

## Section 2.1

## Measuring Economic Activity



How does the health of an economy affect businesses?

## Objective

After completing this section, you will be able to:

- **Describe** common indicators used to measure the strength of an economy.
- **Explain** the four stages of a business cycle.

## Section 2.1 Review

## Check Your Understanding

1. List five of the most widely followed indicators of the economy.  
 Answer: Five economic indicators of the economy are gross domestic product (GDP), inflation, interest rates, unemployment rate, and the stock and bond markets.
2. Identify four components that are used to measure the GDP.  
 Answer: The four components of GDP are consumer spending, business investment, government spending, and net exports.
3. What are the four levels of inflation?  
 Answer: Inflation can be divided into four levels: low, moderate, severe, and hyperinflation.
4. Name the four stages of the business cycle.  
 Answer: The four stages are expansion, peak, recession, and trough.

5. What is the effect of economic expansion on employment and wages?

**Answer:** Businesses react to expansion by increasing production and hiring more workers. During an expansion, wages also begin to increase.

## Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

gross domestic product (GDP)

**Answer:** Market value of all final products produced in a country during a specific time period.

inflation

**Answer:** General rise in prices throughout an economy.

inflation rate

**Answer:** Rate of change in prices calculated on a monthly or yearly basis.

consumer price index (CPI)

**Answer:** Measure of the average change in the prices paid by consumers for typical consumer goods and services over time.

deflation

**Answer:** General decline in prices throughout an economy.

interest

**Answer:** Amount a borrower pays to a lender for a loan.

interest rate

**Answer:** The cost of a loan and is expressed as a percent of the amount borrowed.

labor force

**Answer:** All of the people in a nation who are capable of working and want to work.

unemployment rate

**Answer:** Percentage of the civilian labor force that is unemployed.

productivity

**Answer:** Measure of a worker's production in a specific amount of time.

specialization

**Answer:** Focusing on the production of specific goods so that more products can be produced with the same amount of labor.

stock market

**Answer:** System and marketplace for buying and selling stocks.

bond

**Answer:** Certificate of debt issued by an organization or government.

business cycle

**Answer:** Alternating periods of expansion and contraction in the economy.

expansion

**Answer:** Period when the economy is growing and the GDP is rising.

peak

**Answer:** Marks the end of expansion and is the highest point in the business cycle.

recession

Answer: Period of significant decline in total output, income, employment, and trade in an economy.

depression

Answer: Period of economic contraction that is severe and lasts a long time.

trough

Answer: Lowest stage of a business cycle and marks the end of a recession.

## Section 2.2

# Government and the Economy



How does the government influence the US economy?

### Objective

After completing this section, you will be able to:

- **Describe** the four basic market structures in a free enterprise system.
- **Explain** the government's role in the economy.

## Section 2.2 Review

### Check Your Understanding

1. What are the four basic market structures?

Answer: Monopoly, oligopoly, monopolistic competition, and perfect competition.

2. How do businesses compete for customers?

Answer: Each business competes for customers using price or nonprice competition.

3. List examples of specific roles that the US government plays in the operation of the economy.

Answer: The government regulates the economy, provides public goods, services, and social welfare, provides a legal framework, promotes competition and prevents unfair business practices, and corrects for externalities.

4. How can the government use fiscal policies to manage the economy?

Answer: The government often uses fiscal policies to boost the economy when it is weak. Fiscal policy may also be used to reduce the extreme highs and lows of the business cycle.

5. Why is a legal framework needed for a market economy to function?

Answer: Laws establish boundaries and define acceptable behavior. They help protect individuals and businesses from dishonest business practices.

## Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

market structure

**Answer:** How a market is organized based on the number of businesses competing for sales in an industry.

monopoly

**Answer:** Market structure with one business that has complete control of a market's entire supply of goods or services.

oligopoly

**Answer:** Market structure with a small number of businesses selling the same or similar products.

monopolistic competition

**Answer:** Large number of businesses selling similar, but not the same, products and at different prices; also known as *imperfect competition*.

perfect competition

**Answer:** Characterized by a large number of businesses selling the same product at the same prices.

price competition

**Answer:** When a lower price is the main reason for customers to buy from one business over another.

nonprice competition

**Answer:** Competitive advantage based on factors other than price.

commerce

**Answer:** Activities involved in buying and selling goods on a large scale.

fiscal policy

**Answer:** Tax and spending decisions made by the president and Congress.

monetary policy

**Answer:** Policy that regulates the supply of money and interest rates by a central bank in an economy.

Federal Reserve System

**Answer:** Central bank of the United States that is responsible for the country's monetary system.

money supply

**Answer:** Total money circulating at any one time in a country.

antitrust laws

**Answer:** US laws that promote fair trade and competition among businesses.

price fixing

**Answer:** Occurs when two or more businesses in an industry agree to sell the same good or service at a set price, which eliminates price competition.

collusion

**Answer:** When two or more businesses work together to remove their competition, set prices, and control distribution.

# Chapter Summary

## Section 2.1 Measuring Economic Activity

- The strength of an economy can be measured using certain economic indicators. Some of the most widely followed indicators of the economy are gross domestic product (GDP), inflation, interest rates, unemployment rate, and the stock and bond markets.
- The economy moves through alternating periods of expansion and contraction called the business cycle. The four stages of the business cycle include expansion, peak, recession, and trough. Expansion is a period of when the economy is growing and the GDP is rising. The peak is the highest point in the business cycle. Recession is a period of significant economic decline. Trough is the lowest stage of the business cycle.

## Section 2.2 Government and the Economy

- Market structure is how a market is organized based on the number of businesses competing for sales in an industry. There are four basic market structures: monopoly, oligopoly, perfect competition, and monopolistic competition. Businesses compete for customers using price or nonprice competition.
- The government plays specific roles in the operation of the US economy. It manages the economy, provides public goods and services, establishes a legal framework, promotes competition, and corrects for externalities.

## Review Your Knowledge

1. Explain how the GDP can be used to measure the strength of the economy.

**Answer:** Gross domestic product (GDP), also known as economic output, is the market value of all final products produced in a country during a specific time period. When the GDP rises and continued growth is above average, this indicates that the economy is expanding. When the rate of GDP growth is below average, it is a sign that the economy is weakening. A decline in the GDP signals a recession.

2. Summarize the difference between inflation and interest rates.

**Answer:** Inflation is the general rise in prices throughout an economy. The most significant effect of inflation is that it reduces the purchasing power of money. The inflation rate is the rate of change in prices calculated on a monthly or yearly basis. Interest is the amount a borrower pays to a lender for a loan. An interest rate represents the price of a loan and is expressed as a percent of the amount borrowed. Many different interest rates can be found in an economy because there are many different borrowers, lenders, and types of loans.

3. How is the unemployment rate used to measure the strength of an economy?

**Answer:** Rising consumer demand for goods and services causes the economy to strengthen. Businesses react by increasing production. They eventually hire more workers. This is when the unemployment rate declines. Likewise, the unemployment rate typically remains unchanged until after economic expansion has been underway for six to nine months. When the economy falls into a recession, businesses react by decreasing production and eventually cutting their workforce. This causes the unemployment rate to rise. However, unemployment does rise until after the economic contraction has been underway for a while.

4. Explain how the stock and bond markets reflect economic strength.

**Answer:** When the stock market rises, it means the value of businesses is rising. Investors make decisions based on their expectations of economic growth and corporate profits. As a result, they often buy stocks when they think the economy will get stronger. The interest rates in the bond markets change every day. Rising rates tend to reflect a stronger economy. Lower rates tend to reflect a weaker economy.

5. Describe each of the four stages of the business cycle.

**Answer:** The four stages of a business cycle include expansion, which is a period when the economy is growing; peak, which is the highest point in the business cycle and marks the end of expansion; recession, which is a period of significant decline in the total output, income, employment, and trade in an economy; and trough, which is the lowest stage of a business cycle and marks the end of a recession.

6. Describe each of the four basic market structures.

**Answer:** The four basic market structures are monopoly, oligopoly, perfect competition, and monopolistic competition. A monopoly is when one business has complete control of the entire supply of goods or services in a market. An oligopoly is a small number of businesses selling the same or similar products. Perfect competition is characterized by a large number of businesses selling the same product at the same prices. Monopolistic competition is a large number of businesses selling similar, but not the same, products and at different prices.

7. Explain how the government functions as both a regulator and a provider in the free enterprise economy.

**Answer:** As a *regulator*, the government enacts and enforces laws and regulations to control individual and business activities. As a *provider*, it makes available goods and services for the public benefit in various areas, such as safety, education, and various welfare programs.

8. How does the Federal Reserve regulate monetary policy?

**Answer:** The Federal Reserve looks at many economic indicators to evaluate the condition of the economy. When the economy is slow or weak, it may take action to increase the money supply and lower interest rates. If the economy is growing too fast, the Federal Reserve can take action to slow the economy and avoid inflation. When a nation's production of goods and services is less than the money supply, inflation exists. Increasing interest rates makes borrowing money more expensive.

9. Describe the government's role in providing public safety and well-being.

**Answer:** The government provides certain public goods and services that are available to everyone in the economy. Government agencies collect taxes to pay for the goods and services provided. Examples from students will vary, but should include education, construction and maintenance of roads, police and fire protection, postal services, and public parks.

10. Explain the three major federal antitrust laws.

**Answer:** There are three major federal antitrust laws: Sherman Antitrust Act, Clayton Antitrust Act, and Federal Trade Commission Act. The Sherman Antitrust Act was the first antitrust law in the United States. It removed limits on competitive trade and kept companies from monopolizing markets. The Clayton Antitrust Act gave the federal government more power to detect companies in the early stages of creating monopolies and to prevent them. The Federal Trade Commission Act created the US Federal Trade Commission (FTC), whose mission is to protect consumers and promote fair competition in the marketplace.

## Apply Your Knowledge

1. An interest rate represents the cost of a loan and is expressed as a percent of the amount borrowed. How do interest rates affect the average consumer? Describe how interest rates have affected your personal financial activities.  
**Answer:** Student answers will vary. Evaluate each response individually.
2. Explain the concept of productivity. Choose a type of business and create a chart to illustrate areas of specialization and division of labor within the business operations. Analyze the impact of specialization and division of labor on the overall productivity of the business type you chose.  
**Answer:** Student answers will vary. Evaluate each response individually.
3. Businesses compete for customers using both price and nonprice competition. What are some examples of nonprice factors you have experienced as a consumer? Have nonprice factors ever influenced your buying decisions? Explain your answer.  
**Answer:** Student answers will vary. Evaluate each response individually.
4. The government plays specific roles in our economy to aid business operations. Create a chart that lists each role that government plays in our economy. Next to each role, indicate if the government serves as a regulator or provider.  
**Answer:** Student answers will vary. Evaluate each response individually.
5. Make a list of ten activities that your local government performs in the community. Do any of these overlap with state or federal government activities?  
**Answer:** Student answers will vary. Evaluate each response individually.



## You Do the Math

### Algebraic Reasoning

The order of operations is a set of rules stating which operations in an equation are performed first. The order of operations is often stated using the acronym *PEMDAS*. *PEMDAS* stands for parentheses, exponents, multiplication and division, and addition and subtraction. Anything inside parentheses is computed first. Exponents are computed next. Then, any multiplication and division operations are computed. Finally, any addition and subtraction operations are computed to find the answer to the problem. The equation is solved from left to right by applying *PEMDAS*.

**Find the solution to these equations.**

1.  $8 - (4 \times 3) + 2^3 \div 2 =$

Answer:  $8 - (4 \times 3) + 2^3 \div 2 =$

$8 - (12) + 2^3 \div 2 =$

$8 - (12) + 8 \div 2 =$

$8 - (12) + 4 =$

$= 0$

2.  $3 + 4.5 - 27 \div 9 =$

Answer:  $3 + 4.5 - 27 \div 9 =$

$3 + 4.5 - 3 =$

$= 4.5$

3.  $11^2 + (45 \times 2) =$

Answer:  $11^2 + (45 \times 2) =$

$11^2 + (90) =$

$121 + (90) =$

$= 211$