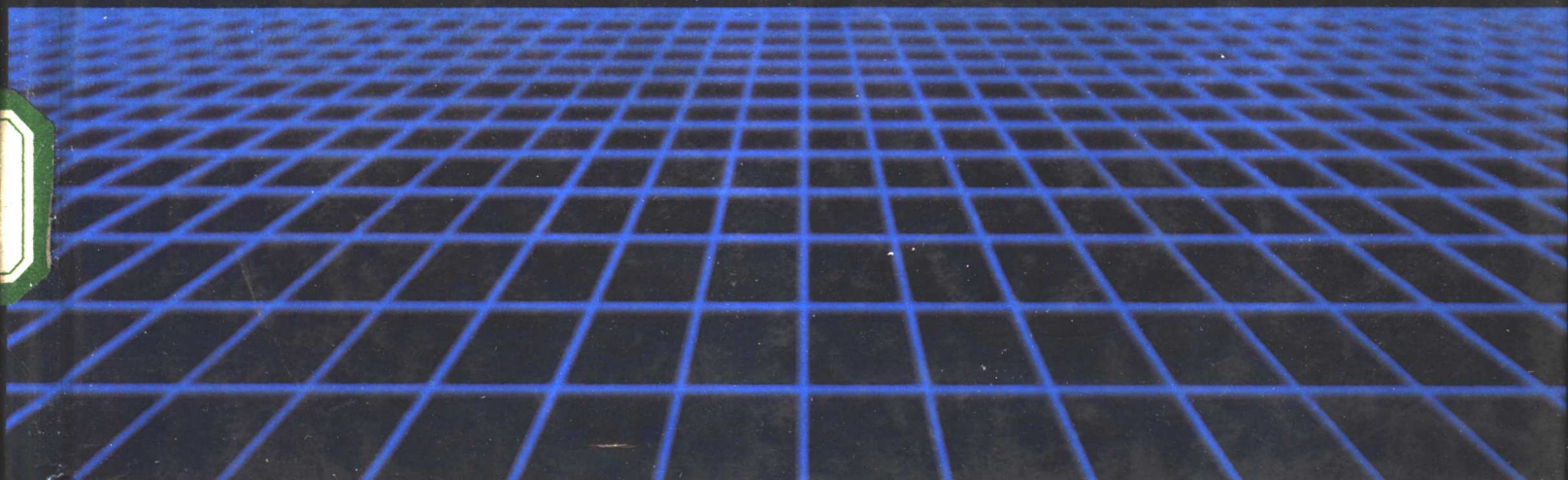
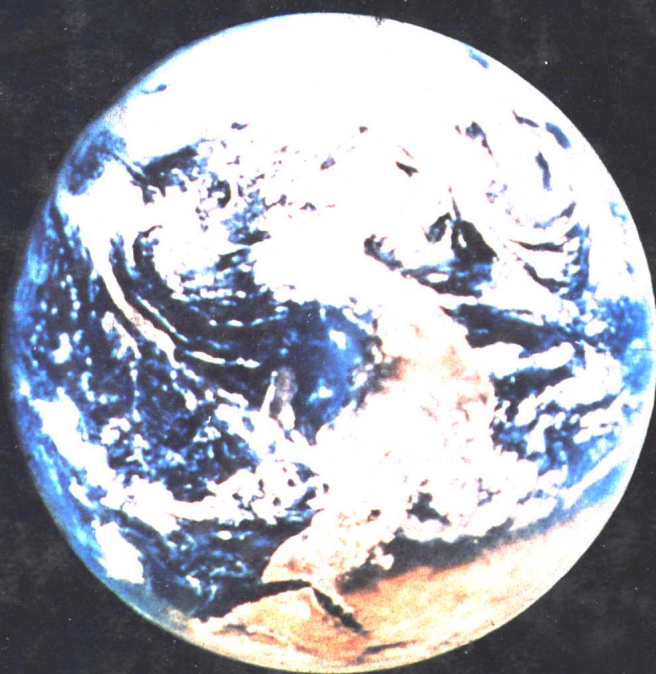


# UNDERSTANDING ECONOMICS



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**RANDOM HOUSE SCHOOL DIVISION / NEW YORK**

## DEDICATION

*To my wife, Deanna, and to our children,  
Mark, Mike, and Lisa, for their support  
and patience during the writing of this book.*

*Project Editor:* Lauren Fedorko

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*Manufacturing Supervisor:* Lenore Zani

*Text Design and Production:* Dimensions and Directions Ltd.

*Photo Research:* Helena Frost / Dana Cooper

*Cover Design:* Thomas Vroman Associates, Inc.

*Cover Photo:* © Allen Lee Page, The Stock Market

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Data on charts and graphs updated 1988.

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ISBN 0-676-39629-1

Manufactured in the United States of America

# The Features of Your Textbook

*Understanding Economics* presents the key concepts of economics in a logical and meaningful order. To help you focus on those concepts, each unit and each chapter contain a number of distinctive features. Together, these study aids will help you look at problems in an analytical way so that you can form opinions, make educated decisions, and apply economic concepts.

## Chapter Features

- **Check Your Understanding.** These questions follow the major sections within each chapter and enable you to review important concepts as they occur.
- **Chapter Highlights.** Each chapter concludes with a helpful summary of key points.
- **Important Terms.** This is a matching exercise, the first of four exercises at the close of every chapter.
- **Extending Your Understanding.** The discussion questions in these sections will lead you to look beyond the basic principles presented in a chapter and examine how those principles apply to real-life situations.
- **Activities.** These special projects and research suggestions take you outside the classroom to investigate real applications of the key concepts introduced in the chapter.
- **Building Skills in Economics.** The final exercise of each chapter will help you develop an important economic skill that could affect your daily life.

## Special Features

- **Career Feature.** These features profile 18 different economics-related occupations. There is a career feature in each chapter.
- **Biography Feature.** Several biographical descriptions examine the lives of individuals who have made significant contributions to economics.
- **Issues Feature.** Each Issue explores the conflicting sides of a topic of economic interest, to give you an opportunity to develop a particular point of view. An Issue is followed by brief questions that will help you analyze the subject.

Throughout the textbook, important economic terms are highlighted in boldface, or darker, type. Terms are defined when introduced and appear again in the Glossary at the back of the book.

The study questions, activities, and special features of your textbook are designed to lead you through the course in a careful and consistent manner. You will find they can be used in a variety of ways, for large- or small-group discussion or as you and your teacher prefer.

*\*Special Note on current printing, 1988*

Most of the tables and graphs have been updated with the latest available data, and coverage of the Tax Reform Act of 1986 has been included in this printing.

# Preface

Economics is a broad subject, and it is impossible to cover everything in a single course or textbook. However, by the time you have completed this course, you will know a great deal about the fundamental principles of economics and how they relate to your life. This knowledge will help you make intelligent and well-informed decisions, both as a consumer and as a citizen. For example, your understanding of economics will help you make decisions about earning money and about saving, investing, or spending your money. The decisions you make will affect you, your family, and others around you. Similarly, your understanding of economics will enable you to interpret candidates' positions on economic issues and help you decide on a candidate who, if elected, may someday vote on economic legislation that will affect the lives of many Americans.

This entire book covers the topics that will give you a solid foundation in economics. Let's briefly examine the major topics that will give you a better idea of how economics relates to you personally.

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## The American Economy

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The American economy is quite remarkable. Through our system of free markets, basic economic questions are answered—and answered far more efficiently than they are in a command economy, such as that of the Soviet Union. Even more amazing is the fact that while these questions are being answered, individuals and businesses are allowed a high degree of freedom to pursue their own self-interests. Indeed, it is this economic freedom that makes the American economic system work. As remarkable as it is, the American economy is not without its problems. As you will learn in the chapters ahead, our economy has been plagued with a number of problems in recent years that have seriously affected millions of Americans.

### How Prices and Wages Are Determined

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Why do some people earn so much more than other people? Why do the prices of some things keep going up, while the prices of other things are coming down? Is there anything that can be done about rising prices? What will determine your future income? Most likely you have asked yourself these questions at one time or another. All of these questions involve the subject of economics, and we will be examining and trying to answer them in the chapters ahead.

### Business in the American Economy

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In order to examine the role of private enterprise in the American economy, we will consider various types of business organizations and list the advantages and disadvantages of each. We will consider the factors that determine the profits of a business firm and the circumstances under which a firm might be able to take advantage of consumers through excessively high prices.

### Labor Unions and Collective Bargaining

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Labor unions are, and always have been, very controversial in the United States, and it's difficult to find individuals who are neutral on the subject. As we study labor unions, you will see how and why unions developed as a strong economic force in the United States. We will define and study collective bargaining—the negotiation process between labor and management—and the laws that govern the collective-bargaining process.

### Unemployment and Inflation

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On a cold January day in 1983, approximately 20,000 applicants stood in line in front of a Milwaukee, Wisconsin, auto frame plant to apply for 200 job openings. The temperature was 17 degrees, and the wind-chill factor was 8 degrees below zero. Yet each job seeker endured the weather for the remote chance that he or she might be one of the lucky ones who would be hired. Similar scenes could be found all across the country in late 1982 and early 1983 as this nation experienced its worst unemployment in nearly half a century. The high unemployment in the early 1980s followed more than a decade of some of the worst inflation in the nation's history. From 1970 to 1980, average prices rose by 112 percent. This means that something that could have been purchased for \$100 in 1970 cost \$212 in 1980.

Both unemployment and inflation affect nearly every American. Inflation affects all Americans directly in the form of higher prices for the things they buy. Although unemployment does not affect every individual directly, it has an indirect impact on almost everyone. In addition to the millions of Americans who were unemployed during the early 1980s, millions of others—relatives, friends, or acquaintances of the unemployed—were affected indirectly. In addition, millions of other workers who did not actually lose their jobs suffered from the constant fear that they might soon join the ranks of the unemployed.



Whether or not unemployment and inflation will be serious problems for you and your generation depends to a large extent on government economic policies. We will examine the problems of unemployment and inflation in great detail and explore ways to reduce the suffering that results from these two basic economic problems.

### Money and Banking

What do gold, seashells, furs, paper, boar tusks, whale teeth, copper, stones, and silver have in common? Each of these items, along with many others, has at some time and place served as money. As you will learn, **money** is anything that is generally accepted and used as a medium of payment. In the United States, money consists of coins, “checkbook” money, and pieces of paper known as Federal Reserve notes. A knowledge of the functions of money, of what constitutes the money supply, and of what the relationship is between the money supply and prices is essential to your understanding of how economics affects your daily life.

We will also look at the organization and functions of banks and the Federal Reserve System, and you will learn how banks can “create” money and how the Federal Reserve attempts to regulate the American economy through a series of actions known as “monetary policy.”

### Poverty and Urban Problems

Poverty has always existed in the United States to some extent, but the high unemployment of the early 1980s led to a sharp rise in poverty. In early 1983, an estimated two million Americans were homeless. Some were living out of their cars or sleeping in churches or other public shelters. Thousands of others were sleeping in the streets or in abandoned buildings. In addition, hungry individuals stood in long lines in many cities across the nation to receive free food. We will examine the causes and the extent of poverty in this country today. We will also

discuss the problems facing the nation’s cities, where many of the poor reside, and will include issues of housing, transportation, and the financing of local government.

### Energy, Pollution, and the Environment

One of the most crucial factors in determining the health of the American economy is the cost and availability of energy. Much of the high inflation of the 1970s was caused by skyrocketing energy prices, because part of the production cost and much of the transportation cost of all manufactured items and all food products is the cost of energy. From 1973 to 1980, the world market price of crude oil rose from \$3 a barrel to about \$33 a barrel. This caused a sharp increase in the prices not only of gasoline and home heating oil, but also in the prices of almost everything else.

A secure future involves more than a healthy economy. It involves a healthy and pleasing environment, too. Unfortunately, there is often a basic conflict between economic growth and a clean environment. Governments are often put in the difficult position of having to examine the costs of protecting the environment and of having to choose between a healthy economy and a healthy environment.

### The International Picture

How many things do you own and use that were not made in the United States? Probably more than you realize. If you consume either cocoa or bananas, you can be almost certain they were produced in a foreign country. In addition, much of your clothing, many small appliances, and many toys and games are produced outside the United States. In fact, even some “American-made” products are not totally American made. For example, some American automobiles contain parts that were manufactured in foreign countries.

The American economy is an integral part of a much larger and more complex world

economy. In addition to the fact that many foreign-made items are sold in the United States, many American jobs depend on sales to foreign nations. We will examine international trade and finance and discuss how many other economic systems differ from our own.

### Personal Economics

Finally, this textbook will help you explore how to get the most for your money. We will deal with such topics as whether you should buy your own home or rent; how you can buy furniture and appliances; and how you can spend your money wisely when you buy food, clothing, and other necessities.

We will also cover borrowing and investing money, and explain the importance of establishing and maintaining a good credit rating. You will learn about various types of loans and lenders, and how you can determine the true cost of loans after interest rates are included. In addition, we will examine different investment options, including bank deposits, corporate bonds, government bonds, corporate stocks, and real estate.

By the time you have completed this book, you will have learned that economics is and always will be a part of your life. You also will have learned that a good understanding of economic principles will help you make better decisions about economic matters and will help you live a more productive and enjoyable life.



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