agreement, however, on a host of other government services that push up spending, which means there is no consensus on how high taxes need to be. In fact, the Tea Party movement grew out of a sense that taxes are too high. "Tea" is actually an acronym for Taxed Enough Already.

But are we? Historically, taxes are actually fairly low as a percentage of personal income, according to the Bureau of Economic Analysis, and as a percentage of GDP, according to the Organization of Economic Development. They're also low in comparison with the rest of the world. Of 30 developed countries across the world, including all of western Europe plus South Korea, Canada, Mexico, Japan, and a handful of eastern European countries, the U.S. ranks fifth lowest measuring as a percentage of GDP. And that includes state and local taxes plus payroll taxes for unemployment, etc., as well as federal income taxes.

Though 2006 is the latest year for which data are available, the rankings don't shift much from year to year—just one or two spots. Which raises the opposite question: Are U.S. taxes too low?

Should they be raised to help close the budget deficit?



Not necessarily. Keep in mind that low taxes typically correlate well with high productivity gains. Ireland, Poland, South Korea, and Slovakia, for example, enjoyed strong growth in labor productivity in the last expansion. All have subpar tax burdens. So higher taxes could have a negative effect on productivity, which would slow growth.

It's something to think about as Congress searches for tax hikes in order to offset spending and reduce the deficit.

### Handout III.11.D, “Chart”

**Directions:** The chart below describes four of the taxes paid by Americans to various levels of government. After studying the chart, complete the exercise below.

Name of Tax and Description
<p><b>1) Income Taxes</b></p> <p>Many states, some cities, and the federal government impose an income tax. Americans pay up to 35% of their paychecks on income taxes. People with higher incomes generally pay not only a greater amount of money, but a higher <b>percentage</b> of their income in taxes than people with lower incomes.</p>
<p><b>2) Corporates Taxes</b></p> <p>Such taxes are levied on the profits of businesses. Businesses with higher earnings generally pay not only a greater amount of money, but a higher <b>percentage</b> of their earnings in taxes than people with lower earnings.</p>
<p><b>3) Property Taxes</b></p> <p>These taxes are imposed mostly on real estate owners. Because everyone in the same locality pays the same tax rate on their property, poorer people tend to spend a larger percentage of their income on housing than wealthier people.</p>
<p><b>4) Sales Taxes</b></p> <p>Such taxes are levied by state and local governments (there is no federal sales tax) at the point of purchase for specific goods and services. The level of government charging the tax determines the tax rate. Because everyone who buys the same item (e.g., a television set) pays the same amount of money as a tax, people with lower incomes pay a higher <b>percentage</b> of their income in sales taxes than wealthier people.</p>

<http://www.granthammond.com>

<http://everythingfinanceblog.com/read/42>

**Exercise:** Identify two differences and two similarities among the taxes described above. List those similarities and differences in the following chart:

Differences	Similarities
1.	1.
2.	2.

**Handout III.11.E, “Q&A”**

**Directions:** Read the Q&A handout below. Then complete the exercise that follows.

**Question:** *Can you explain the differences between a progressive and regressive tax?*

**Answer:** A *progressive tax* is defined as a tax whose rate increases as the taxpayer's income increases. That is, individuals who earn high incomes have a greater proportion of their incomes taken to pay the tax.

A *regressive tax*, on the other hand, is one whose rate increases as the payer's income decreases.

Income tax is the only tax in the U.S. whose rate is tied directly to income. It is a progressive tax, according to the definition above; individuals and families with high incomes are taxed at a higher rate than individuals and families with low incomes.

Other taxes like sales tax are often called *regressive* taxes in that individuals or families at the low end of the income spectrum spend a higher proportion of their income than those at the high end. Combined with the fact that sales tax is tied to consumption rather than income, this leads some to the conclusion that low-income individuals and families pay a greater proportion of their money on sales taxes than wealthier people.

**Exercise:** Review Handout III.11.D, “Chart,” then complete the exercise below by placing an X in the appropriate box to indicate whether the two taxes listed below are progressive or regressive taxes. In the box marked “Reasons,” explain the reasons for your answer.

Tax	Progressive	Regressive	Not Sure	Reasons
Property tax				
Corporate tax				

## UNIT III/LESSON 12

# The Federal Reserve and the Banking System

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**Time Frame**

**1 day**

**Standards**

**NES: Economics – Describe the Federal Reserve’s role as the central bank of the U.S.**

**NES: Skills – Follow directions**

**Apply effective listening skills**

**Make oral presentations**

**Prepare written reports**

### Guiding Question

How does the Federal Reserve operate as the central bank for the United States?

### Materials

Handouts III.12.A-D

### Objectives

*Students will be able to:*

- Describe the purposes and structure of the Federal Reserve as the U.S. central bank.
- Explain the relationship between the Federal Reserve and the banking system.
- Examine the Federal Reserve’s role in the financial crisis of 2008.

### Teacher Background

The Federal Reserve is the United States’ central bank. In this capacity, the Fed is the government’s bank, a bank for bankers, and a bank regulator, with a variety of responsibilities ranging from supervising banks to distributing currency. In order to perform these duties effectively, Congress has given the Fed an extraordinary amount of independence, allowing it to raise its own funds and establish a central arm (the Board of Governors) to work with the government and 12 regional banks to work with private financial institutions.

In Handout III.12.A, the class will examine a book cover about the Federal Reserve. This book cover will serve as a springboard to determine students’ prior knowledge about the Fed. Handout III.12.B allows students to examine some of the Fed’s tasks as the central bank of the U.S. Finally, in Handout III.12.C, students will look at the organization of the Fed to determine whether or not the central bank is too independent from government.

## Teaching Strategies/Supporting Activities

- Distribute Handout III.12.A, "Book Cover." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - What do you know about the Federal Reserve?
  - Why do you learn about the Federal Reserve from this book cover?
  - If we had a Federal Reserve expert with us in class today, what question would you want to ask him or her about the U.S. central bank?
- Distribute Handout III.12.B, "Central Bank." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you write in the exercise as your conclusion to this handout?
  - Based on what you read, what is a central bank?
  - Why do most countries have central banks?
  - Why do many people believe it is important for a central bank to have its independence from commercial banks and political leaders?
  - In what ways are central banks among the most powerful institutions in their countries?
- Distribute Handout III.12.C, "Major Roles." Have students explain their answers to the following questions:
  - What did you learn about the Federal Reserve from this chart?
  - How would you describe in your own words the following Federal Reserve roles: bank regulator, a bank's bank, and the government's bank?
  - Which of these three is most important role in your opinion?
- Distribute: Handout III.12.D, "How the Fed Is Organized." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn about the Fed's organization from this handout?
  - Why is the Fed called a "decentralized" central bank?
  - What evidence is there that the Fed is independent within government?
  - Why do you think the Congress gives the Federal Reserve so much independence?
  - Would it be a better idea if the Fed was not so independent?

### Summary/Assessment

Ask students to explain their answers to the following question:

Based on what you learned about the Fed in this lesson, what are some topics that should be included in the book (*The Federal Reserve: Our Central Bank*) whose cover you looked at in Handout III.12.A?

### Follow-Up

Some people blame the Fed, in part, for the financial crisis of 2008, accusing the institution of not properly regulating banks under its control. Have students research this issue and write a one-page editorial under the title, "Did Our Central Bank Do All It Could to Prevent the Financial Crisis of 2008?" For this editorial, students should devote some time to an examination of the role and powers available to a central bank. (Remind the students that an editorial expresses an opinion and that any opinion must be supported by evidence, which can only be obtained after consulting a variety of sources.)

### Handout III.12.A, "Book Cover"

**Directions:** Study the book cover below and complete the exercise that follows.



<http://4closurefraud.org/wp-content/uploads/2010/06/federal-reserve.jpg>

**Exercise:** In the space below, write three things you either know about the Federal Reserve (the Fed) or learned about it from looking at this book cover.

1.

2.

3.

## Handout III.12.B, "Central Banks"

**Directions:** Now that you know that the Fed is our central bank, you probably want to know what central banks are. Read the handout below to learn more about central banking. Based upon what you read on the handout, complete the "Conclusion" below.

### What Are Central Banks?

June 05, 2010

The central bank has been described as "the lender of last resort," which means that it is responsible for providing its economy with funds when commercial banks cannot cover a supply shortage. In other words, the central bank prevents the country's banking system from failing. However, the primary goal of central banks is to provide their countries' currencies with price stability by controlling inflation. A central bank also acts a regulator of commercial banks and is the sole distributor of currency and coins in circulation. Time has proved that the central bank can best function in these capacities by remaining independent from government fiscal policy and therefore uninfluenced by the politicians who run a country. The central bank should also be completely divested of any commercial banking interests.

#### How the Central Bank Influences an Economy

A central bank has two main kinds of functions: (1) macroeconomic functions – in which, the central bank regulates the level of inflation by controlling money supplies and (2) microeconomic functions – in which the central bank acts as a lender of last resort, which most often occurs when a commercial bank does not have enough funds to meet its clients' demands. (Commercial banks typically do not hold reserves equal to the needs of the entire market.) When this happens the commercial bank can turn to the central bank to borrow additional funds at an interest rate set by the central bank. At times when the central bank wants to encourage borrowing (e.g., to stimulate an economy in recession) it will set lower rates. By raising rates, the central bank discourages borrowing, thereby keeping spending down, which prevents an economy from overheating.

#### Conclusion

Central banks are responsible for

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They can do this by

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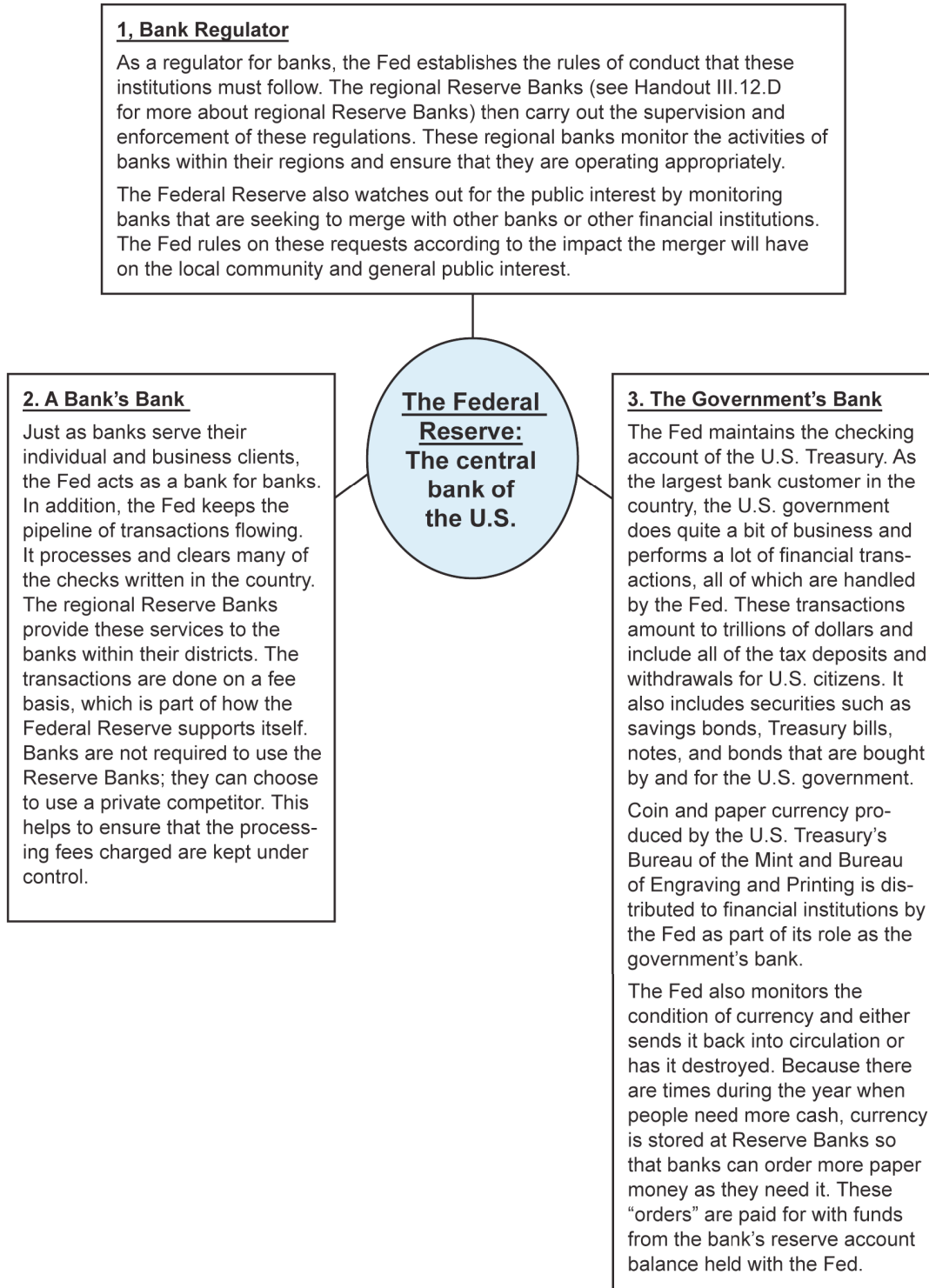
For these reasons, central banks are considered very powerful.

Adapted from <http://www.investopedia.com/articles/ViewArticlePrintable.aspx?url=%2farticles%2f03%2f050703.asp>



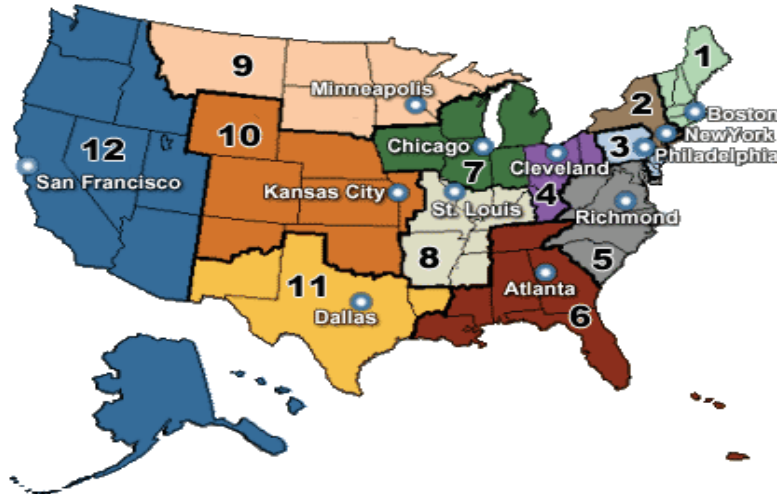
### Handout III.12.C, "Major Roles"

**Directions:** The chart below outlines three of the Federal Reserve's major roles as the central bank of the United States.



### Handout III.12.D, "How the Fed Is Organized"

**Directions:** Read the handout below and underline the three most important things you learned on the page.



The Federal Reserve System was established in 1913 when Congress passed the Federal Reserve Act. Although the Fed is independent within the government, it is ultimately accountable to Congress because Congress can amend the Federal Reserve Act at any time. Its actions, however, do not require any kind of approval from the government.

The Fed is called a "decentralized" central bank, which in itself seems to be a contradiction. It works, however, because the Fed is uniquely structured to eliminate government control but still remains accountable to both the government and the public. The Board of Governors represents the interests on the government side, and the regional Reserve Banks (whose boards of directors consist of local citizens) represent the interests of the private side. In order to operate independently of the government, the Fed funds itself through the transactions it conducts.

#### The Board of Governors

The Fed has a seven-member Board of Governors and 12 regional Reserve Banks. The U.S. president appoints (and the Senate confirms) the seven Governors, whose 14-year terms are staggered to prevent a single president from being able to appoint too many governors. The chairman of the Federal Reserve, who serves a four-year term, is also appointed by the president.

#### Member Banks

Any national bank that is chartered by the federal government is automatically a member of the Federal Reserve System. State banks have to meet specific standards that the Board of Governors sets in order to become members. Member banks are required to buy stock in their regional Reserve Banks. This stock doesn't give the bank any kind of voting privileges and cannot be sold or used as collateral for loans. What the banks do get is a six percent dividend on the stock and the ability to vote for a number of directors of the Reserve Bank.

(continued)

## Handout III.12.D, "How the Fed Is Organized" (continued)

### District Directors

Each of the 12 Reserve Banks has nine directors on its board. The directors are responsible for the overall operations of their banks and report to the Board of Governors. The directors are divided into three groups that represent a cross-section of ideas and interests for the region. These groups are called Class A, Class B and Class C. Class A represents commercial banks that are members of the Federal Reserve System. These member banks elect both the Class A and Class B directors. Class B and Class C directors do not come from the banking industry. They represent the economic interests of the local district, including agriculture, manufacturing, labor, consumers, and nonprofits, and are elected by the Board of Governors. This allows both the private sector and the government/public sector to have representation.

### Regional Reserve Banks

Each regional Reserve Bank president is appointed to a five-year term by the bank's Board of Directors, but the Board of Governors gets the final say-so in the appointment.

*Taken from: <http://money.howstuffworks.com/fed.htm/printable>*

## UNIT III/LESSON 13

### Fiscal Policy

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**Time Frame**

**1 day**

**Standards**

**NES: Economics** – Describe how the government’s use of taxation and spending affects the economy  
Explain how the government uses fiscal policies to achieve macroeconomic goals

**NES: Skills** – Follow directions

Apply effective listening skills

Make oral presentations

Prepare written reports

### Guiding Question

How does the United States government use fiscal policy to help shape the economy?

### Materials

Handouts III.13.A-E

### Objectives

*Students will be able to:*

- Define fiscal policy.
- Provide examples illustrating the government’s use of fiscal policy either through raising or lowering taxes or increasing or decreasing spending.
- Identify the problems involved in using fiscal policies to stabilize the economy.

### Teacher Background

Fiscal policy is the use of government expenditure and taxation to influence the economy. Changes in the level and composition of government spending and taxation can impact the following variables in the economy:

- Aggregate demand and the level of economic activity;
- The pattern of resource allocation;
- The distribution of income.

The three main possible stances of fiscal policy are neutral, expansionary, and contractionary. A neutral stance of fiscal policy implies a healthy economic environment, in which government spending is fully funded by tax revenue and, overall, the budget outcome has a neutral effect on the level of economic

activity. An expansionary stance of fiscal policy use means that government spending is exceeding tax revenue. Finally, a contractionary fiscal policy usually occurs when government spending is lower than tax revenue. Typically, this fiscal policy is associated with a period of serious inflation.

Students will answer two poll questions in Handout III.13.A to determine their attitudes towards government taxing and spending policies, In Handout III.13.B, the class will create illustrations to accompany PowerPoint slides for a lesson explaining the basics of fiscal policy. Selected students will act out on interview with an economics expert talking about automatic stabilizers in Handout III.13.C. The related exercise asks the class to pose one question about automatic stabilizers to the expert. Supply-side economic fiscal policy is the focus of Handout III.13.D. Finally, Handout III.13.E calls upon students to examine problems inherent in using fiscal policy to stabilize the economy.

### Teaching Strategies/Supporting Activities

- Distribute Handout III.13.A, "Poll." Ask students to follow the directions on the handout, then have them explain their answers to the following questions:
  - How did you respond to Question #1?
  - How did you respond to Question #2?
  - Why is there so much disagreement over taxing and spending policies of the government?
- Distribute Handout III.13.B, "Slide Presentations." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - In your own words, how would you define fiscal policy?
  - Why is cutting taxes and raising government spending the fiscal policy that is often followed during economic downturns?
  - Why is raising taxes and cutting government spending the fiscal policy that is often followed during times of inflation?
  - How can you explain why these fiscal policies do not always work as they are supposed to during economic downturns or periods of inflation?
- Distribute: Handout III.13.C, "Automatic Fiscal Policies." Assign six students the following roles: Interviewer #1 (I-1); Interviewer #2 (I-2); Interviewer #3 (I-3); Interviewer #4 (I-4); Interviewer #5 (I-5); and Economist (E). Have the six students act out the interview according to the script on the handout. Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn about automatic fiscal policies from this interview?
  - Why are unemployment insurance, welfare, and income tax programs called automatic stabilizers?
  - How are these automatic stabilizers supposed to work?
  - What question would you have asked of the economics expert about automatic fiscal policies?

- Distribute: Handout III.13.D, "Supply-Side Economics." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - In your own words, how would you describe supply-side economics?
  - How is supply-side economics supposed to work?
  - What are some of the reasons that a number of economists oppose the supply-side approach?
  - To what extent do you believe, as supply-siders do, that in an economic downturn it is better to cut taxes to stimulate the economy, rather than to increase government spending?
- Distribute: Handout III.13.E, "Editorial." Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What is this editorial about?
  - How would you summarize in your own words each of the four problems associated with using fiscal policy that are identified in this editorial?
  - Which of these problems do you think is the most difficult to overcome?

### Summary/Assessments

Ask students to explain their answers to the following question:

What suggestions would you offer about fiscal policy to make it a more effective tool in keeping the economy stable and healthy?

### Follow-Up

Present to the class the most current data about the following indicators: Economic growth (GDP), the employment situation (unemployment rate and non-farm payroll jobs created), and price levels (CPI). After allowing the students some time to study this data, have them explain their answers to the following questions:

- According to the data presented here, what would be your diagnosis about the health of the economy at the present time?
- Based on this diagnosis, what fiscal policy should government officials be pursuing at the present time? (I.e., should the government be increasing or decreasing spending, raising or lowering taxes, or doing nothing?)

**Handout III.13.A, "Poll"**

**Directions:** Indicate what your response to the two statements below by placing a check mark next to choices A, B, C, or D.

## 1. Government Spending

- A. The U.S. government should **spend more money** on programs to promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).
- B. The U.S. government should **spend less money** on programs to promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).
- C. The U.S. government **spends just the right amount of money** on programs to promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).
- D. **I'm not sure** whether the government spends too much or not enough money on programs to promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).

## 2. Taxes

- A. The U.S. government should **raise taxes** to pay for programs to promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).
- B. The U.S. government should **lower taxes**, even if it means that it will not be able to pay for programs that promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).
- C. The U.S. government should **keep taxes as they are now** because that it is all Americans can afford to pay.
- D. **I'm not sure** whether the government should tax more, tax less, or keep taxes as they are to pay for programs that promote a higher standard of living for people in need (e.g., the poor, the elderly, and the unemployed).

**Handout III.13.B, "Slide Presentation"**

**Directions:** Assume that the three slides below, which contain words but no illustrations, are being prepared to explain fiscal policy, the subject of today's lesson. Under each space marked "illustration," create a picture that you think would go well with the words above it. Use stick figures to represent people, if you prefer.

Slide #1	Slide #2	Slide #3
<p><i>Wording:</i>  <b>Fiscal policy –</b>  <b>Definition:</b>            Using government <u>spending</u> and <u>taxation</u> to influence the economy</p> <p><i>Illustration:</i></p>	<p><i>Wording:</i>  <b>Fiscal policy –</b>  <b>Purpose:</b>            To change or reverse the direction of the business cycle</p> <p><i>Illustration:</i></p>	<p><i>Wording:</i>  <b>Fiscal policy –</b>  <b>Examples:</b></p> <ol style="list-style-type: none"> <li>1. During recessions, spending is increased and taxes are cut</li> <li>2. During inflation spending is cut and taxes are increased</li> </ol> <p><i>Illustration:</i></p>



### Handout III.13.C, "Automatic Fiscal Policies"

**Directions:** Fiscal policies come about when the government takes certain actions, like passing laws that increase/decrease spending or raise/lower taxes. Such policies also result from "automatic stabilizers" taking effect. After hearing the interview below acted out, write a question that you would have asked about automatic stabilizers to the expert who appears in this interview.

**I-1: Today we are honored to have with us an expert on automatic fiscal policies or automatic stabilizers. Let's begin by asking why such policies are called "automatic."**

E: As opposed to actions requiring a vote by Congress, automatic fiscal policies take place most of the time whether or not lawmakers take any action.

**I-2: Can you give us some examples?**

E: Three automatic fiscal policies that we hear a lot about are: 1) unemployment insurance, 2) welfare, and 3) income tax programs.

**I-3: Tell us about unemployment insurance first, please.**

E: Sure. Through unemployment insurance, states provide payments to eligible workers who have lost their jobs. During a recession, when large numbers of people are out of work, the number of people receiving payments increases, automatically. In this way, additional funds are pumped into the economy to fight the recession. When things get better in the economy and people return to work, the amount of payments going to the unemployed declines. While unemployment insurance automatically goes to people during their first months without a job, sometimes Congress must pass laws to **extend** the number of weeks an individual may receive unemployment. These extensions usually are needed during very deep recessions, when high unemployment rates exist.

**I-4: How does welfare act as an automatic fiscal policy?**

E: Welfare goes to poor individuals and families. Some of it comes in the form of cash payments. Other forms of welfare come as in-kind services (e.g., food stamps). Like unemployment benefits, welfare payments automatically increase in economic hard times. These increased payments can lead to more spending that helps bring us out of the economic downturns. During expansions, welfare payments tend to shrink.

**I-5: Finally, tell us how income tax programs act as automatic stabilizers.**

E: During good economic times, more tax money is taken out of people's paychecks as their earnings increase. As a result, people cannot spend as much as they might, preventing the economy from overheating, causing inflation. On the other hand, if we suffer through a recession, incomes tend to fall and so do the amount paid in taxes—this leaves taxpayers with more money to spend. The increased spending helps fight the recession.

Let me conclude by saying that the automatic stabilizers do not always do enough to fight recessions or inflation, which explains why Congress sometimes has to take additional actions to keep the economy healthy.

**Question:**

### Handout III.13.D, "Supply-Side Economics"

**Directions:** Supply-side economists favor a different approach to fiscal policy from what has been presented thus far in this lesson. After reading the description below (taken from an Internet site on Supply-Side economics), complete the exercise that follows.

#### What Is Supply-Side Economics?

Supply-side economics is the theory that the correct approach to remedy an economic downturn is to reduce taxes, not increase government spending. Supply side advocates believe that reducing taxes during a downturn will stimulate the economy because it will lead to increased consumer purchasing. According to the supply-side argument, the boost to economic growth will generate a large tax base over time, more than making up for the revenue lost from the tax cut.

#### How Is Supply-Side Economics Supposed to Work?

By cutting income taxes, more money will go into workers' paychecks, which they will spend. This increase in consumer demand means businesses can produce more goods and services, which will lead to more jobs. Workers can then bargain for higher wages, which will translate back into higher tax revenues.

#### How Well Does Supply-Side Economics Actually Work?

Economists disagree whether supply-side economics really works because it is difficult to find real-world proof. That's because it is nearly impossible to isolate the impact of tax cuts alone on economic growth and on revenue. For example, President George W. Bush cut taxes in 2001 and 2003. The economy grew, and revenues increased. Supply-siders, including the President, said that was because of the tax cuts. Other economists point to lower interest rates instituted by the Federal Reserve as the real stimulator of the economy, not the tax cuts.

<b><u>STUDY SUPPORTING SUPPLY-SIDE:</u></b>	<b><u>STUDY THAT DOES NOT SUPPORT SUPPLY-SIDE:</u></b>
<p>Under President George W. Bush, the U.S. Treasury Department developed a model that showed that the Bush tax cuts would ultimately increase production by .7%. However, it is important to note that the model makes certain assumptions that some economists would not agree with.</p>	<p>A study by the National Bureau of Economic Research found that, rather than generating large amounts of money for the government, cutting taxes will result in 17% less income tax and 50% less corporate tax revenues going to the government. This study shows that, over the long-term, the revenue lost by tax cuts will be only partially regained. Without a decrease in spending, the study concludes, tax cuts will lead to an increase in the budget deficit, which will harm the economy over time.</p>

**Exercise:** After completing the reading above, write what you believe would be an appropriate conclusion to this reading about supply-side economics.

Conclusion: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

### Handout III.13.E, "Editorial"

**Directions:** Read the editorial below and circle the most serious problem associated with using fiscal policy to stabilize the economy.

## Editorial: The Problem with Fiscal Policy

**T**he difficulty with fiscal policy as a cure for our economic ills is that government measures do not always work as they are supposed to. One of the problems is that the success of fiscal programs is often tied to effective forecasting about the economy. While economists can determine if the economy is doing well or doing poorly, predicting which way and when the economy will turn in the future is much more difficult. Very often, the government does not recognize we are in recession until many months after the recession has begun. With such poor forecasting, it is difficult to apply fiscal policy cures effectively. Even when forecasts are more accurate and timely, Congress and the president get in each other's way, preventing the appropriate action from being taken when it is needed.

Second, politics often prevents effective fiscal policy actions from being taken. For example, since lowering taxes and increasing spending is generally more popular than the opposite, lawmakers tend to favor the former. On the other hand, politicians are reluctant to raise taxes and cut spending on programs that go to needy people. It is for these reasons that fiscal policies to fight recessions are easier to enact than those that used against inflation.

Next, fiscal policies are limited by the rigidity of the budget. Certain large budget items, like defense needs, interest payments, and social security, must be met and are difficult or impossible to limit, regardless of the economic conditions that exist. After these expenses are allotted for, Congress has only a limited amount of funding it can cut.

Finally, there is often a lack of coordination between the fiscal policies of the federal government on one hand and those of states and localities on the other. Often states and localities are spending money at time when they should be showing restraint, and cutting spending when it should be increased. Unlike the Federal government, which, by printing more money, can spend more than it takes in through taxes, states and localities cannot spend more than they take in when attempting to fight economic downturns.

## UNIT III/LESSON 14

# Business in the Global Economy

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### Time Frame

1 day

### Standards

*NES: Economics – Describe the nature of international trade  
Determine the impact of cultural and social environments on world trade*

*NES: Skills – Follow directions  
Apply effective listening skills*

*Make oral presentations  
Prepare written reports*

### Guiding Question

How is globalization affecting the U.S. economy?

### Materials

Handouts III.14.A-D

### Objectives

*Students will be able to:*

- Define the term “globalization.”
- Examine some of the positive and negative effects of globalization on American businesses and the U.S. economy.
- Discuss whether or not globalization is good for small businesses.

### Teacher Background

Globalization is a process of interaction and integration among the people, companies, and governments of different nations, a process driven by international trade and investment and aided by information technology. This process has effects on the environment, on culture, on political systems, on economic development and prosperity, and on human physical well being in societies around the world.

In the first activity, students are asked to formulate a definition of the term “globalization.” In Handout III.14.A, students will compare their definition of globalization with one presented on a popular web site. Handout III.14.B offers a chart dealing with the changes in international trade that have coincided with globalization. In the exercise for Handout III.14.B, students are asked to draw conclusions about what they learned from the chart about expansion of trade and globalization. Handout III.14.C looks at globalization through the eyes of a small business owner. Finally, Handout III.14.D calls upon students to create a title for a reading dealing with some the challenges that globalization presents, especially those confronting working people.

## Teaching Strategies/Supporting Activities

- Write the word “globalization” on the board. Ask students to explain their answers to the following questions:
  - What does this term mean to you?
  - What does globalization mean to the U.S. economy?
  - What evidence can you show that globalization affects our everyday lives?
- Distribute Handout III.14.A, “Blog.” Have students explain their answers to the following questions:
  - What did you learn about globalization from this blog?
  - How do the ideas about globalization expressed in this blog compare to the ideas about the subject that you expressed in an attempt to define the term?
  - According to the definition appearing in this blog, globalization has effects “on economic development and prosperity.” What are some of those effects? How important are these effects on Americans: significant for most people, it depends on who you are, or not very great?
- Distribute: Handout III.14.B, “Chart.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What information appears in this chart?
  - What is the most important conclusion you can draw from this chart about globalization and international trade?
  - Is it better if imports outnumber exports, exports outnumber imports, or does it depend on other factors?
- Distribute: Handout III.14.C, “Small Businesses.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What is this handout about?
  - What arguments does this handout present to support the belief that globalization is good for small business?
  - How convincing are the arguments presented here to support the claim that globalization is good for small businesses?
- Distribute Handout III.14.D, “Reading.” Have students complete the exercise on the handout, then have them explain their answers to the following questions:
  - What did you learn from this reading?
  - What did you suggest as a title for the reading?
  - What arguments can be made that globalization is doing more harm than good for the American worker? What arguments can be made for the opposite point of view?

- In addition to its effects on workers, what are some other challenges that globalization has created for the U.S. economy?
- What do you think Joseph Schumpeter meant by the term “creative destruction”? How does creative destruction apply to what’s happening to the U.S. economy as a result of globalization?
- Do you agree with Schumpeter’s belief that we should accept the destruction of old economic ways as a positive happening because it clears the way for new and better ways of doing things, like globalization?

### Summary/Assessment

Ask students to explain their answers to the following question:

Based on what we have learned about globalization in this lesson, what advice would you give entrepreneurs about how to prepare themselves to succeed in the global economy?

### Follow-Up

- Have students interview three businesspeople who operate in their communities, asking each these questions:
  - How much, if any, has your business been affected by globalization?
  - Do you think globalization is a good or bad thing for entrepreneurs?
  - What should a future businessperson do to prepare to work in the global economy?
- Have a class discussion on globalization focusing on the questions that students used in their interviews.

### Culminating Activity: “Economics Jeopardy”

- Draw the following point chart on the board:

POINT CHART				
Economic Systems	U.S. Economic System	Business Cycle and Economic Indicators	Monetary and Fiscal Policy	Global Economy and International Trade
5 Points	5 Points	5 Points	5 Points	5 Points
10 Points	10 Points	10 Points	10 Points	10 Points
15 Points	15 Points	15 Points	15 Points	15 Points
20 Points	20 Points	20 Points	20 Points	20 Points
25 Points	25 Points	25 Points	25 Points	25 Points

- Here are the rules for "Economics Jeopardy":
  1. Divide the class into two teams.
  2. Toss a coin to determine which team goes first.
  3. The student seated in the first seat in the first row for Team One begins by selecting any of the five point boxes under one of the five categories that appear on the "Point Chart." As each student selects a point box, cross off that box from the "Point Chart."
  4. Refer to the "Answer Chart" (below) to get the answer that corresponds to the point box selected. Then, read that answer aloud. In order to earn the number of points attached to the box, the student must respond with the correct **question** (For example for the answer "He was the first President of the U.S.," the correct question would be "Who was George Washington?") The correct questions for all 25 boxes appear in the "Answer Chart."
  5. Keep going down the row of Team One, awarding points for each correct response, until a student responds incorrectly. For each incorrect response that a student provides, his or her team loses the number of points of the box selected. Then call on any student from Team Two who raises his or her hand. If the student called from Team Two does not provide the correct response, Team Two loses no points. Tell the class the correct question.
  6. Now it is Team Two's opportunity to select from the point boxes. Begin with the student sitting in the first seat in the first row for Team Two. Follow the same pattern described above until all 25 boxes have been selected.
  7. After all 25 boxes have been selected, the team with the most points wins.

## ANSWER CHART

	Economic Systems	U.S. Economic System	Business Cycle and Economic Indicators	Monetary and Fiscal Policy	Global Economy and International Trade
5 Points	A: The basic economic problem all societies face.	A: The two factors that determine the prices of goods and services in the U.S. economy.	A: This indicator measures the total market value of goods and services produced by a country in one year.	A: The name of the central bank of the U.S., which makes monetary policy.	A: The name of one company that sells its electronic products all over the world.
	<i>Q: What is scarcity? (Or, What is meeting unlimited needs and wants with limited resources?)</i>	<i>Q: What are supply and demand?</i>	<i>Q: What is the Gross Domestic Product or GDP?</i>	<i>Q: What is the Federal Reserve?</i>	<i>Q: What is Apple/ Microsoft/Samsung/Panasonic?</i>
10 Points	A: Adam Smith is said to be the father of this economic system.	A: Many people refer to the U.S. as a mixed, rather than a purely capitalist, economy for this reason.	A: The number of phases in the business cycle.	A: The two bodies of government that make U.S. fiscal policy.	A: The term used in international trade to describe a tax on imported goods.
	<i>Q: What is capitalism?</i>	<i>Q: What is the fact that the government plays a role in the economy?</i>	<i>Q: What is four?</i>	<i>Q: Who are the President and Congress? (Or, Who are the Executive and Legislative branches?)</i>	<i>Q: What is a tariff?</i>
15 Points	A: In this economic system, the government makes almost all decisions about what goods and services are produced.	A: One kind of activity or service performed by government, rather than private industry, in this country.	A: The name one of the phases of the business cycle.	A: In making fiscal policy, the government uses these two powers.	A: This fact was a major cause of the globalization of the economy.
	<i>Q: What is a command or communist economy?</i>	<i>Q: What is the post office/road building, etc.?</i>	<i>Q: What is expansion, peak, trough, or recession?</i>	<i>Q: What are the powers to tax and spend?</i>	<i>Q: What are technological breakthroughs in science, technology, and transportation?</i>

(continued)



## ANSWER CHART (continued)

	Economic Systems	U.S. Economic System	Business Cycle and Economic Indicators	Monetary and Fiscal Policy	Global Economy and International Trade
20 Points	A: One of the three basic questions all economic systems must answer.	A: The phrase used to describe the stream of funds and economic activities that go back and forth among the government, businesses, and public in this country.	A: This type of indicator is given its name because it moves ahead of the economy.	A: When the Fed wants to fight inflation, it usually takes this action.	A: The name for the trade agreement that went into effect in 1994, involving the U.S., Canada, and Mexico.
	<i>Q: What is What to produce?/How to produce it?/How to distribute what is produced?</i>	<i>Q: What is the circular flow?</i>	<i>Q: What is a leading indicator?</i>	<i>Q: What is raising short-term interest rates?</i>	<i>Q: What was NAFTA?</i>
25 Points	A: In this kind of economic system people's economic roles are the same as those of their parents and grandparents.	A: The right U.S consumers have to decide for themselves which goods they will buy.	A: This phase of the business cycle occurs when the economy hits bottom, immediately prior to the expansion phase.	A: This is one example of an automatic fiscal policy stabilizer.	A: In international trade, the term given to the situation in which a country can produce a good at a lower opportunity cost than another country.
	<i>Q: What is a traditional economic system?</i>	<i>Q: What is consumer sovereignty?</i>	<i>Q: What is the trough phase?</i>	<i>Q: What is unemployment insurance/welfare/income tax programs?</i>	<i>Q: What is comparative advantage?</i>

### Handout III.14.A, "Blog"

**Directions:** Read the definition of globalization that appears in the blog below and compare it to the definition you offered at the beginning of the lesson.

#### Globalization 101



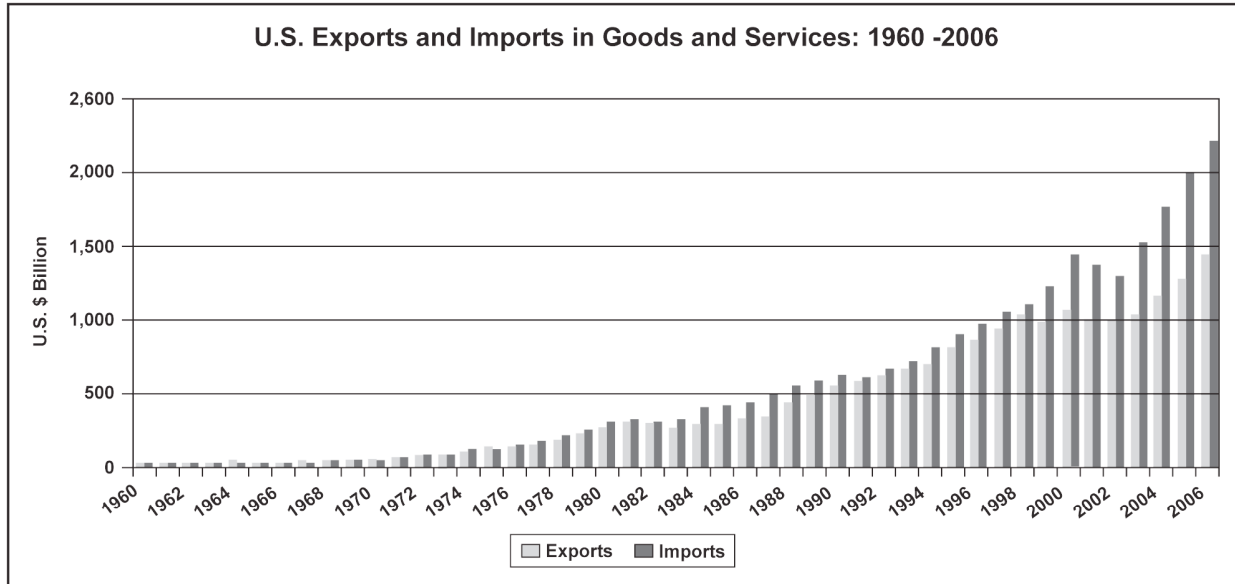
I have said from beginning of this blog that its principal concern is the issue of globalization and its implications for the people of the world and impact on the planet itself.

#### Defining Globalization

- No universal definition of globalization.
- Economic definition: It's about trade, finance and communications.
- Broader definition: Tom Friedman – an International System that replaced the Cold War.
- A good definition I have found (Levin Institute, SUNY):  
"Globalization is a process of interaction and integration among the people, companies, and governments of different nations, a process driven by international trade and investment and aided by information technology. This process has effects on the environment, on culture, on political systems, on economic development and prosperity, and on human physical well-being in societies around the world." (www.globalization101.org)

### Handout III.14.B, “Chart”

Directions: Study the chart below and complete the exercise that follows.



[http://www.craigbellamy.net/images/world\\_economy.jpg](http://www.craigbellamy.net/images/world_economy.jpg)

**Exercise:** State one conclusion you can draw from the information contained in the chart above about what has happened between 1960 and the present day.

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### Handout III.14.C, "Small Businesses"

**Directions:** Read the Q & A on this page. Underline three arguments that appear below that support the belief that globalization is "especially good for small business."

**Q: As a small business owner, I am frustrated by how globalization has affected my business. I am especially upset by the increasing outsourcing of jobs overseas by my large corporate competitors. They seem to have so many advantages already; now, by outsourcing work overseas, they are making it even harder for us small businesses. How am I supposed to compete when they can now hire people in India? — *Small Business Owner, Somewhere, USA***

**A:** Let me first say that I haven't lost my job because it has been outsourced overseas, and I feel bad for those who have. That said, however, in the bigger picture, I think free trade and globalization get a bad rap. The fact is, globalization is good for the world, and it's especially good for small business.

When talking about globalization, I am referring to increasing free trade, the outsourcing of jobs overseas, the opening of new markets, fewer trade barriers, and global economic integration. In a fragmented world, globalization creates bonds. In a world where too many people yearn for freedom, globalization offers hope. In a world where totalitarianism is all too present, globalization fosters democracy. And in a world where small businesses face increasing competition, globalization creates markets and opportunities.

Free trade and globalization often get a bad rap because there is a belief that they allow huge multinational corporations to act without concern for human rights or democratic values. But the fact is free trade helps small business far more than anyone else. Here's an example: I work with a company that makes a product that it sells to companies across the country. The product is manufactured in China and imported to the U.S. because it is far less expensive to have it made there. Yet by doing so, by riding the globalization wave, my colleagues have been able to create a business that employs many people in the USA and creates wealth for its owners. If they manufactured the product here, they wouldn't be able to compete.

So the first thing to note is that globalization creates jobs. Here's another example: According to Howard Shatz, in his testimony before the House Committee on Small Business (September 2003), between manufacturers, wholesalers, and other "trade facilitators," fully 94% of exporters in California are small- and medium-size businesses. That is an amazing statistic; more than 9 out of 10 exporters are small businesses. Why is that? By opening new markets with fewer barriers, free trade and globalization make it easier for U.S. small business to manufacture and sell their goods overseas. The Internet alone has opened a whole new avenue of markets for those small businesses smart enough to take advantage of it.

*(continued)*

**Handout III.14.C, "Small Businesses" (continued)**

Much of this trade goes to our largest trading partner, Mexico, where a growing number of small businesses have cropped up to import U.S. goods. According to a University of Miami study, "99% of Mexico's private sector is composed of small businesses that generate over 80% of employment in Mexico." And that new, booming market awaits the small business savvy enough to tap it. So the second benefit is that globalization creates markets. Free trade and globalization not only foster small business growth at home, it fosters business growth abroad, and that, in turn, according to the study, "fuels ... demand within Mexico for U.S.-made goods and services." It's a win-win relationship, where both sides benefit.

These days, maybe the most positive offshoot of globalization, according to Dan Griswold in his paper, "Trading Tyranny for Freedom: How Open Markets Till the Soil for Democracy," is that "economic integration promotes civil and political freedoms directly by opening a society to new technology, communications, and democratic ideas.... By promoting faster growth, free trade promotes political freedom indirectly by creating an economically independent and politically aware middle class."

Significantly, Griswold notes, "nations that have [opened] themselves to the global economy are significantly more likely to have expanded their citizens' political and civil freedoms."

By creating jobs at home, by nurturing a middle class abroad, by fostering democratic ideals, by developing new markets, by tearing down borders and barriers, globalization has a very positive impact on the world at large, and it is the U.S. small business that is at the forefront of this revolution. American small businesses can continue to change the world for the better by riding the globalization/free trade wave and selling their goods to emerging markets overseas.

### Handout III.14.D, "Reading"

**Directions:** After reading the passage below, suggest a title and write it on the line provided.

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(title)

Changes resulting from global production and trade have been difficult for certain sectors of the U.S. economy, especially for workers in these affected sectors. As other countries have developed new manufacturing capacities, the lower wages of workers in those countries have given them a cost advantage relative to manufacturing in the United States. This has led to a steady increase in U.S. imports of manufactured goods that are cheaper than equivalent domestic goods. It has also prompted a number of U.S. companies to close factories in the United States and build new ones in developing countries, where they can take advantage of lower wages and improved manufacturing skills. Combined with technological changes and other factors, these developments in trade have:

1. Contributed to a gradual shrinkage in the share of the U.S. workforce holding secure, manufacturing jobs with decent wages; and
2. Spurred a long-term decline in the inflation-adjusted income of workers in the manufacturing sector.

American workers with a low degree of skills have been hit hardest by foreign imports and plant closings, because they tend to work in the industries in which emerging industrial countries are most competitive. Over the past few decades, as employment and wages have declined in traditional U.S. manufacturing sectors, many more jobs have been created in higher tech manufacturing industries and in the service sector. These jobs are often higher paying than the manufacturing jobs that have been eliminated. Many workers with manufacturing backgrounds lack the training and education necessary to transition into these new fields.

The changing structure of American trade over the past few decades is in many respects a reflection of a larger set of changes in the structure of the U.S. economy. The relative shares of U.S. economic output accounted for by each of the three major forms of economic activity (manufacturing, services, and agriculture) are constantly changing. At the beginning of the 20th century, the dominant trend was the decline of agricultural production and the rise of manufacturing. In recent decades, the dominant trend has been the decline of manufacturing and the rise of the high technology and service sectors.

These long-term changes in the structure of an economy can be marginally shaped by policy. To a large extent, though, they are the inevitable result of the routine operation of a capitalist economy.

The Austrian economist, Joseph Schumpeter, in his book *Capitalism, Socialism and Democracy*, famously characterized capitalism as a process of "creative destruction." That is, a free market economy will naturally eliminate firms and industries that are less efficient or produce inferior goods. When these companies are eliminated, their more efficient competitors are allowed to maximize the advantages they bring to the market. Efforts to keep these old industries propped up not only inhibit the operations of better firms, but they usually come at the great expense of taxpayers.

Rather than trying to delay or prevent such trends, the alternative would be to offer assistance to those individuals or communities that experience difficulty.

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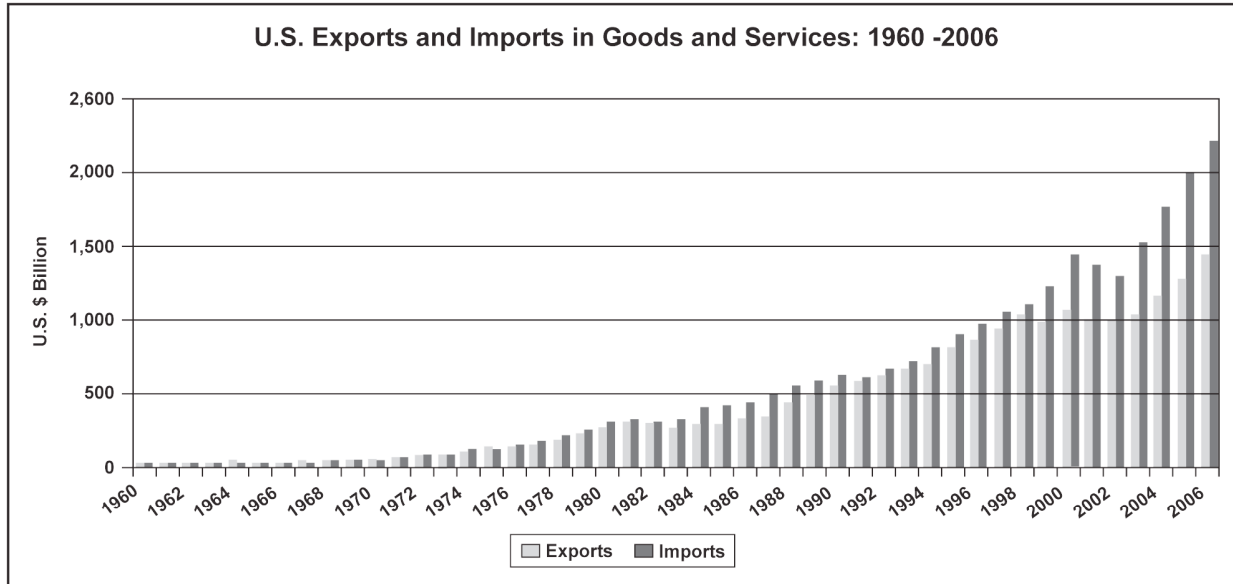
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