

CHAPTER 6

Economic Activity

Sections

6.1 Economic Measurement

6.2 Government and the Economy



College
and Career
Readiness

Reading Prep

Before reading this chapter, flip through the pages and make notes of the major headings. Compare these headings to the objectives. What did you discover? How will this help you prepare to read new material?

Check Your Marketing IQ

Before you begin the chapter, see what you already know about marketing by taking the chapter pretest. The pretest is available at www.g-wlearning.com/marketing/.

DECA Emerging Leaders

Sports and Entertainment Marketing Team Decision-Making Event, Part 2

Career Cluster: Marketing
Instructional Area: Economics

Procedure, Part 2

1. In the previous chapter, you studied the performance indicators for this event.
2. The event will be presented to you through your reading of the Knowledge and Skills Developed, Specific Performance Indicators, and Case Study Situation. You will have up to 30 minutes to review this information and prepare your presentation. You may make notes to use during your presentation.
3. Teams will meet with the judge for a **15-minute** presentation. The team will spend no more than 10 minutes at the beginning of the interview describing the team's analysis of the situation given. Both members of the team must participate in the presentation. The judge will spend the remaining 5 minutes questioning the participants. Each participant must respond to at least one question posed by the judge.
4. Turn in all your notes and event materials when you have completed the event.

Case Study Situation

You are to assume the roles of merchandise managers for Deluxe Linens, a popular brand of luxury bath towels. The **marketing manager (judge)** has asked your team to decide the best way the company should respond to rising cotton prices.

Deluxe Linens was introduced 15 years ago when the economy was soaring and consumers had much more disposable income. The company sells luxury

bath towels made from 100 percent cotton that are known for superior softness and absorbency. Deluxe Linens bath towels are sold in department stores and are moderately priced.

In the last year, continuous bad weather has resulted in smaller cotton crops overseas. Since all textiles worldwide are made from the same cotton crops, all textile companies are competing for the small supply of cotton. This has created a steady increase in cotton prices. Before the year is over, prices for cotton will be more than double the usual price.

Deluxe Linens cannot afford to pay the steep prices for cotton and still sell the merchandise at moderate prices. The marketing manager has come up with two possible solutions to the rise in cotton prices and wants you to determine which is the best option for Deluxe Linens. You can raise the price of Deluxe Linens' bath towels or switch to a less-expensive cotton blend.

Your team will explain which solution you have chosen and the reasoning for the choice to the marketing manager (judge) in a meeting to take place in the marketing manager's office. The marketing manager will begin the meeting by greeting you and asking to hear your ideas. After you have explained your solution and reasoning and have answered the marketing manager's questions, the marketing manager (judge) will conclude the meeting by thanking you for your work.

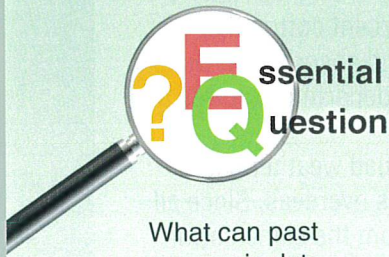
Critical Thinking

1. How does the present economy affect a company's sales strategy?
2. What other option should the marketing manager (judge) consider in response to the rising prices?

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Section 6.1



What can past economic data reveal about the future?

Economic Measurement

Learning Objectives

- LO 6.1-1 Identify common indicators used to measure economic activity.
- LO 6.1-2 Describe the four stages of the business cycle.
- LO 6.1-3 Explain three classifications of economic indicators.

Key Terms

gross domestic product (GDP)
standard of living
inflation
inflation rate
consumer price index (CPI)
deflation
interest
interest rate
labor force

unemployment rate
specialization
stock market
business cycle
expansion
peak
recession
depression
trough

LO 6.1-1 **Economic Indicators**

Economic activity is the production, distribution, and consumption of products. The market forces of supply and demand, the profit motive, and competition influence the economic activity of individuals, businesses, and governments. Businesses respond to these market forces by deciding which goods and services to produce, how much to produce, and at what price. These economic decisions have a direct impact on the activity and health of the economy. A *healthy economy* is one that is experiencing growth through high productivity, a high rate of employment, and stable prices in the market.

The strength of the economy can be measured using certain economic indicators. An *indicator* is a sign that shows the condition or existence of something. Indicators enable individuals, businesses, and governments to make wise economic decisions.

Some of the most widely followed indicators of the economy include gross domestic product (GDP),

inflation, interest rates, labor, and the stock and bond markets.

Gross Domestic Product

Gross domestic product (GDP) is the market value of all final products produced in a country during a specific time period. It is also known as *economic output*. GDP is measured in dollars and is one of the most closely followed economic indicators. GDP is used by the president and Congress to prepare the federal budget. It is used by companies when preparing business plans and sales forecasts. Financial institutions also use GDP as an indicator of economic activity, which can affect consumer interest rates.

Per capita GDP is the GDP of a nation divided by its population. It shows the amount of economic output for each person in the country. When per capita GDP is high, there is more economic output per person. When per capita GDP is low, there is less economic output per person. This may indicate the economy is suffering.

Per capita GDP is one way to measure a country's standard of living. **Standard of living** refers

to the financial well-being of the average person in a country. One of the goals of a government is to increase the standard of living for its citizens.

Measuring the standard of living with per capita GDP has some drawbacks. Per capita GDP does not consider quality-of-life factors, such as health, safety, environmental concerns, and political freedom. These factors are important, but are difficult to measure.

Measuring GDP

One way to measure GDP is to add together the total amounts of money spent in the economy in each of the following categories: consumer spending, business spending, government spending, and net exports. These four categories are shown in the graph in Figure 6-1.

Consumer spending includes everything people buy for personal use, such as food, clothing, cars, medical care, and entertainment. It is considered an economic indicator because the rate of consumer spending is linked to the health of the economy. When consumer spending is high, economic growth is often strong. If consumer spending is low, the economy tends to be weak.

Business spending includes all purchases made for capital goods and construction. These may include factories, machines, and warehouses. Business spending is also called *investment spending*.

Government spending includes spending by national, state, and local governments. The



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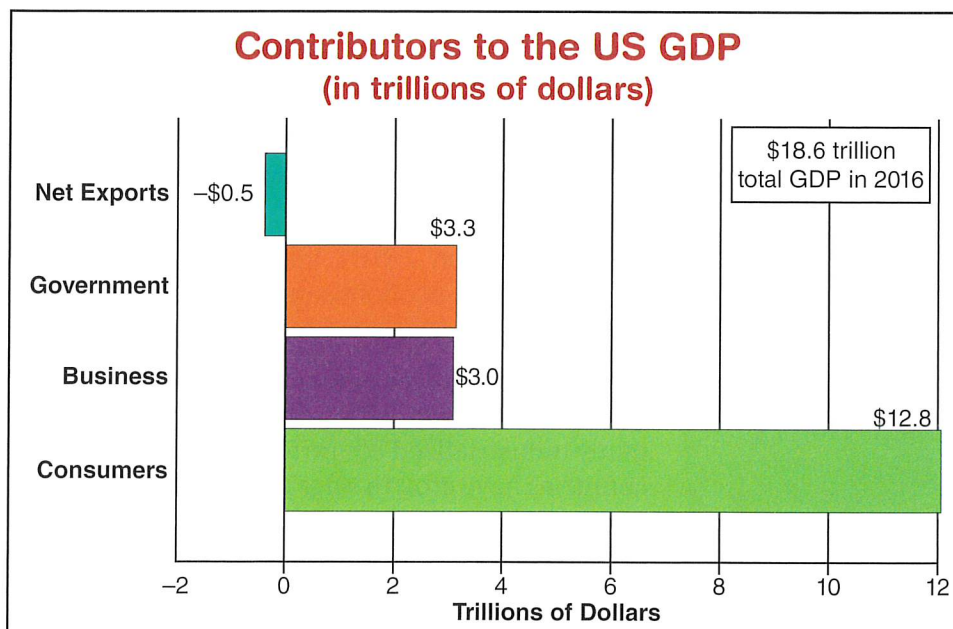
Business spending includes all purchases made for capital goods, such as factories, machines, and warehouses. *How does business spending contribute to the overall economy?*

government spends on projects and services, such as national defense, police and fire protection, roads, and many social programs.

Net exports are a country's exports minus imports. If a country imports more goods and services than it exports, it is spending more on trade than it is earning.

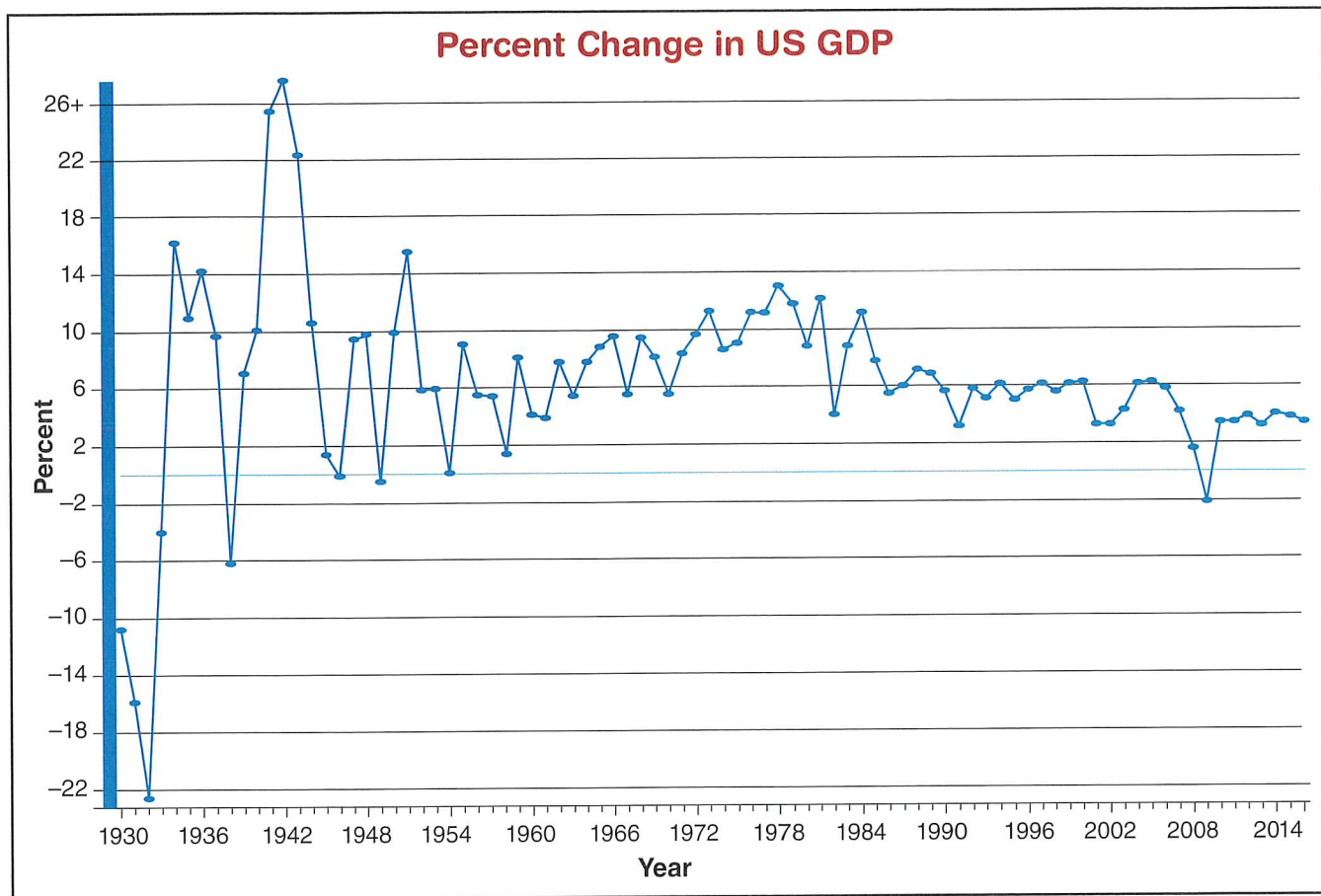
Growth Rate of GDP

GDP changes over time, as referenced in the graph in Figure 6-2. The *economic growth rate* shows the amount and direction of the change in



Source: US Bureau of Economic Analysis; Goodheart-Willcox Publisher

Figure 6-1 The GDP includes consumer, business, and government spending, as well as net exports.



Source: US Bureau of Economic Analysis; Goodheart-Willcox Publisher

Figure 6-2 The GDP changes from year to year. It can rise, fall, or be negative, depending on consumer, business, and government spending for that year.

GDP for a specific time period, such as a quarter or year. When GDP is rising, the economy is growing. When GDP growth is above average, it indicates a strong economy. When the rate of GDP growth is below average, it is a sign that the economy is weakening. Sometimes economic growth turns

negative and GDP falls, which can indicate a recession.

The formula for growth rate of the economy, which is a rate of change, is as follows.

$$\frac{[(\text{GDP for time 2} - \text{GDP for time 1}) \div \text{GDP time 1}] \times 100 = \text{economic growth rate}}$$

For example, GDP was \$18.6 trillion for 2016 and \$18.0 trillion for 2015. The growth rate in 2016 was 3.3 percent.

$$\frac{[(\$18.6 \text{ trillion} - \$18.0 \text{ trillion}) \div \$18.0 \text{ trillion}] \times 100 = 3.3\% \text{ economic growth rate}}$$

In the United States, economic growth has averaged about three percent a year since 1929, excluding inflation. This is the range of growth for many industrialized countries. Many fast-growing countries have growth rates that are higher.

Inflation

Inflation is the general rise in prices throughout an economy. The most significant



Employability Skills

Emotional Control

Emotional control is the process of directing one's feelings and reactions toward a desirable result that is socially acceptable. The lack of emotional control in a workplace situation can cost an individual his or her job. Learning how to manage emotions helps a person think logically and act appropriately.

effect of inflation is that it reduces the purchasing power of money. **Inflation rate** is calculated as the rate of change in prices over a period of time, usually monthly or yearly, and expressed as a percent. The economic impact of inflation can be significant because it affects business costs and consumer spending.

When inflation is at an average or lower rate, prices are stable. *Price stability* is when the prices of products in the marketplace are changing very slowly or not at all. This is reflected as an inflation rate of about zero to three percent. Price stability is usually considered good for the economy because lower inflation leads to lower interest rates, which makes borrowing money less expensive. Price stability also makes financial planning easier because wages tend to keep up with prices better.

In contrast, economic problems begin when inflation rates increase to four percent or higher. High inflation leads to higher interest rates, which make borrowing money more expensive. It also disrupts the financial planning of workers because prices rise faster than wages. High inflation generally adds uncertainty to an economy.

There are several indicators of inflation, but the consumer price index is the most widely used. The **consumer price index (CPI)** is a measure of the average change in the prices paid by consumers for typical consumer goods and services over time. The CPI is compiled by the US Bureau of Labor Statistics.

Inflation can be divided into four levels: low to average, high, severe, and hyperinflation, as shown in Figure 6-3. Each level is based on the inflation rate. Severe inflation is also called *double-digit inflation*. Inflation in the United States has averaged around three percent annually over the past 100 years. *Hyperinflation* is an extremely rapid, out-of-control rise in inflation. A country's currency is severely devalued by hyperinflation. The United States has never experienced hyperinflation.

Deflation is a general decline in prices throughout an economy. It is the opposite of inflation. This situation usually occurs when the economy is very weak. The last time there was significant deflation in the United States was during the Great Depression in the 1930s.

Interest Rates

Interest is the amount a borrower pays to a lender for a loan. An **interest rate** represents the cost of a loan and is expressed as a percent of the amount

Levels of Inflation		
Level	Inflation Rate	Effect on Economy
Low to average	0% to 3%	Good. Economy and prices are stable.
High	4% to 9%	Some problems. Prices begin rising faster than wages. Purchasing power falls.
Severe (double-digit)	10% or higher	Economic problems increase. Purchasing power falls more quickly.
Hyper-inflation	Over 1,000%	Occurs rarely, but destroys the value of money and the economy. One of the most well-known instances of hyperinflation occurred in Germany after World War I.

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Figure 6-3 The terms for inflation levels are usually applied to changes that occur on a month-to-month or year-to-year basis.

borrowed. Many different interest rates can be found in an economy because there are many different borrowers, lenders, and types of loans. Borrowers can be consumers, businesses, and governmental agencies. Lenders include banks, finance companies, and investors. Loans are made in the form of home mortgages, auto loans, student loans, business loans, and for other purposes.

The interest rate on a loan is determined by the forces of supply and demand. An increase in demand to borrow money tends to increase interest rates. Interest rates usually decrease when the demand for loans falls. As a result, interest rates typically rise when the economy is strong and there is more demand to borrow money to buy various goods and services. Interest rates often decline when the economy is weak and there is less demand to borrow money.

An increase in the supply of money available for lending may also lower interest rates. The supply is influenced by the amount of money that is saved in an economy and made available for loans. The government can change the supply of money to influence interest rates.

Labor

All the people in a nation who are capable of working and want to work are called the **labor force**. It does not include children, individuals who



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All people in a nation who are capable of working and want to work are included in the labor force. *Who of your family and friends is a part of the labor force?*

are retired, or people who choose not to work. The total labor force includes civilian workers as well as those who are in the military.

Labor is important in an economy. Without labor, goods and services would not be available. Those who provide labor receive wages. Workers spend their wages on goods and services, which supports businesses and economic activity.

Unemployment Rate

The civilian labor force is divided into two categories: employed and unemployed. *Employed* includes everyone who is working. *Unemployed* includes those who do not have a job, but are actively looking for one. The **unemployment rate**

is the percentage of the civilian labor force that is unemployed.

If every person who is willing and able to work has a job, the economy would be at *full employment*. Interestingly, even when the economy is considered to be at full employment, the unemployment rate is still about four percent. This is because there are always people who are not working for many different reasons. They may be entering or reentering the workforce or may be between jobs.

An unemployment rate between four and five percent indicates a healthy economy. An unemployment rate above this level indicates a weakening economy because it means businesses are not hiring or are eliminating part of their labor force. Higher levels of unemployment cause consumer spending to weaken, which reduces the rate of economic growth.

Productivity

Productivity is a measure of a worker's production in a specific amount of time, such as an hour, a day, or a week. The more a worker produces in the amount of time specified, the higher his or her productivity. Higher productivity means more products can be produced at the same cost, often in a shorter amount of time. It also means fewer workers are needed, so employers have lower costs. This, in turn, generally results in more profit. More profit enables companies to reinvest more money in their businesses.

Productivity can also lead to a higher standard of living for consumers. When the selection of products is greater, individuals have more choices when making purchase decisions.



Green Marketing

Greenwashing

Many companies promote their environmentally friendly products and initiatives. However, some companies that promote themselves as green businesses do not actually follow environmentally conscious practices. This type of deception is called *greenwashing*. Businesses that implement greenwashing marketing tactics intend to benefit from the positive image of being an environmentally friendly company without the expense of implementing green initiatives.

The Federal Trade Commission issued the *Green Guides* to address the public need of validating eco-friendly claims. The publication provides guidance for marketers, including general principles that apply to all environmental marketing claims, understanding how consumers interpret particular claims, how companies can substantiate claims, and how marketers can avoid deceiving consumers.



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When the selection of products is greater, individuals have more choices. *How do you think product selection is related to a nation's standard of living?*

Businesses are always looking for ways to increase productivity that will also increase profitability. One way to increase productivity is to increase efficiency through specialization.

Specialization is focusing on the production of specific goods so more products can be produced with the same amount of labor. Specialization is often centered on the factors of production. Nations typically specialize in products for which they have the resources and talent to produce. Trying to produce all the products to meet all the needs of every consumer is not always efficient or profitable.

Specialization can also apply to labor. Henry Ford was one of the first to apply specialization in his company by using the assembly line. Before the assembly line, ten Ford workers produced ten cars in a day. With an assembly line, each worker specialized in one-tenth of the car's assembly. Work was much more efficient, and the same ten workers produced thirty cars in a day.

Stock and Bond Markets

The **stock market** is a system and marketplace for buying and selling stocks. A *stock* represents

the right of ownership in a corporation. Ownership of a corporation is divided into *shares*. Each share represents a partial ownership. Buying partial ownership in a corporation is a form of investment. People who buy shares of stock in a company are called *stockholders* or *shareholders*.

When the value of the stock market increases, it indicates the value of businesses is rising. Investors make decisions based on their expectations of economic growth and profits for a corporation. As a result, they often buy stock when they think the economy will get stronger. This sends the value of the stock market higher.

A falling stock market means the market value of businesses is falling. Investors tend to sell stocks when they think the economy will get weaker. This sends the value of the stock market lower.

The values in stock markets continually go up and down and do not always reflect the actual state of an economy. History has shown that stock markets tend to peak right before a downturn in the economy. However, nobody really knows when a market has reached its peak. As a result, many investors are surprised when stock markets fall.

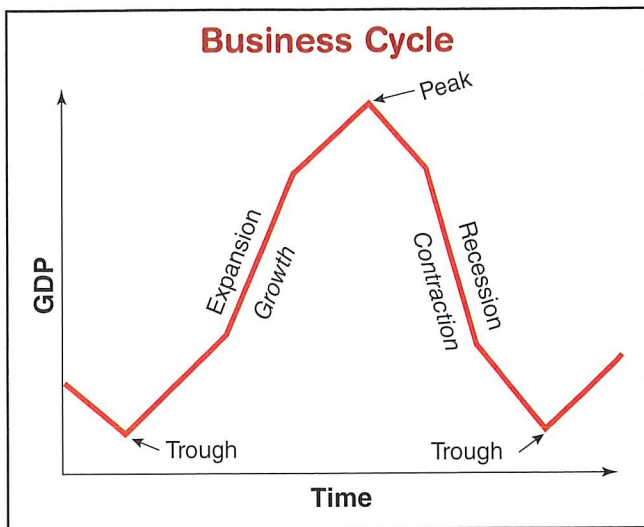
A **bond** is a certificate of debt issued by an organization or government. Corporations and governments issue bonds to borrow large amounts of money. The bonds are sold to investors, who are essentially the lenders to corporations and governments. Bondholders are paid interest for the use of their money.

Bonds can be traded in a market among investors after they are issued. *Trading* means to buy or sell. There are markets for various corporate and government bonds. The largest market is for bonds issued by the US government. The interest rates in the bond markets can change every day. Rising rates tend to reflect a stronger economy. Lower rates tend to reflect a weaker economy.

LO
6.1-2

Business Cycle

The economy of the United States has been very successful and experienced growth over many years. However, the economy does not grow at the same rate each year. In some years, the economy and GDP grow by more than the average amount. At other times, they grow less than the average amount or may even decline. These alternating periods of expansion and contraction in the economy are called the **business cycle**.



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Figure 6-4 A single business cycle includes all the economic activity from the beginning of one trough to the next.

There are four stages of the business cycle: expansion, peak, recession, and trough. Each stage can vary in length. The graph in Figure 6-4 illustrates the cyclical movement in our economy. Understanding these stages helps individuals, businesses, and governments make better economic decisions.

Expansion

Economic **expansion** is a period in which the economy is growing and the GDP is rising. It usually begins with an increase in consumer demand for goods and services. Businesses react to expansion by increasing production and hiring more workers. During an expansion, wages also begin to increase. More workers and higher wages produce an even greater demand for goods and services. Inflation tends to increase during periods of economic expansion because increased consumer demand forces prices to rise. Many individuals and businesses prosper during periods of expansion. *Prosperity* is a time period of growth and financial well-being. The expansion phase impacts the economy by fueling widespread growth in many parts of the country.

Peak

The **peak** is the highest point in the business cycle and marks the end of expansion. At this point, consumer demand for goods and services

starts to slow. Businesses react by reducing production and workers. Wage growth tends to slow or stop. Overall economic growth slows. Economic expansion may end for a reason that is obvious. One example of this is the Great Recession of 2008, which started with a financial crisis and housing market collapse. Other times, the reason for the end of expansion is not clear.

Recession

Recession follows a peak in the business cycle. **Recession** is a period of significant decline in the total output, income, employment, and trade in an economy. It usually lasts from twelve to eighteen months, but may be less. The recession phase impacts the economy by causing a widespread *contraction*, or decline, in many parts of the country. The inflation rate tends to decline during a recession. Falling consumer demand forces many businesses to lower prices. In addition, wages fall as businesses cut back on hiring.

A period of economic contraction that is severe and lasts a long time is called a **depression**. The last period of depression in the United States was from 1929 to 1940. During this time, many banks failed, unemployment reached over 20 percent, many people lost their homes, and there was widespread poverty. The causes of the Great Depression are still debated by economists. However, some reasons include the crash of stock prices, a decline in business spending, and a reduction in the money supply.



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During economic expansion, the economy is growing and consumer demand for goods increases. *What are other signs of prosperity during periods of economic expansion?*

Trough

A **trough** is the lowest stage of a business cycle and marks the end of a recession. The period of expansion that follows a trough is called *economic recovery*. The reasons a recession comes to an end are not always clear. However, the economy begins to grow again and is fueled by increased consumer demand for goods and services. The business cycle continues again into another period of expansion.

LO
6.1-3

Economic Indicators and the Business Cycle

Economic indicators can provide information about which stage of the business cycle an economy is in and the stage that is coming next. This information can be valuable when making marketing decisions.

The relationship between different economic indicators and the business cycle is not always the same. As a result, indicators are commonly classified as being leading, lagging, or coincident.

- A *leading indicator* is one that changes *before* a change in economic activity.
- A *lagging indicator* is one that changes *after* a change in economic activity.
- A *coincident indicator* is one that changes *at the same time* as a change in economic activity.

Some important indicators that are widely used when analyzing the business cycle include GDP, inflation rate, unemployment rate, and the stock market.

GDP

GDP is a coincident indicator of economic activity. When GDP is rising and the growth rate is increasing, it is a sign of economic expansion. Recall that the average growth rate of real GDP has been about three percent over the long term. When GDP is growing faster than average, the economy is strong. The economy is weakening when the rate of GDP growth is declining and falling below average. When GDP growth turns negative, it signals a recession.

Inflation Rate

The inflation rate is also considered a coincident indicator of economic activity. The inflation rate generally tends to rise during an economic expansion. This happens because increased consumer demand forces prices higher. In addition, more hiring during an expansion also tends to increase overall wages. Conversely, the inflation rate generally tends to decline during a recession. This is because consumer demand falls, which tends to lower prices. In addition, workforce cuts during a contraction also tend to decrease overall wages.

Unemployment Rate

The unemployment rate is a lagging indicator of economic activity. An economic expansion usually begins with rising consumer demand for goods and services. Businesses then respond by increasing production and eventually hiring more workers. The unemployment rate declines, but not until after the expansion has been underway for around six to nine months. During a recession, the



You Do the Math

Types of Numbers

An effective marketing manager realizes that information needed to make strategic decisions involves understanding numbers. *Real numbers* are all whole and fractional or decimal numbers on a continuous number line. *Whole numbers* are numbers with no fractional or decimal portion. *Decimals* are numbers with digits to the right of the decimal point.

To add a positive number, move to the right on the number line. To subtract a positive number, move to the left on the number line.

Solve the following problems.

1. $5.87 + 4.956 + 2.011 + 4 =$
2. $34 + 9 - 127 + 783 =$
3. $112.058 + 2.1 + 93.237 =$
4. $987 + 705 + 827 + 4 =$
5. $73 + 8 - 12 =$

unemployment rate rises, but not until after the contraction has started and been underway for a while.

This lagging relationship was evident during the Great Recession. Real GDP declined in the first quarter of 2008, but the unemployment rate remained steady at about five percent during that period. The unemployment rate eventually increased to 5.4 percent in the second quarter of 2008. It continued to rise and eventually peaked at 10 percent. However, the peak occurred in October 2009, about four months after the recession had ended, according to the National Bureau of Economic Research (NBER).

Stock Market

The stock market is considered by many to be a leading indicator of economic activity. This is because investors make decisions based on what they believe will happen in the future. As a result, changing stock prices reflect expectations for changes in economic activity. Many believe a rising stock market will lead an economic expansion and a falling stock market will lead a contraction.

This leading relationship was also evident during the Great Recession. The stock market reached a peak in late October 2007. It began to decline a few months before the recession actually started. The stock market eventually dropped over 40 percent. It troughed in early March 2009, and then started recovering about three months before the recession ended.



Robert Lucian Crusitu/Shutterstock.com

The stock market is considered by many to be a *leading indicator* of economic activity. *What do you know about the stock market?*

Section 6.1 Review

Check Your Understanding

1. What is a healthy economy?
2. State the most significant effect of rising inflation.
3. What is per capita GDP and what does it show?
4. What is meant by *full employment*?
5. Name the type of economic indicator that changes *after* a change in economic activity.

Build Your Vocabulary

As you progress through this text, 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 them to your personal glossary.

business cycle
consumer price index (CPI)
deflation
depression
expansion
gross domestic product (GDP)
inflation
inflation rate
interest

interest rate
labor force
peak
recession
specialization
standard of living
stock market
trough
unemployment rate

Section 6.2



Why do governments exist in our society?

Government and the Economy

Learning Objectives

LO 6.2-1 Describe four basic market structures.

LO 6.2-2 Identify the role of government in the US economy.

Key Terms

market structure

monopoly

oligopoly

monopolistic competition

perfect competition

price competition

nonprice competition

fiscal policy

monetary policy

Federal Reserve System

money supply

price-fixing

collusion

externality

LO
6.2-1

Market Structure

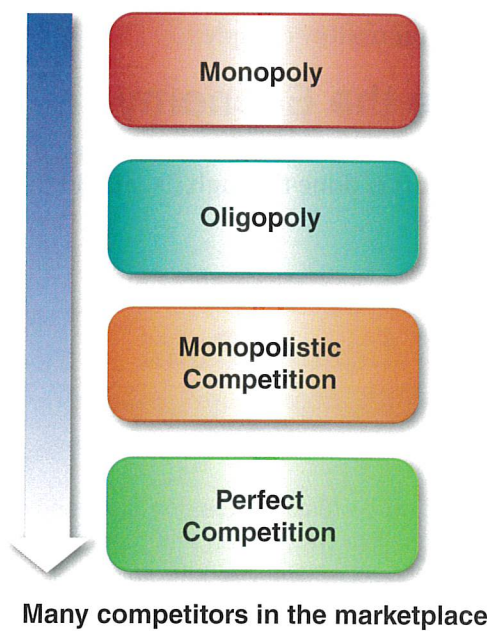
Market structure is how a market is organized based on the number of businesses competing for sales in an industry. Competition is a critical force in a free-enterprise system. As shown in Figure 6-5, there are four basic market structures that represent varying degrees of competition.

- A **monopoly** is a market structure with one business that has complete control of a market's entire supply of a product.
- An **oligopoly** is a market structure with a small number of businesses selling the same or similar products.
- **Monopolistic competition** is a large number of businesses selling similar, but not the same, products and at different prices. This is also known as *imperfect competition*.
- **Perfect competition** is characterized by a large number of businesses selling the same product at the same prices.

Most businesses operate in a market structure of monopolistic competition. Each business competes for customers using price or nonprice competition.

Basic Market Structures

No competitors in the marketplace



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Figure 6-5 Four basic market structures represent various levels of competition in an economy.

Price competition is when a lower price is the main reason for customers to buy from one business over another. Although lowering prices may attract more customers, it could also reduce total profit. **Nonprice competition** is when strategies other than price are used to attract customers. These might include things like better quality or customer service or more convenience.

LO
6.2-2

Role of Government in the US Economy

Even a free-enterprise system needs government involvement to function efficiently. First, the government acts as a *regulator*. It creates and enforces laws that protect liberties and private property rights. It also provides political stability.

Second, the government acts as a *provider*. It makes goods and services available for the public's benefit in various areas, such as safety, education, and welfare programs. Examples of specific roles the government plays in the operation of our economy include:

- manage the economy;
- provide public goods and services;
- provide a legal framework;
- promote competition; and
- correct for externalities.

Governmental policies are intended to help a free-enterprise system operate in an efficient manner. However, these policies are difficult to implement and not always successful because the economy is incredibly complex.

Manage the Economy

The government takes a role to manage the economy. This is done through fiscal and monetary policies.



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As a *regulator*, the government creates and enforces laws. *In what ways does the government regulate aspects of your life?*

Fiscal Policy

Fiscal policy is the tax spending decisions made by the president and Congress. 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. For example, the government may choose to lower taxes during an economic contraction. This would give people more money to spend and may reduce the impact of a sharp fall in the economy. However, consumers and businesses may choose to save the money from lower taxes instead of spending it. Fiscal policy is the decision made by the government, but the action taken by the people can be unpredictable.

Monetary Policy

Monetary policy is policy that regulates the supply of money and interest rates by a central bank in an economy. The **Federal Reserve System** is the central bank of the United States, created



Case in Point

Hyundai

Marketing professionals study business cycles to help determine strategies to which consumers will react in a positive way. When the economy is stable, consumers are more willing to spend more money. When the economy is in a slump, though, consumers may not be willing or able to spend. However, businesses must continue generating revenue through all business cycles.

Hyundai Motor Company is a good example of how a business can generate sales in a slow economy by using creative marketing techniques. The auto industry suffered losses during the Great Recession. To keep sales moving during this slow economic period, Hyundai introduced an innovative sales program. The company advertised that buyers could purchase a new car and return the vehicle within a year if they lost their jobs—with no questions asked. Through a consumer-oriented marketing program, Hyundai strengthened its image and kept sales stable.

by Congress in 1913. It carries out the nation's monetary policy "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." The Federal Reserve, also called the *Fed*, looks at many economic indicators to evaluate the condition of the economy.

When the economy is slow or weak, the Fed may take action to increase the money supply and lower interest rates. **Money supply** is the total money circulating at any one time in a country. It includes both cash and money in the bank. Lower interest rates make borrowing money easier, which may encourage consumers and businesses to spend more. When more money is spent, the economy grows faster.

If the economy is growing too fast, the Federal Reserve can take action to slow the economy and avoid inflation. When the demand for goods and services grows faster than the supply, inflation can increase. Higher interest rates make borrowing money more expensive. As a result, individuals and businesses become more cautious about spending, and demand is reduced.

Provide Public Goods and Services

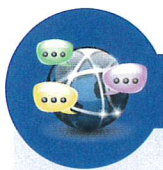
The government provides certain public goods and services that are available to everyone in the economy. Governmental agencies collect taxes to pay for these goods and services. Public education is an example of a public service provided by the government. A nation benefits when its population is well educated. This can result in a society that

is generally more productive and stable. However, education is expensive. If private schools were the only options, few people could afford the cost of education. Other public services include construction and maintenance of roads, police and fire protection, postal services, and public parks.

The main motives in a market economy are money and profit. People who have money can buy what they need and want. However, people with little money may struggle to meet basic needs. The government has developed social programs to offer goods and services to citizens in need. Medicare and Social Security are among the largest social programs that benefit retirees and the disabled. Unemployment compensation provides some money to workers who have lost their jobs. The Federal Emergency Management Agency (FEMA) provides relief to victims of disasters, such as hurricanes and earthquakes. There are many other programs at the federal, state, and local levels.

Provide a Legal Framework

A legal framework is necessary for a market economy to function. Laws are needed to define and enforce property rights and provide for public safety. They establish boundaries and define acceptable behavior. They help protect individuals and businesses from dishonest business practices. Laws are made and enforced at all levels of government. Criminal laws define conduct that threatens public safety and outlines punishment for such acts. Civil laws define conduct between individuals in situations such as contracts and property.



Social Media

SMM Terms

There are many SMM terms that are necessary for a marketer to know and understand. The list is always growing, so it is important to stay current. Some examples are:

- OLA: online advertising
- engagement rate: measure of social media users interacting with your social media
- PTAT: people talking about this
- trending: a word or topic that is popular at any given minute
- impression: how many times a post has been displayed
- CTA: call to action
- conversion rate: how many people are acting on the call to action

Keeping on top of new terms and learning the proper way to use social media is a priority for social-media marketing.

Federal Antitrust Laws	
Sherman Antitrust Act (1890)	This act supports fair commerce and trade by making the formation of monopolies and agreements to practice price fixing illegal. Violations of this act are punishable as criminal felonies.
Clayton Antitrust Act (1914)	This act helps prevent the formation of monopolies that will reduce competition. Businesses planning a merger or acquisition must notify the Department of Justice Antitrust Division and the Federal Trade Commission.
Federal Trade Commission Act (1914)	This act prohibits unfair competition in interstate commerce. It also created the Federal Trade Commission to oversee related business activity.

Source: US Department of Justice; Goodheart-Willcox Publisher

Figure 6-6 Federal antitrust laws are enforced by departments of the federal government. Individual states also enforce their own antitrust laws.

Promote Competition

The United States has laws to ensure that markets are competitive, open, and fair. *Antitrust laws* promote fair trade, open markets, and competition among businesses. These laws have been established to prevent monopolies and unfair pricing and business practices. **Price-fixing** occurs when two or more businesses in an industry agree to sell the same product or service at a set price. This practice eliminates price competition. When two or more businesses work together to remove their competition, set prices, and control distribution, it is called **collusion**.

There are three major federal antitrust laws: Sherman Antitrust Act, Clayton Antitrust Act, and

Federal Trade Commission Act. These three laws are shown in Figure 6-6. The US Department of Justice and the Federal Trade Commission enforce antitrust laws in the US economy.

Correct for Externalities

An **externality** is something that is not directly connected to an economic activity, but that affects people. For example, emissions from a factory can be harmful to those living close to the business. It can cause problems for those who inhale the fumes. Controlling emissions is not an economic activity. However, the government can impose fines and taxes on industries to reduce this type of externality.

Section 6.2 Review

Check Your Understanding

1. Which market structure is characterized by a large number of businesses selling similar, but not the same, products and at different prices?
2. Distinguish between price and nonprice competition.
3. How does the government manage the economy?
4. What two major policies are used by the government to manage the economy?
5. Name one antitrust law.

Build Your Vocabulary

As you progress through this text, 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 them to your personal glossary.

collusion
externality
Federal Reserve System
fiscal policy
market structure

monetary policy
money supply
monopolistic competition
monopoly
nonprice competition

oligopoly
perfect competition
price competition
price-fixing

Chapter Summary

Section 6.1 Economic Measurement

LO 6.1-1 Identify common indicators used to measure economic activity.

Various economic measurements are used to analyze the economy. They include gross domestic product (GDP), inflation, interest rates, unemployment rate, and the stock and bond markets.

LO 6.1-2 Describe the four stages of the business cycle.

Alternating periods of expansion and contraction in the economy are called the business cycle. Expansion is when the economy is growing and the GDP is rising. Peak marks the end of expansion and is the highest point in the cycle. Recession is a significant decline in the economy. A trough is the lowest stage of the cycle and marks the end of a recession.

LO 6.1-3 Explain three classifications of economic indicators.

Economic indicators can provide information about which stage of the business cycle an economy is in and the stage that is coming next. A leading indicator changes before a change in economic activity. A lagging indicator changes after a change in economic activity. A coincident indicator changes at the same time as changes in economic activity.

Section 6.2 Government and the Economy

LO 6.2-1 Describe four basic market structures.

Market structure is how businesses are organized in an industry to compete for sales and profit. Four basic market structures represent varying degrees of competition.

A monopoly is the least competitive structure, followed by oligopoly, monopolistic competition, and perfect competition.

LO 6.2-2 Identify the role of government in the US economy.

The government acts as both a regulator and provider of public goods and services to help our free-enterprise system operate in an efficient manner. The government manages the economy, provides public goods and services, provides a legal framework, promotes competition, and corrects for externalities.

Check Your Marketing IQ

Now that you have completed the chapter, see what you have learned about marketing by taking the chapter posttest. The posttest is available at www.g-wlearning.com/marketing/.

Review Your Knowledge

1. Identify common indicators used to measure economic activity.
2. Interpret the measure of consumer spending as an economic indicator.
3. Describe the concept of price stability as an economic measure.
4. Describe the four stages of the business cycle.
5. Explain three classifications of economic indicators.
6. Describe four basic market structures.
7. Identify the role of government in the US economy.
8. Describe the role of the Federal Reserve System.
9. What is the purpose of antitrust laws?
10. Provide an example of an externality.

Apply Your Knowledge

1. Identify examples of economic measurements used to analyze the economy. How do these measurements relate to the marketing process for the marketing plan you are writing?
2. How can the current GDP be useful information for a marketing manager?
3. How might the inflation rate influence your decision to market a product? Consider both high and low inflation.
4. How might your marketing plan for a product be impacted during a period of high inflation, when costs are increasing rapidly?
5. Do you think it is a better strategy to increase profits by increasing productivity or decreasing expenses? Briefly explain.
6. How might your marketing strategy differ if you try to increase sales by encouraging current customers to buy more, instead of attracting new customers?
7. Create a graphic illustration of the business cycle that includes each stage using the information in this chapter as a basis. Describe the condition of the economy during each stage of the business cycle. Cite examples of how the business for which you are creating a marketing plan might benefit during each phase.
8. Explain how marketing strategies differ in the recession phase of a business cycle instead of the expansion phase. Then, explain how marketing strategies differ in the expansion phase versus the recession phase.
9. Provide five nonprice examples of ways the business you have chosen can compete for customers in the marketplace.
10. Discuss the importance of public goods and services on your local economy. How might these affect your decisions for marketing a product?

Apply Your Math Skills

When making marketing decisions that impact the business, the economic growth rate is useful for planning purposes. Use the formula for economic growth rate to perform the calculations that follow.

$$[(\text{GDP for time 2} - \text{GDP for time 1}) \div \text{GDP time 1}] \times 100 = \text{economic growth rate}$$

1. Assume GDP was \$19.5 trillion in a recent year. It was \$19.0 trillion the year before. What was the economic growth rate?
2. Suppose GDP grows to \$20.5 trillion, compared to \$19.5 trillion. What will be the economic growth between these two years?

Communication Skills



**College
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Reading Analyze the quality of the illustrations presented in this chapter. Is the information coherent? Is concrete evidence presented? Note any changes you would make to specific figures.

Writing To become career ready, it is important to learn how to communicate clearly and effectively using reasoning. Using the information in this chapter, write a summary of your assessment of the role of government in a free-enterprise system.

Listening Active listening is fully participating as you process what a person says. Active listeners know when to comment and when to remain silent. Use active listening skills while your instructor presents this chapter. Participate in the discussion by making relevant comments when appropriate and build on the instructor's ideas by asking related questions.

Internet Research

Economic Indicators Search the Internet for the current information on GDP, standard of living, inflation rate, interest rate, unemployment rate, productivity, stock market reports, and CPI in the United States. What do these figures indicate about the overall economic health of US markets? Explain how these economic indicators are used in a market economy by businesses, government, and individuals for business analysis and marketing decisions.

Role of Government in the Free-Enterprise System Using the Internet, research the *role of government in the free-enterprise system*. How does the information you learned in this chapter help support your research?

Federal Worker Protection Use online resources to identify a federal regulatory agency or law that was developed to protect workers. Summarize the events that led to the creation of this agency or law. Include your thoughts on how the existence of this agency or law might impact both domestic and foreign trade.

Teamwork

Together with your team, discuss how businesses, governments, and individuals are connected. Determine the relationship between these entities in the current economic climate of your state and country. Make notes on the key points your team discusses.

Portfolio Development



**College
and Career
Readiness**

Digital Presentation Options

Before you begin collecting items for a digital portfolio, you will need to decide how you are going to present the final product. This will dictate file naming conventions and file structure. There are many creative ways to present a digital portfolio.

One option is to create an electronic presentation with slides for each item. The slides could have links to documents, videos, graphics, or sound files.

Websites are another option for presenting a digital portfolio. You could create a personal website to host the files and have a main page with links to various sections. Each section page could have links to pages with your documents, videos, graphics, or sound files. (Be sure you read and understand the user agreement for any site on which you place your materials.)

Another option is to place the files on a CD. The method you choose should allow the viewer to easily navigate and find items.

1. Establish the types of technology that are available for you to create a digital portfolio. Will you have access to cameras or studios? Do you have the level of skill to create a website?
2. Decide the type of presentation you will use. Research what will be needed to create the final portfolio product.