

# Chapter 3

## Economic Activity in a Changing World

### Learning Objectives

After completing this chapter, you'll be able to:

1. **Identify** how economic activity is measured.
2. **Explain** how inflation and deflation work.
3. **Discuss** the four phases of the business cycle.

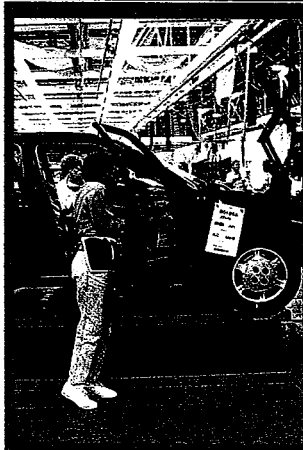
### Why It's Important

Economic activity affects everyday life. The history of the economy affects industries and people of today and tomorrow.

### Key Words

gross domestic product (GDP)  
standard of living  
inflation  
deflation  
budget deficit  
national debt  
budget surplus  
business cycle  
prosperity  
recession  
depression  
recovery

### BusinessWeek



### Feature Story

#### Moving up the Ladder

**From Cheap Labor to Skilled Workers.** Inside his cramped, two-bedroom house, in a subdivision of identical tan- and cream-colored dwellings, José Brigido Aguirre boasts of the changes in his life. Since he moved from his small hometown to booming Ciudad Juarez on the U.S.-Mexican border, he's found

employment as a technician in a factory. Thanks to a mortgage he lined up through a program funded by the government and his employers, Delphi Automotive Systems Corp. in Troy, Mich., Aguirre, 25, now supports three generations—eight people in all—under one roof on \$135 a week before taxes.

Source: Excerpted with permission from "Moving up the Ladder: From Cheap Labor to Skilled Workers," *BusinessWeek Online*, November 6, 2000.

### An Extension Activity

Imagine your friend from Mexico City just landed an internship with Southwest Airlines in Dallas, Texas. Your friend is a little nervous about living in a new country with new etiquette. Research business etiquette tips that he or she might use to fit in.



### The Full Story

To learn more about globalization, visit the *Introduction to Business Web* site at [www.introbus.glencoe.com](http://www.introbus.glencoe.com), and click on *BusinessWeek Feature Story*, Chapter 3.

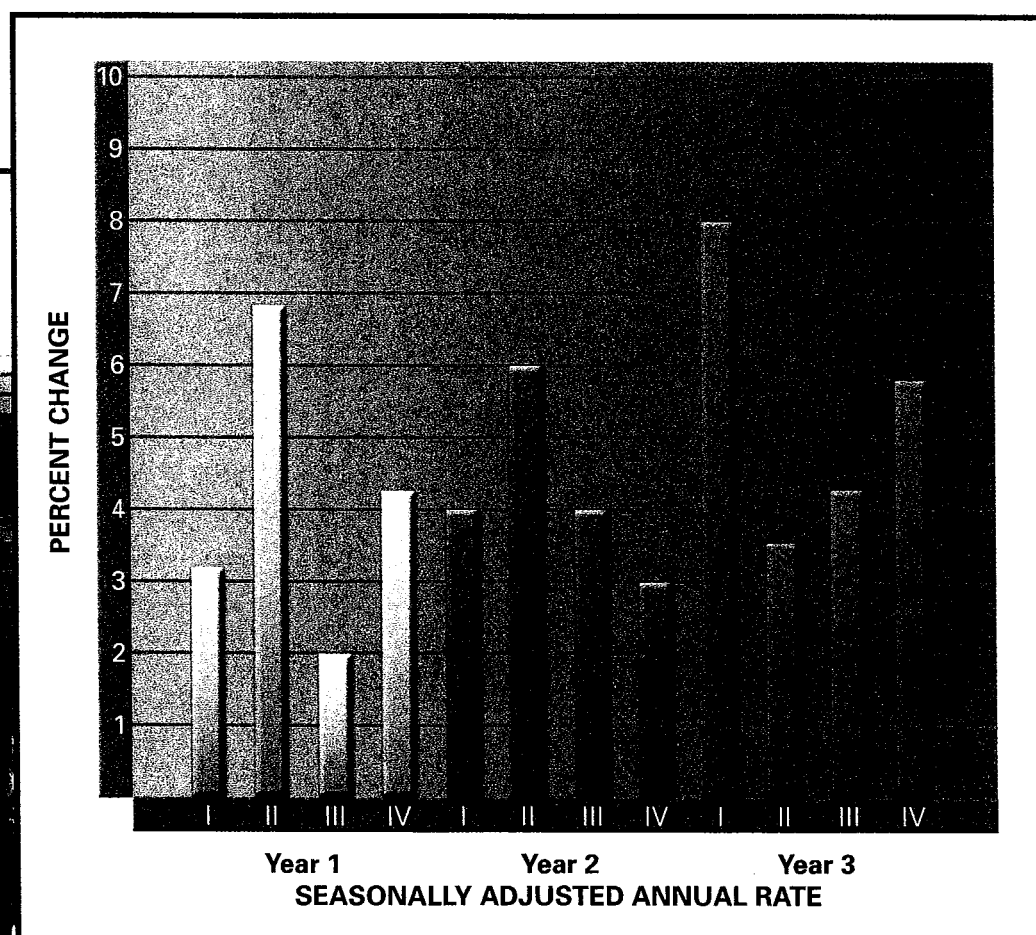
## The Influences on Economics

George Santayana, the American writer said, "Those who cannot remember the past are condemned to repeat it." In the realm of economics, the wealth of nations rises and falls through periods of war, recession, and prosperity. You'll remember that a major purpose of an economic system is to produce the goods and services wanted by people. You might also say that almost anyone can start a business in the U.S. economy. Measuring an economic system's activity greatly impacts everyone. Figure 3.1 illustrates how the GDP seasonally adjusts.

### GROSS DOMESTIC PRODUCT

➡ The gross domestic product (GDP) is the output of goods and services produced in a country.

**What percentage did the GDP increase from the end of Year 2 to the beginning of Year 3?**



## Measuring Economic Activity

Baseball fans know that batting averages, strikeouts, RBIs, and ERAs are figures used to measure a player's performance. Figures are also used to measure economic performance. These figures are called *economic indicators*. They measure things like how much a country is producing, whether its economy is growing, and how it compares to other countries.

### Gross Domestic Product (GDP)

Goods and services that satisfy your wants and needs are the final output of an economy. They're the result of all the economic activity in the country. One way of telling how well an economy is performing is to determine how many goods and services it produces during a certain period of time.

An important measure of a country's economic health is its level of *productivity*, or how much it produces. The total value of the goods and services produced in a country in a given year is called its **gross domestic product (GDP)** (see Figure 3.1). The United States has a very high GDP compared to other countries.

To calculate the GDP, economists compute the sum of goods and services. They include four main areas:

- consumer goods and services
- business goods and services
- government goods and services
- goods and services sold to other countries

The GDP doesn't include the goods and services that aren't reported to the government, like daycare, babysitting, and mowing lawns.

The United States produces so much more than other countries that it has a higher standard of living. The **standard of living** is the amount of goods and services the average citizen can buy. In the 1990s, the GDP of the United States grew from about \$5.5 trillion to almost \$9 trillion. This is a sign that the U.S. economy has continued to grow over time.

### Unemployment Rate

The *unemployment rate* measures the number of people who are able to work but don't have a job during a given period of time. There are different reasons for being unemployed, some more serious than others. For instance, if you just quit your job or you just graduated from school you're probably looking for work. This type of unemployment is temporary and has little effect on the economy. Another type of unemployment is seasonal. If you harvest crops or work in retail during the holiday season, you may only work during a certain part of the year.

## Real-World Application

part 1 of 4



### ERAS THAT CHANGED THE ECONOMY

The Colonial Era, 1578–1776.

People lived off the land.

They traded some of what they produced with England, but they traded mostly among themselves.

**Did colonists develop their own industries?**

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A more serious type of unemployment is caused by changes in industry. New technology can replace workers or require new skills. Companies merge or restructure and “downsize,” laying off thousands of workers. These types of workers can remain unemployed for a long period of time unless they’re retrained or a company finds them new jobs. The worst type of unemployment occurs when the entire economy slows down. Millions of people in every industry can lose their jobs because there isn’t enough work. This type of unemployment lasts until the economy recovers, which can take years.

Changes in the unemployment rate show whether an economy is picking up or slowing down. For example, in 1999, the unemployment rates in Japan and the United States were almost the same, about 4.4 percent. Between 1990 and 1999, however, the unemployment rate in the United States steadily decreased while in Japan it almost doubled. This shows that the U.S. economy was actually growing while the Japanese economy was declining.

## Rate of Inflation

Another important measure of economic strength is the rate of inflation. **Inflation** is a general increase in the cost of goods and services. Inflation can happen when an economy actually becomes too productive. The more people are employed, the more people spend. As the demand for goods goes up, producers raise their prices. To pay the higher

### You Make the Call

#### Dealing With Different Economic Systems

You’re the president of a large biotechnology company that produces new vaccines for several tropical diseases. The communist government of Cuba has requested that you sell the vaccine to help stop a serious disease. Only your company has developed the vaccine. Personally, you’re opposed to communist societies.

#### Making an Ethical Decision

1. Should you encourage other company executives to approve sale of the vaccine?
2. Does it matter if the disease is deadly? What if it wasn’t fatal but caused blindness and was highly infectious?
3. If the United States doesn’t allow its citizens to trade with Cuba, would you still discuss the topic with executives? If the executives want to help, how else could your company get the vaccine to those who need it?

prices, workers demand higher wages. When wages go up, producers raise prices again to pay for the higher wages, and so on. This situation might spiral out of control and lead to *hyperinflation*.

Many other factors can lead to inflation, such as the government printing too much money. When the supply of goods is greater than the demand it can result in deflation. **Deflation** is a general decrease in the cost of goods and services. When an economy produces more goods than people want, it has to lower prices and cut production. As a result, people have less money to buy goods so the demand continues to go down. This is what happened to some of the Asian nations in the 1990s. Manufacturing countries like Japan and Taiwan over-produced goods such as TVs and VCRs, which led to an economic collapse.

The United States tries to maintain a slow but steady rate of economic growth to avoid both inflation and deflation. This is done by controlling productivity and keeping a certain number of people unemployed. That way there is less risk of producers making too many goods or workers demanding higher wages.

## National Debt

Countries can run up large debts. The main source of income for a government is taxes. It uses the tax money to pay for social programs like defense, education, and social security. When the government spends more on programs than it collects in taxes, the difference in the amount is called the **budget deficit**. The U.S. government ran up a huge deficit in the 1980s when it cut taxes while increasing spending on programs. To pay for the difference, the government borrows money from the public, banks, and even other countries. The total amount of money a government owes is its **national debt**. If the debt gets too large, a nation can become dependent on other nations or unable to borrow any more money. This is the case in many developing nations.

On the other hand, a situation when a government's revenue exceeds its expenditures during a one year period is a **budget surplus**. The government will probably use a surplus to cut taxes, reduce the national debt, or increase spending for certain programs. For the most part, a surplus is a rarity.



### Fast Review

1. What are some reasons for unemployment?
2. What is the difference between inflation and deflation?

## Real-World Application

part 2 of 4



### ERAS THAT CHANGED THE ECONOMY

The Industrial Revolution, 1861–1914. Society transitioned from an agricultural economy to one relying on complex machinery. Farming still ruled most industry even with the invention of Eli Whitney's cotton gin.

**How did factories influence the workforce?**

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# The Business Cycle

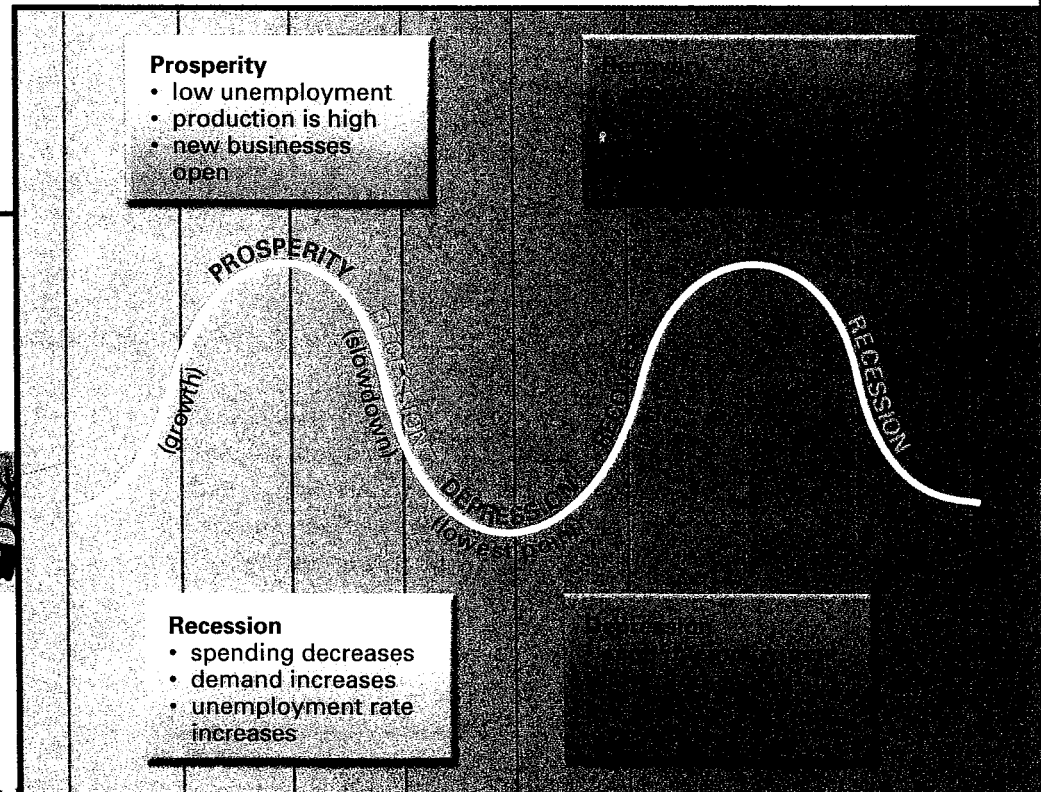
Once you enter the workforce, you'll experience many ups and downs over the years. You could make a lot of money drawing cartoons for an animation studio, get laid off, and take a temporary job managing a copy shop. You could go back to school to study computer graphics, and then get a job doing special effects, or start your own business. Some of the changes you go through will be due to changes in the economy.

Economies go through ups and down as a result of wars, foreign competition, and changes in technology. Over long periods of time these changes seem to form patterns. For example, the U.S. economy went through slumps in the 1930s, the 1950s, and the 1970s. Slumps in economic activity were always followed by a new wave of productivity. This rise and fall of economic activity over time is called the **business cycle**. The business cycle has four phases—prosperity, recession, depression, and recovery. Figure 3.2 shows the ebb and flow of the business cycle.

## BUSINESS CYCLE MODEL

➔ The repeated rise and fall of economic activity over time is called a business cycle.

What are the four phases of the cycle?



GRAND  
OPENING

400 WORKOUTS-AEROBICS NOW AVAILABLE FAMILY FITNESS

Every phase indicates changes to an economy, to industries, and to working people. Changes in the economy can affect some industries, such as the manufacturing industry or the health-care industry, as well as working people. A period of expansion or economic growth affecting the auto industry may mean more job opportunities and higher employment in that industry.

The economic ups and downs of one country can affect other countries too. In a global economy, in which several countries are trading goods and services with one another, one country's economy can affect its other trading partners. If the U.S. economy is in a period of economic expansion, the United States may purchase goods and services from other countries—promoting expansion in those countries. In today's global economy, most countries are interdependent (that is, their economies are linked together).

## Prosperity

**Prosperity** is a peak of economic activity. Unemployment is low, production of goods and services is high, and new businesses open. This condition spreads throughout the economy. Wages are usually higher so there is a greater demand for goods to be produced. More people can buy houses, so the building industry is busier. People also want to buy more goods from other countries, so those countries benefit as well.

The 1990s was a record period of prosperity in the United States. Much of it was due to the low rate of inflation and the Internet creating new business opportunities. Prosperity, however, doesn't last. Any number of things can change. Companies produce too much, people stop buying, or inflation starts to rise.

## Recession

During a **recession**, economic activity slows down. Spending decreases and so does the demand for products. Businesses produce less so they need fewer workers. The unemployment rate then increases so people have less to spend. There is a general drop in productivity and the GDP declines.

A recession can affect only one industry, related industries, or spread to the entire economy. For example, if there is a recession in the auto-making industry, it leads to a recession in industries that make parts for cars, like steel and rubber. When this happens, it's called the *ripple effect*. In the 1970s an oil shortage in the United States caused gas prices to increase. Gas is used for every kind of economic activity, from driving

## Real-World Application

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### ERAS THAT CHANGED THE ECONOMY

The Era of Mass Production, 1914–1995. World War I (WWI) was the first mechanized war. It created a demand for massive resources. By the end of WWI, Henry Ford had perfected the assembly line.

**How did the assembly line change American society?**

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to work to transporting goods to market. As a result, the price of everything went up and led to a major recession.

## Depression

A deep recession that affects the entire economy and lasts for several years is called a **depression**. During a depression there is high unemployment and low productivity. It can be limited to one country but usually spreads to related countries. The state of the economy is affected by large numbers of people out of work, acute shortages, and excess capacity in manufacturing plants.

# Working Lifestyle

What are you doing at 10 A.M.?



## A Heritage of Life

From spring planting through autumn harvest, Tom Wall's days start at 6:30 A.M. and might not end until 11:00 P.M. It's barely 10:00 A.M. and Wall has already been at work for two-and-a-half hours. He's fed the livestock, cared for newborn pigs, and set the computerized feed mill for the babies.

Wall is a farmer. He and his father farm the land he grew up on near Morse, Iowa. Wall and his family grow corn and soybeans on 900 acres. His 2,100-hog operation is "far-row to finish," which means he raises the animals from babies until they're big enough for market.

The Wall farm isn't just a small business—the family manages several million dollars worth of assets in equipment, buildings, and inventory. He and his father provide most

of the labor. In addition to farming, Wall also runs a thriving seed business from a machine-shed/warehouse/office he built on the property. He sells corn, soybean, and alfalfa seed produced by Monsanto and Garst seed companies.

"To succeed as a farmer, you have to wear a lot of different hats," Wall says. "And you have to be willing to commit the time and effort to make things work."

## Salary

Full-time farmers earn between \$15,704 and \$32,188.

## Outlook for This Career

The increasing world population will increase the demand for food. Thus the employment outlook for farmers is expected to remain steady.

## Connecting Careers Activity

Research how biological career paths might influence dairy, crop growing, and livestock farmers. Write a small paragraph on the influences.

CAREER PATH





Fortunately, depressions are rare. The stock market crash on October 29, 1929, or “Black Tuesday,” marks the beginning of the Great Depression. Between 1929 and 1933, GDP fell from approximately \$103 to \$55 billion—a decline of nearly 50 percent. At the same time, the number of people out of work rose nearly 800 percent—from 1.6 to 12.8 million. During the worst years of the Depression, one out of every four workers was jobless. Even workers who had jobs suffered. The average manufacturing wage, which had reached fifty-five cents an hour by 1929, plunged to five cents an hour by 1933.

Many banks across the country failed. The FDIC didn’t exist at the time, so depositors were not protected. To prevent panic withdrawals, the federal government declared a “bank holiday” in March of 1933. Every bank in the country closed for several days, and many never reopened.

The money supply fell by one-third. Currency was in such short supply that towns, counties, chambers of commerce, and other civic bodies resorted to printing their own money. This was used to pay teachers, firefighters, police officers, and other municipal employees.

## Recovery

A rise in business activity after a recession or depression is called a **recovery**. During a recovery, production starts to increase. People start going back to work and have money to spend again. The new demand for goods and services stimulates more production and the GDP grows. Recovery leads back to prosperity as new businesses open.

A recovery can take a long time or it can happen quickly. In 1939 the United States was only beginning to recover from the depression when World War II began. During the war, the United States recovered much faster because of the demand for war production.

During a recovery businesses might start to innovate a new product or a new way of performing a task. When a business innovates, it often gains an edge on its competition, because its costs go down or its sales go up. Profits increase, business grows, and economic activity soars.

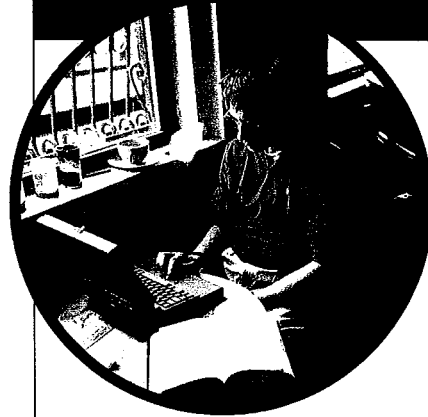


### Fast Review

1. What are the four phases of the business cycle?
2. How does the ripple effect impact the economy?

## Real-World Application

part 4 of 4



### ERAS THAT CHANGED THE ECONOMY

The Cyber Era, 1995–present. The Internet has changed business and consumer behaviors. Business is done anywhere in the world, 24 hours a day.

**How has the Internet changed the way people do business?**

# Chapter 3 Review

## Summary

1. Gross domestic product, the unemployment rate, and the rate of inflation are types of economic measurements. The GDP is the total value of goods and services produced in a country in a given year. When a country produces much more than other countries it has a higher standard of living. The worst kind of unemployment occurs when the entire economy slows down. People in every industry can lose their jobs because there isn't enough work.
2. Inflation occurs when the costs of goods and services rise. When the supply of goods is greater than the demand it can result in deflation. If wages go up, producers raise prices again to pay for the higher wages then this situation might lead to hyperinflation.
3. The four phases of the business cycle are prosperity, recession, depression, and recovery. Prosperity is the peak of economic activity. During a recession, economic activity slows down. A deep recession that affects the entire economy and lasts for several years is called a depression. The rise in business activity after a recession or depression is called a recovery.

## Using Business Key Words

When talking about the business cycle and economic activity, people use the following terms. See how well you know them by matching each term to its definition.

- **gross domestic product (GDP)**
  - **standard of living**
  - **budget deficit**
  - **budget surplus**
  - **national debt**
  - **inflation**
  - **deflation**
  - **business cycle**
  - **depression**
  - **prosperity**
  - **recovery**
  - **recession**
1. The amount of goods and services the average citizen can buy.
  2. Repeated rise and fall of economic activity over time.
  3. A general rise in the prices of goods and services.
  4. Period of severe economic decline.
  5. The monetary value of all the goods and services produced in a country in a given year.
  6. A general decrease in the costs of goods and services.
  7. When the government spends more than it collects in taxes.
  8. A time when economic activity slows down.
  9. The total amount of money a government owes.
  10. The peak of economic activity.
  11. A rise in business activity after a recession or depression.
  12. A situation when a government's revenue exceeds its expenditures during one year.

# Chapter 3 Review

## Review What You Learned

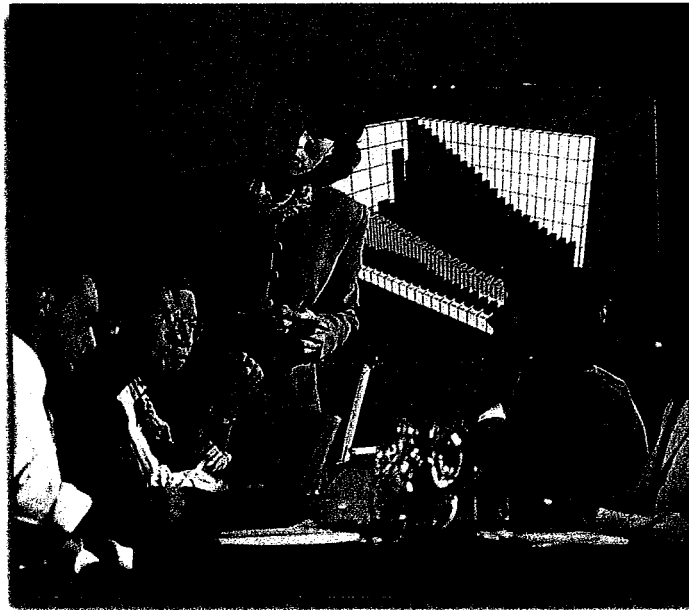
13. What do economic indicators measure?
14. What is one very important measure of a country's economic health?
15. Name three reasons people become unemployed.
16. What do changes in the unemployment rate indicate?
17. Describe hyperinflation.
18. What is the main source of income for the U.S. government?
19. What are the four phases of the business cycle?
20. What is the difference between a recession and a depression?
21. Describe the Industrial Revolution.
22. What was the impact of mass production of cars on other industries?

## Understanding Business Concepts

23. Explain why you think the gross domestic product (GDP) in the United States is very high compared to other countries.
24. If many people in a country were able to afford a few food items and there was a severe housing shortage, would that country have a high or low standard of living? Explain.
25. Suppose you go to the grocery store to buy toothpaste, canned soup, and a loaf of bread. You also consider buying a can of soda, but notice the price is 20 cents higher than it was last week. The prices of the other items seem to be the same as always. Is the soda price increase an example of inflation? Why or why not?
26. Why do you think inflation would be especially difficult for retired people?

## Critical Thinking

27. Do you think it's a good idea for the government to control economic growth when the inflation rate begins to increase? Why or why not?
28. The Internet has revolutionized how people do business. How has it revolutionized school and the teaching and learning process?
29. How would you rate the standard of living for a country in which all the residents have adequate housing, ample food to eat, good medical care, but in which few people have expensive cars, boats, and jewelry?
30. How might knowledge of nationwide economic statistics help you?



## Viewing and Representing

**Examining the Image.** In a group of three, examine the photo and ask one another journalistic questions beginning with the words who, what, where, when, why, and how. Whose point of view is expressed here? How relevant and reliable is this picture? Discuss your reactions to the photograph.

# Chapter 3 Review

## Building Academic Skills

### LANGUAGE ARTS

#### Creating a Poster

In a group of three or four, create the next economic era after the Cyber Era. Describe the inventions, how people will work and go to school, and the impact on the economy. Create a poster that illustrates your new era.

### HISTORY

#### A Historic Figure

Research an American who had an impact on the U.S. economy during the Colonial Era or the Industrial Revolution. Write a two-page paper and share your findings with the class.

### MATH

#### A Graphic Illustration

Choose five products that you purchase frequently. Find out how prices for these products have changed since you were born. Determine if

the rise in price is the result of inflation or other factors. Calculate the percentage of increase or decrease for each product. Present the data graphically.

### COMPUTER TECHNOLOGY

#### Government Databases

The federal government uses many economic indicators to measure how well the economy is doing. Among these indicators are the following: the number of building permits issued, the average workweek for production workers in manufacturing, the number of unfilled orders for durable goods, consumer installment debt, common stock prices, and unemployment claims.

Work in a group of three or four to conduct online research to retrieve government databases of three of these indicators from 1980 to the present. Present the data in chart form and analyze in a brief paragraph what the numbers indicate about the economy.

## Linking School to Home

**Tracking News Stories.** During a two-week period, read the newspaper or watch the national news each day. Be sure to take notes if you're watching television. Write down the news story's crucial points including any key words that you just learned in this chapter. You could also clip and save any newspaper or periodical articles that apply to this assignment. Count how many articles or stories relate to the economy in the United States and in other countries around the world. Select one news story and write a 200-word essay about it.

## Linking School to Work

**Oral History.** Interview a relative or someone in your community who lived through the Great Depression from 1929 to 1939. Find out what he or she remembers about this period in history and how it impacted life. Ask questions about the standard of living at this time. How does it compare to today's economic state? What goods and services weren't available then but are widely used today? Create an oral presentation to share your interview findings with the class. If possible, invite the person you interviewed to attend your presentation.

# Chapter 3 Review

## E-Homework

### Applying Technology

**Finding Trends.** Using the Internet, find the dollar amount of the current national debt. What was it ten years ago? The year you were born? Fifty years ago? Has it gone up or down?

**Web Pages.** Imagine you would like to do business on the Internet. You know what kind of business you want to open. You know how to create a Web page. Using the Internet, research several virtual businesses that might be considered your competition. Evaluate their sites for the following:

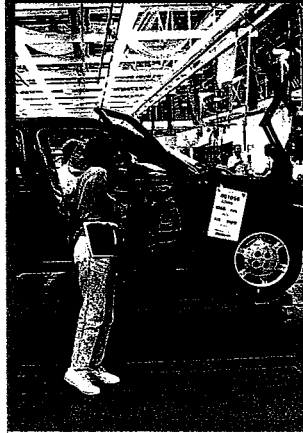
- Is the price of the product clearly defined?
- What process is used to place orders?
- Is the site easy to use and user friendly?

## Connecting Academics

**Math.** Find unemployment statistics for the following years: 1933, 1944, 1955, 1966, 1977, 1988, 1999, and the most recent year for which statistics are available. Present the information in a bar graph. Use computer software if possible. Discuss the reasons for the differences shown in the graph.

**History.** Did economists accurately predict the economic boom in the early '90s? Study economic forecasts one year before March 1991. Did all economists agree on the direction the economy would take? What indicators did economists use to base their predictions? Present a scorecard-type summary of economic forecasters, March 1990 to March 1991.

## BusinessWeek Analyzing the Feature Story



You read the first part of “Moving up the Ladder: From Cheap Labor to Skilled Workers” at the beginning of this chapter. Below are a few questions for you to answer about the article. You’ll find the answers to these ques-

tions when you’re reading the entire article.

First, here are the questions:

31. What economic era is affecting workers in underdeveloped countries? How has it affected them?
32. What helps underdeveloped countries succeed in the global era?

### CREATIVE JOURNAL ACTIVITY

Research another country’s economic system. Write a report discussing which economic eras have influenced it in the past. Predict its future.



### The Full Story

To learn more about globalization, visit the *Introduction to Business* Web site at [www.introbus.glencoe.com](http://www.introbus.glencoe.com), and click on *BusinessWeek* Feature Story, Chapter 3.