



Chapter

19

The American Economy



Why It Matters

An economic system is a set of rules that governs what goods and services to produce, how to produce them, and for whom they are produced. In this chapter, you will learn how the economic system of the United States answers these questions.



BIG Ideas

Section 1: Economic Resources

An economic system is the way a society organizes the production and consumption of goods and services. Four different key factors of production are necessary to produce goods and services.

Section 2: Economic Activity

The basis of the market economy is voluntary exchange. In the American economy, the exchange usually involves money in return for a good or service. Economic growth occurs when a nation's total output of goods and services, flowing in a circular motion among several sectors, increases.

Section 3: Capitalism and Free Enterprise

Free enterprise is the freedom of individuals and businesses to operate and compete with a minimum of government interference or regulation. The American economic system is the most successful in the history of the world.

◀ Grain farmer checks barley crop in East Grand Forks, Minnesota

FOLDABLES™ Study Organizer

Categorizing Information Study Foldable Make the following Foldable to help you categorize information about the different sectors of economic activity.

Step 1 Fold a sheet of paper from side to side, leaving a 2-inch tab uncovered along the side.



Step 2 Turn the paper and fold it in half once and once again, creating fourths.



Reading and Writing

As you read the chapter about economic activity, categorize information about each part of the economy under each flap.

Step 3 Unfold and cut along the three fold lines through the top side of the paper.



Step 4 Label the flaps as shown.





Section
1

Economic Resources

Guide to Reading

Big Idea

An economic system is the way a society organizes the production and consumption of goods and services.

Content Vocabulary

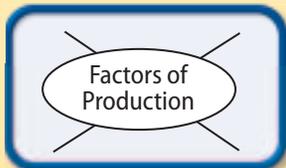
- goods (p. 517)
- services (p. 517)
- factors of production (p. 517)
- natural resources (p. 517)
- labor (p. 517)
- capital (p. 517)
- entrepreneur (p. 517)
- Gross Domestic Product (GDP) (p. 518)
- standard of living (p. 518)

Academic Vocabulary

- output (p. 517)
- innovate (p. 517)

Reading Strategy

Categorizing As you read the section, complete a diagram like the one below by identifying the four factors of production.



NORTH CAROLINA STANDARDS
Civics and Economics

7.01 Describe the basic factors of production such as land, labor, capital, and entrepreneurial skills and their impact on economic activities.

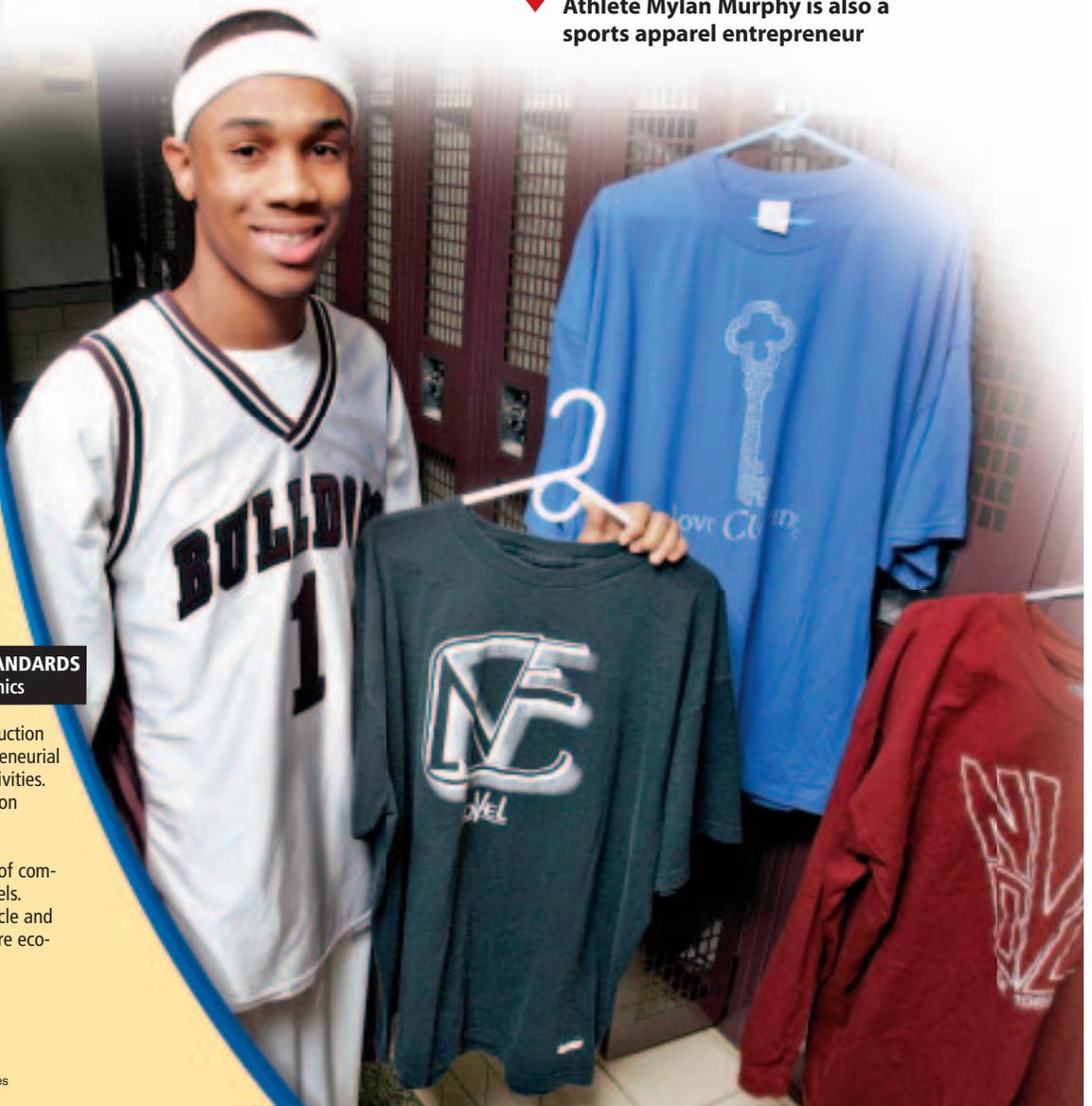
7.05 Explain the impact of investment on human, capital, productive, and natural resources.

8.06 Explain how changes in the level of competition can affect price and output levels.

9.01 Identify phases of the business cycle and the economic indicators used to measure economic activities and trends.

Real World Economics Do you know what an entrepreneur is? Mylan Murphy knows, because he became one when he started his own line of sports-themed clothing while still in the eighth grade. Mylan turned his love of basketball and his talent as an artist into a real business. Although he is too young to sign a contract, Mylan has enlisted his older brother, Mark, to be his business partner. The American economy depends on entrepreneurs, like the Murphys, as one of the four essential factors of production that keeps the economy running.

▼ **Athlete Mylan Murphy is also a sports apparel entrepreneur**





Goods and Services

Main Idea Four factors of production are necessary to produce goods and services.

Economics & You What goes into making your CD player or your backpack? Read to find out what four production elements are necessary.

In 2000, the United States’s annual **output**, or amount produced, totaled nearly 25 percent of the world’s total output. Some of this production is in the form of **goods**, such as books and automobiles. More of this production is in the form of **services**, or work performed for someone else. Services include haircuts, home repairs, and entertainment.

Factors of Production

There are four **factors of production**, or resources necessary to produce goods and services. These are natural resources, labor, capital, and entrepreneurs.

Natural Resources The first factor, **natural resources**, refers to all the “gifts of nature” that make production possible. Natural resources include actual surface land and water as well as fish, animals, forests, and mineral deposits.

Labor The nation’s workforce, **labor**, is its human resources. Labor includes anyone who works to produce goods and services.

Capital Another factor of production is **capital**, which are the manufactured goods used to make other goods and services. The machines, buildings, and tools used to assemble automobiles, for example, are *capital goods*.

Capital goods are unique in that they are the *result* of production. For example, we cannot find a hammer in the forest the way we can find a tree—someone actually has to make a hammer. Capital goods differ from



Entrepreneurs A Miami, Florida, teenage entrepreneur owns and operates a hair care business. **Explaining Why do entrepreneurs start new businesses?**

consumer goods. Consumer goods directly satisfy wants—things such as clothes, clocks, foods, and radios. Capital goods satisfy wants indirectly by aiding production of consumer goods.

Entrepreneurs The **entrepreneur** is the fourth factor of production. This is an individual who starts a new business, introduces new products, and improves processes. Being an entrepreneur involves being **innovative**, or original, and being willing to take risks in order to make profits.

Reading Check Classifying Under what factor of production would you classify oil deposits? A diamond-cutting machine?

Gross Domestic Product

Main Idea GDP is the total value of all the *final* goods and services produced in a country in one year.

Economics & You Have you ever heard the United States described as a rich country? Read to find out how a nation's wealth is measured.

People often measure their economic well-being by the amount of their incomes and their ability to provide for themselves and their families. The success of the overall economy is measured in a similar way. One measure of the economy's size is **Gross Domestic Product (GDP)**. This is the total value, in dollars, of all the *final* goods and services produced in a country during a single year. A final good is a good, such as a loaf of bread, that is sold to its user. The intermediate goods that go into making a loaf of bread—flour or wheat, sugar—are not counted in GDP.

In addition, the sale of used goods is not counted as part of GDP. When ownership of products already produced is transferred from one person or group to another, no new production is generated. Although the sale of a used car, chair, or CD player may give someone cash, only the original sale is included in GDP.

Measuring GDP

Remember that GDP is a measure based on money. If we are to compare the number of goods and services produced, it is helpful to get a meaningful idea of their relative worth. Look at the diagram at the top of the page for an example. Suppose there is a tiny economy in which only three goods are produced, in these quantities: 10 bicycles, 10 computers, and 10 watches. Furthermore, suppose the price of a bicycle is \$200, the price of a computer is \$1,500, and the price of a watch is \$100. To find

Measuring GDP

GDP is the total dollar value of all final goods and services produced in a nation in a single year.

10 bicycles	10 computers	10 watches
		
at \$200 each = \$2,000	at \$1,500 each = \$15,000	at \$100 each = \$1,000

Gross Domestic Product = \$18,000

Analyzing Charts

- Explaining** How is GDP calculated?
- Calculating** In this example, what percentage of GDP comes from the production of bicycles?

GDP of this economy, we multiply the price of each good by the quantity of that good produced and then add the amounts.

How Is GDP Used? Economists study GDP figures regularly to analyze how the economy is doing. GDP is an important indicator of **standard of living**, the quality of life based on the possession of necessities and luxuries that make life easier.

Weaknesses of GDP GDP is a reasonably accurate and useful measure of economic performance. It is not a measure of society's overall well-being, though. Many things might make a country better off without raising GDP, such as reductions in crime or in drug and alcohol abuse.

Keep in mind that the statistics used in computing GDP are accurate only to a point. Statistics about easily measurable things,



such as government purchases, are reliable. Some workers, however, are given food, fuel, or housing as part of their wages. To minimize error in calculating GDP, economists must take into account that GDP can include only an estimate of the value of such goods and services.

Quantity vs. Quality Remember that GDP measures *quantity*. It does not reflect improvements in the *quality* of products. There is a great difference between a \$1,000 computer purchased today and a computer costing the same amount just a few years ago. Because of this, economists must take great care to account for quality improvement. Greater production of goods and services is only one of the many factors that contribute to raising the standard of living of any country.

Net Domestic Product

The loss of value because of wear and tear to durable goods, such as automobiles and refrigerators, is called depreciation. The same concept applies to capital goods—machinery and equipment. GDP does not take into account that some production merely keeps machines and equipment in working order and replaces them when they wear out.

Net domestic product (NDP)—another way of measuring the economy—accounts for the fact that some production is only due to depreciation. NDP takes GDP and subtracts the total loss in value of capital goods caused by depreciation.

Reading Check **Contrasting** What is the difference between final goods and intermediate goods?

Section Review

1

Vocabulary

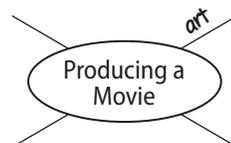
- Write** a paragraph in which you use these key terms: *goods, services, factors of production, natural resources, labor, capital, entrepreneur, Gross Domestic Product (GDP), standard of living.*

Main Ideas

- Identify** each of the following as one of the four factors of production:
 - carpenter
 - hammer
 - forest
- Describing** What is gross domestic product and how is it measured?

Critical Thinking

- Comparing** How does the factor of production of entrepreneurship differ from the factor of labor?
- BIG Ideas** Create a diagram like the one below and label the center oval as shown. Fill in an example of each factor of production that went into developing this service.



- Applying** Think like an entrepreneur. Identify a new product or service that you believe many people will want to buy. Outline the details of the new product or service. Then explain why you think people will want to buy it.

CITIZENSHIP Activity

- Persuasive Writing** Which of the four factors of production do you think has had the greatest impact on the development and enduring strength of the U.S. economy? Why? Write a position paper stating and supporting your reasons.



Study Central™ To review this section, go to glencoe.com.



Section
2

Guide to Reading

Big Idea

The basis of the market economy is voluntary exchange. In the American economy, the exchange usually involves money in return for a good or service.

Content Vocabulary

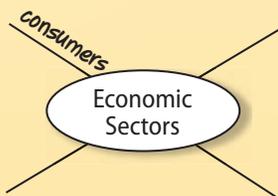
- market (p. 521)
- factor market (p. 521)
- product market (p. 522)
- productivity (p. 524)
- specialization (p. 524)
- division of labor (p. 524)
- economic interdependence (p. 525)

Academic Vocabulary

- sector (p. 521)
- consume (p. 522)
- input (p. 523)

Reading Strategy

Categorizing As you read the section, complete a diagram like the one below by identifying the four sectors of the economy.



Economic Activity

Real World Economics Would you know to shop on the Internet for shoes if you had really large feet? When Neil Moncrief started www.2bigfeet.com, specializing in large-sized shoes, the search engine Google listed his site first on searches for “big feet.” Soon Moncrief was getting 95 percent of his business from the Internet. Later Google changed the way its search engines worked and sales decreased dramatically. Moncrief’s experience is an example of how business success is based on many factors, including economic interdependence.

▼ Neil Moncrief stands outside his Albany, Georgia, store



NORTH CAROLINA STANDARDS Civics and Economics

7.04 Analyze the impact on economic activities of specialization, division of labor, consumption and production increases.

7.05 Explain the impact of investment on human, capital, productive, and natural resources.

8.03 Explain the circular flow of economic activities and how interactions determine the prices of goods and services.



Justin Sullivan/Getty Images

Economic Sectors and Circular Flow

Main Idea Resources, goods and services, and money flow in a circular motion among several sectors.

Economics & You The term *market* may mean to you a place to buy fresh fruits and vegetables, but it has a special meaning to economists. Read to find out more.

In the study of economics, a **market** is not necessarily a place. Rather, it is the free and willing exchange of goods and services between buyers and sellers. In other words, markets are places where people come together. Markets may be local, regional, national, or global. In this section, you will learn about the major groups of decision makers and the major markets in the market system. For example, a market exchange may take place in a worldwide market for a good such as crude oil. It may also take

place in a neighborhood market for services such as paper delivery, snow shoveling, and babysitting.

Circular Flow of Economic Activity

In a market system, the flow of resources, goods and services, and money is actually circular, as shown in the diagram on page 522. Economists use this model to show how economic decision making in the market system works. The consumer **sector**, or part, makes up one group of economic decision makers, but there are others—the business, government, and foreign sectors.

The Consumer Sector

What role do consumers play in the circular flow? Consumers earn their income in **factor markets**—the markets where productive resources are bought and sold. Here, workers earn wages, salaries, and tips in exchange for their labor. People who own land may loan it in return for a type of income called rent. Finally, people who own capital exchange it for interest.

Economic Activity Within the circular flow of economic activity, consumers buy goods from businesses, and sell resources to businesses. **Explaining** Is the house builder a member of the consumer sector, the business sector, or both?





The Business Sector

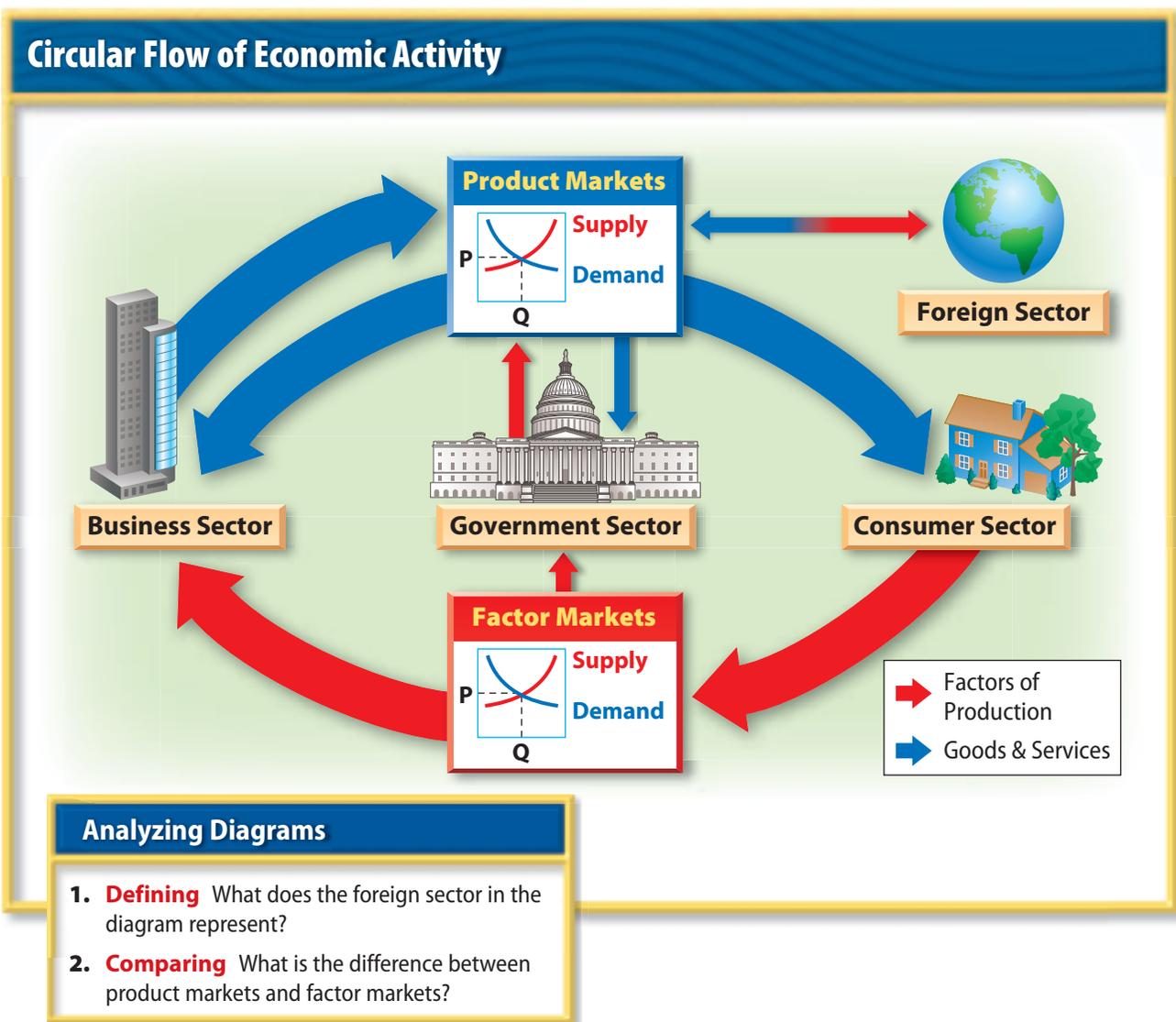
After individuals receive their incomes, they spend them in **product markets**—markets where producers offer goods and services for sale. The business sector receives payments in the product markets where they sell goods and services to consumers. Businesses use these payments to pay for the natural resources, labor, and capital they use. These resources are then used to manufacture additional products that are sold in the product markets.

As the diagram shows, the business sector purchases some of the output it produces—primarily capital goods—so that it can

continue to produce more goods and services. These purchases include things such as tools, factories, and other goods needed for current production. In actual practice, the business sector is much smaller than the consumer sector. While the consumer sector purchases about two-thirds of all output, the business sector usually **consumes**, or uses, only about 15 to 20 percent of our GDP.

The Government Sector

The government sector is another sector that plays a part in economic decision making. This sector is made up of all three levels of government—federal, state, and





local. Because the government sector also produces goods and services, it purchases productive **inputs**, or resources, in the factor markets. Since the time of World War II, the government has become a bigger part of the economy.

Revenues and Expenditures The government receives revenue from the services it sells. For example, public universities charge tuition, public hospitals charge fees, and city buses charge fares. The total cost of government services is seldom covered by fees alone, however. The government sector receives most of its revenues from taxes on businesses and individuals.

Government also uses its revenue to purchase final goods and services in the product markets. School systems, for example, purchase books, buses, and computers while the military purchases trucks, fighter planes, and ships. Historically, the government is the second-largest sector in our economy, purchasing approximately 20 percent of our GDP.

The Foreign Sector

The foreign sector in the diagram represents all the countries in the world. Notice on the diagram on page 522 that this sector is the only one with a line that has an arrow at both ends. The reason is that we both sell products to and buy products from other countries.

The value of the goods and services the United States purchases from other countries and the value of the goods and services it sells to other countries tend to offset one another. As a result, the foreign sector generally accounts for less than 4 percent of our nation's GDP.

Reading Check Describing In the circular flow of activity, in what economic activities is the consumer involved?

Civics ONLINE

Student Web Activity Visit glencoe.com and complete the Chapter 19 Web Activity.

Erika Fields

Erika Fields, 17, of Cleveland, Ohio, wondered why public schools in some urban areas get less state money than some schools in suburban areas. To help bring about change, and to make school funding more fair, Fields combined her voice with others in "Our Voice."



QUESTION: What is Our Voice?

ANSWER: Our Voice is a group of students who study school funding issues. We try to make a difference by testifying before education committees, holding rallies, and speaking out for fairness in how tax money is distributed to schools.

Q: Tell us about your newspaper.

A: *Our Voices: Students Speak Out* is a student-produced, statewide paper that talks about funding for public schools in Ohio.

Q: Do only teens from your school work on the paper?

A: No. Students from different schools contribute articles and illustrations. We open it up to everyone who has something to say about public schools—negative or positive.

Q: What is the paper's goal?

A: We are working to get our state lawmakers to produce an equal school funding system—to make sure that each and every student has an equal education.

ACTION FACT:

Fields enjoys singing—*"Our Voice"* teens speak out and is planning to become a doctor.



Making a Difference

CITIZENSHIP

What is the purpose and goal of Our Voice, the group?



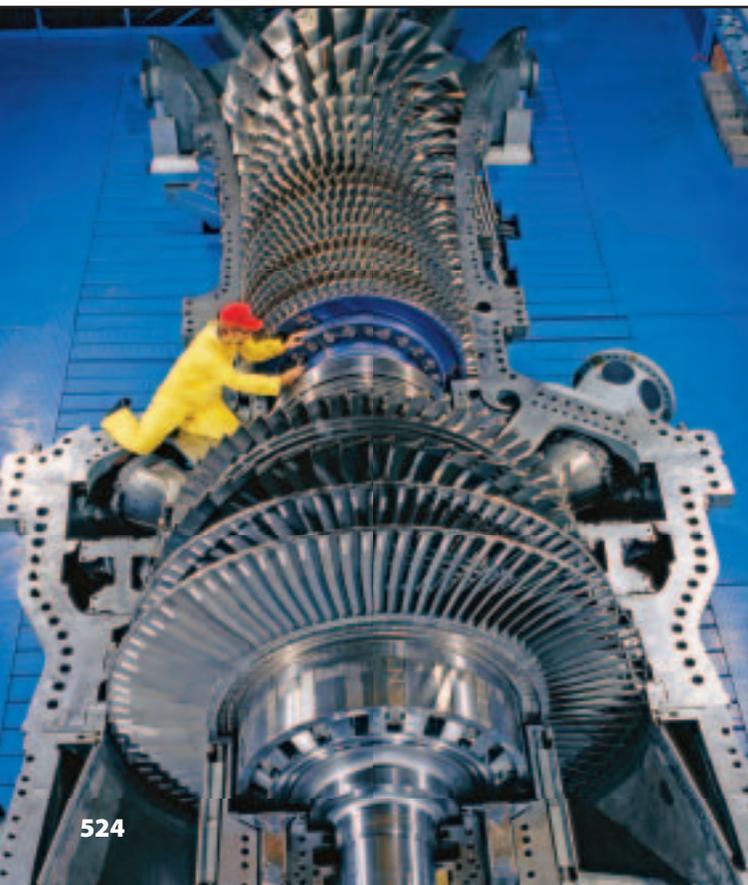
Promoting Economic Growth

Main Idea Economic growth occurs when a nation's total output of goods and services from all economic areas increases.

Economics & You You have probably told yourself at some time or another that you need to be more productive. Find out what productivity means in our nation's economy.

Economic growth occurs when a nation's total output of goods and services increases over time. This increase means that the circular flow becomes larger. Economic growth is important because it raises people's standard of living. This growth is a major goal of our economy and is a way officials can tell if our economy is healthy.

Division of Labor A quality control engineer at a South Carolina plant inspects the fan assembly of a gas-fired turbine. *Explaining In what way is the engineer's job an example of the division of labor?*



Productivity

When scarce resources are used efficiently, everyone benefits. Efficient use of resources is described by the term **productivity**. This is a measure of the amount of output (goods and services) produced by a given level of inputs (land, labor, capital, and entrepreneurship) in a specific period of time. Productivity goes up whenever more output can be produced with the same amount of input in the same amount of time, or when the same output can be produced with less input.

Productivity is often discussed in terms of labor, but it applies to all factors of production. For this reason, business owners try to buy the most efficient capital goods, and farmers try to use the most fertile land for their crops.

Specialization

Specialization takes place when people, businesses, regions, or even countries concentrate on goods or services that they can produce better than anyone else. As a result, nearly everyone depends upon others to produce many of the things that he or she consumes. Specialization is important because it improves productivity.

Few individuals or households seriously consider producing their own food, shelter, and clothing. When people specialize, they are usually far more productive than if they attempt to do many things. For example, Maria is a carpenter who wants to build a house. Even if Maria is capable of building the entire house without any help, she would likely be better off to hire other workers who specialize in foundations, plumbing, and electrical wiring.

Division of Labor

Division of labor is breaking down a job into small tasks performed by different workers. Division of labor makes use of differences in skills and abilities.



For example, you and your coworker would each do the tasks for which you are best suited. Even if your abilities are identical, specialization can be advantageous. By applying all your time to a single task, you are more likely to discover better techniques. Division of labor improves productivity.

Human Capital

Productivity also tends to increase when businesses invest in human capital—the sum of people’s skills, abilities, and motivation. Employers are usually rewarded with higher-quality products and higher profits. Workers often benefit from higher pay, better jobs, greater motivation, and more satisfaction with their work.

Economic Interdependence

Because of specialization, our economy displays a strong degree of **economic interdependence**. This means that we rely on others, and others rely on us, to provide goods and services.

Events in one region of the country or the world often have a dramatic impact elsewhere. For example, bad weather in a country where sugarcane is grown can affect sugar prices in the United States, which in turn can affect the demand for sugar substitutes elsewhere.

Interdependence and Trade-Offs Today, economic technology usually describes the use of science to develop new products and new methods of producing and distributing goods and services. Without satellite technology, for example, it would be impossible to buy and sell goods and services with nations around the world.

This example does not mean that economic interdependence is necessarily bad. The gain in productivity and income that results from increased specialization usually offsets the cost associated with the loss of self-sufficiency.

Reading Check Explaining What are the benefits of specialization?

Section Review 2

Vocabulary

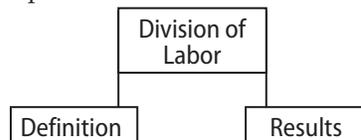
- Write** a paragraph in which you use the following terms: *productivity, specialization, division of labor, economic interdependence*. Then, write a second paragraph using these terms: *market, factor market, product market*.

Main Ideas

- Describing** What is a factor market?
- Explain** Why is productivity important to economic growth?

Critical Thinking

- BIG Ideas** Describe how either you or a relative of yours who has a job fits into the circular-flow model. Be sure to discuss both the factor market and the product market.
- Explaining** On a chart like the one below, define *division of labor* and explain how it improves the efficiency of production.



CITIZENSHIP Activity

- Expository Writing** Use the information in this section to write a short speech you could give to fourth graders on the topic “Why Economic Growth Is Important.” Remember to make your explanation simple enough for younger students to understand.



Study Central™ To review this section, go to glencoe.com.



Financial Literacy

Education and Earning Power

As you probably already know, levels of education and income are related. High-income workers generally have more education than low-income workers. For example,

- high school dropouts earn less than high school graduates;
- high school graduates earn less than college graduates;
- college graduates with bachelor's degrees earn less than those with advanced degrees.

Not only is it likely that income will rise with further education, but also the chances of becoming unemployed are reduced. Unemployment rates for high school graduates are twice that for college graduates. For example, in April 2006, the unemployment rate for workers with a bachelor's degree or higher was 2.2 percent, 3.8 percent for workers with some college or an associate degree, 4.4 percent for those with a high school diploma, and 7 percent for workers with less than a high school diploma.

Level of Education	Median Income*	
	Female	Male
Not a high school graduate	\$18,938	\$26,468
High school graduate	26,074	35,412
Some college	30,142	41,348
Bachelor's degree	41,327	56,502
Master's degree	50,163	70,640
All full-time workers	\$31,565	\$41,939



*The median income is the middle income in a series of incomes ranked from smallest to largest.

Source: National Center for Education Statistics.

Did You Know?

“More than two-thirds of the new jobs being created in our economy are in occupations that require some kind of post-secondary education.”

—Secretary of Labor Elaine Chao, May 31, 2006

Source: US Dept of Labor: www.dol.gov/sec/media/speeches/20060531_miami.htm



Analyzing Economics

1. **Comparing** What are the median incomes for men and for women who are employed full-time?
2. **Calculating** What is the difference in median income between female high school graduates and females who attain bachelor's degrees?



Catherine Karnow/CORBIS

Section 3

Guide to Reading

Big Idea

Free enterprise is the freedom of individuals and businesses to operate and compete with a minimum of government interference or regulation.

Content Vocabulary

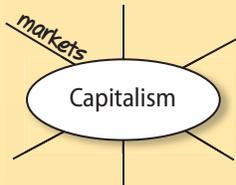
- capitalism (p. 528)
- free enterprise (p. 528)
- consumer sovereignty (p. 529)
- private property rights (p. 529)
- competition (p. 530)
- profit (p. 530)
- profit motive (p. 530)
- voluntary exchange (p. 530)
- laissez-faire economics (p. 531)

Academic Vocabulary

- accumulate (p. 528)
- dispose (p. 529)
- incentive (p. 529)

Reading Strategy

Organizing As you read the section, complete a diagram like the one below by identifying the features of capitalism. Then provide an example of each feature.



NORTH CAROLINA STANDARDS Civics and Economics

- 7.06** Compare and contrast how different economic systems address key economic factors.
- 8.02** Describe how the free enterprise system encourages private ownership of property and promotes individual initiative.

Capitalism and Free Enterprise

Real World Economics Where would you guess the world's busiest McDonald's restaurant is located? Los Angeles? New York? Tokyo? The answer is Moscow, in the former Soviet Union. How does this American restaurant do so well in a former Communist country? In Russian cities, McDonald's caters to the local citizens, not to American tourists. Teens in Moscow hang out at fast-food places in the same way teens in other countries do. Economic reforms in Russia have moved the country more toward a capitalistic, market-oriented system.

▼ **A McDonald's on St. Petersburg's main avenue, Nevsky Prospekt**



Capitalism

Main Idea The economic system of the United States is known as capitalism, in which private citizens own and use the factors of production to seek a profit.

Economics & You Do you feel that the products you want to buy are available? Read to find out what power you have as a consumer.

The economy of the United States is built largely on free markets and private ownership. It is known as **capitalism**, an economic system in which private citizens own and use the factors of production in order to seek a profit.

Free enterprise is another term to describe the American economy. In a free enterprise economy, competition is allowed to flourish with a minimum of government interference. One of the most remarkable characteristics

of our nation's economy is its ability to grow and **accumulate**, or collect, wealth. No other economic system in the history of the world has been as successful.

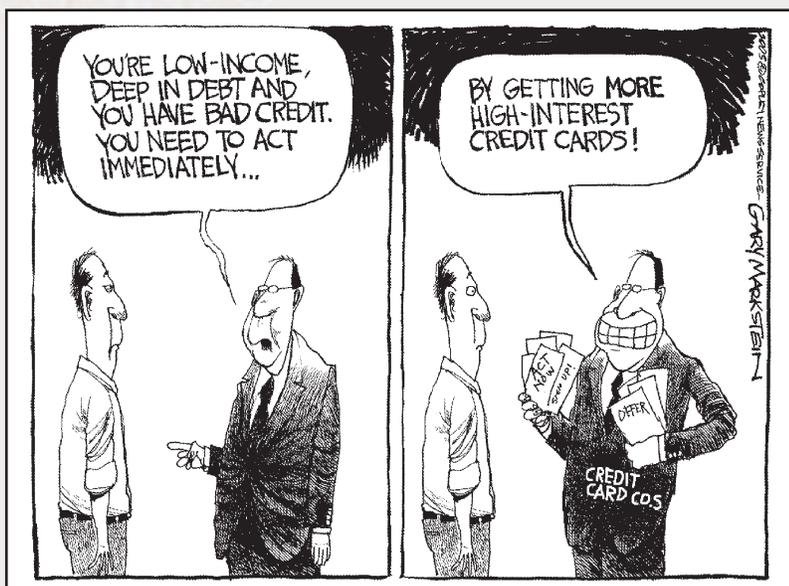
What Makes Capitalism Work?

Several unique features of capitalism combine to contribute to its success in the United States and in other countries. These features are the use of markets, economic freedom, private property rights, competition, profit motive, and voluntary exchange.

Markets Markets are one important part of our economic system. Markets are the places where the prices of goods and services are determined as exchange takes place. Markets may be local, regional, national, or global. Markets also connect the different sectors of the economy. To illustrate, review the chart on page 522. It shows that consumers and businesses interact primarily in the product and factor markets.

TIME

Political Cartoons



Gary Markstein/Copley News Service

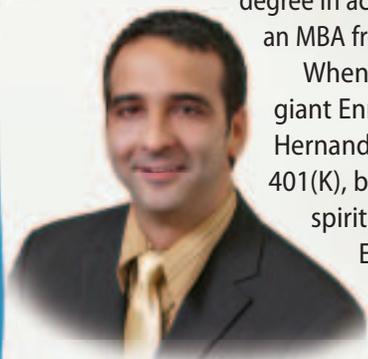
With this cartoon, Gary Markstein is making a point about consumer credit. Examine the first panel of the cartoon.

1. What "immediate action" would it be logical for the consumer to take in light of his financial situation?
2. Now look at the second panel. How are credit card companies depicted?
3. Why might credit card companies offer high-interest cards to consumers who are already in debt?

American Biography

David Hernandez (1969 –)

David Hernandez was only 5 years old when his family left their home in Cuba and moved to the United States. When Hernandez's father died, David delivered newspapers, mowed lawns, and took on odd jobs to help his family. It would have been easy for him to give up on his dream to attend college. Instead, he worked his way through college and graduated magna cum laude from Palm Beach Atlantic University with a degree in accounting. He later earned an MBA from New York University.



When his employer, the energy giant Enron, collapsed, David Hernandez lost his job and his 401(K), but not his entrepreneurial spirit. Along with his brother, Eliezer, and two former colleagues, Hernandez saw an opportunity to build his own

company. His plan was to provide small- and mid-sized businesses, with low-cost electric power and great customer support. In less than 4 years, Liberty Power grew from grossing less than \$1 million in its first year to more than \$100 million in 2005, making it the largest Latino-owned electricity provider in the country.

The company's corporate responsibility does not end with its customers. In January 2004 Hernandez created the Liberty Power Foundation to support education in the communities the company serves.

Making a Difference

CITIZENSHIP

"It's not only important to do well; philosophically, I believe that it's important to do good." **Discuss the meaning of this quote by David Hernandez.**

When you go to work, your labor is being sold in the factor markets. When you go shopping, the goods and services you buy are being purchased in product markets. In our economic system, the consumer is especially important because businesses usually try to produce the products that people want most. Because of the effort to match products to wants, we use the term **consumer sovereignty** to describe the consumer as the "king," or ruler, of the market, the one who determines what products will be produced.

Economic Freedom In the United States, we place a high value on the freedom to make our own economic decisions. Each of us can choose the type of job or occupation we would like to have, and we can choose when and where we would like to work.

As consumers, we have the right to choose the products we will buy. Businesses have

the right to choose the products they will produce and offer for sale. However, along with this freedom come certain costs. In particular, individuals must normally accept the consequences of their decisions in our free enterprise system. If an entrepreneur starts a business that fails, the government usually does not help out.

Private Property Rights Another major feature of capitalism is **private property rights**. These rights mean that we have the freedom to own and use, or **dispose** of, or throw away, our own property as we choose as long as we do not interfere with the rights of others. Private property rights give us the **incentive**, or drive, to work, save, and invest because we know we can keep any gains that we might earn. In addition, people tend to take better care of things if they actually own them.



Competition Cloth making was primarily a home-based craft during colonial times. By the early 1800s, power-loom technology mechanized cloth making, and prices for cloth came down. **Explaining** What are the benefits of competition?

Competition Capitalism thrives on **competition**—the struggle between buyers and sellers to get the best products at the lowest prices. The competition between sellers keeps the cost of production low and the quality of the goods higher than they would otherwise be. Buyers likewise compete among themselves to find the best products at the lowest prices.

Competition thus rewards the most efficient producers. Competition also forces the least efficient producers out of business or into other industries. The result is that competition makes for efficient production, higher-quality products, and more satisfied customers.

The Profit Motive Under free enterprise and capitalism, people are free to risk their savings or any part of their wealth in a business venture. If the venture goes well, the people will earn rewards for their efforts. If things go poorly, they could lose part or even all of the investment. The possibility of financial gain, however, leads many to take risks in hopes of earning a profit.

Profit is the amount of money left over after all the costs of production have been paid. The **profit motive**—the driving force that encourages individuals and organizations to improve their material well-being—is largely responsible for the growth of a free enterprise system based on capitalism.

Voluntary Exchange **Voluntary exchange** is the act of buyers and sellers freely and willingly engaging in market transactions. Who benefits when you buy something—you or the seller? Both are giving something up to gain something else. As long as the transaction involves a voluntary exchange, both you and the seller benefit—or the exchange would not have happened in the first place.

The exchange takes place because both parties feel they will make a profit. Voluntary exchange, then, is both a characteristic of capitalism and a way for us to improve our economic well-being.

Reading Check **Summarizing** What benefits are derived from competition?



History of Capitalism

Main Idea Capitalism developed gradually in Europe and had a powerful influence on America’s constitutional Framers.

Economics & You If you have a job, why do you work? Read to find out how a famous economist answers this question.

In 1776 Adam Smith, a Scottish philosopher and economist, provided a philosophy for the capitalist system in his book *The Wealth of Nations*. Smith’s book offered a detailed description of life and trade in British society. It also scientifically described the basic principles of economics for the first time.

Smith wrote that individuals left on their own would work for their own self-interest. In doing so, they would be guided

as if by an “invisible hand” to use resources efficiently. From the writings of Smith and others came the idea of **laissez-faire economics**. Laissez-faire, a French term, means “to let alone.” According to this philosophy, government should not interfere in the marketplace. The government’s role is confined to those actions necessary to ensure free competition.

Many of America’s Framers were influenced by *The Wealth of Nations*. James Madison read it, and Alexander Hamilton borrowed heavily from it in his writings. In a 1790 letter he sent, Thomas Jefferson wrote, “. . . in political economy I think Smith’s *Wealth of Nations* is the best book extant [in existence] . . .”

Reading Check Explaining What is the role of government, according to the laissez-faire philosophy?

Section Review 3

Vocabulary

- 1. Explain** what *free enterprise* means, then explain how each of the following terms relates to free enterprise: *capitalism, consumer sovereignty, private property rights, competition, profit, profit motive, voluntary exchange, laissez-faire economics*.

Main Ideas

- 2. Describing** What does the idea of consumer sovereignty express?
- 3. Explaining** What are the limits of private property rights?

Critical Thinking

- 4. Explaining** According to Adam Smith, what are the results of individuals working for their own self-interest?
- 5. Determining** Under capitalism, how would you answer the question: For whom are goods produced?
- 6. BIG Ideas** There are six features of capitalism mentioned in this section. On a diagram like the one below, identify the two features that you think are most important. Explain your answer.



CITIZENSHIP Activity

- 7. Analyzing** Survey five fellow students, friends, and neighbors to discover what the term *free enterprise* means to them. Review your findings and analyze why people might have different views of free enterprise.
- 8. Descriptive Writing** Adam Smith said that people work for self-interest. Do you agree? Write a paragraph describing someone who works for this reason or for another reason.



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LANDMARK SUPREME COURT CASE STUDIES

Gibbons v. Ogden

In the early years of the nation, each state jealously guarded its own commerce. Trade barriers among the states restricted commerce and stood in the way of a strong national economy. What changed this situation?

Background of the Case

In the early 1800s, the state of New York licensed Robert Fulton and his partner to operate a steamboat monopoly along its waterway. The partners then used their license to grant Aaron Ogden a monopoly on ferryboat travel between New York City and Elizabethtown, New Jersey. Thomas Gibbons, however, had a federal license to run boats between New York and New Jersey.

Ogden wanted to shut down his competition. He sued to close down Gibbons' operation. It was up to the Supreme Court to decide which would prevail—Ogden's state license or Gibbons' federal license.

The Decision

John Marshall delivered the Court's unanimous opinion on March 4, 1824. His decision rested on the power of Congress to "regulate commerce," as granted in Article I, Section 8, of the U.S. Constitution. Marshall interpreted *commerce* to mean "every species of commercial [interaction]," including navigation.

“This power [to regulate commerce], like all others vested in Congress, is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations other than are prescribed in the Constitution. . . . [However, this rule does not apply to] . . . commerce, which is completely internal, which is carried on between man and man in a State, or between different parts of the same State. . . .”

—Justice John Marshall



New York Harbor, painted by Thomas Birch, 1827

The decision gave the federal government sole power to regulate all possible forms of commerce between states. It also affirmed Congress's right to regulate trade with foreign nations. States retained the right to regulate trade entirely inside their borders, and Ogden lost his license.

Why It Matters

The *Gibbons* decision took on more significance in later years than it did at the time. Marshall's broad interpretation of the commerce clause, in fact, helped pave the way for today's strong national government. It allowed Congress to prevent companies from fixing prices. In 1964, Congress was able to prohibit racial discrimination in businesses serving the public because such discrimination was seen as affecting interstate commerce.

Analyzing the Court Decision

1. **Describing** How did Marshall define the commerce clause?
2. **Analyzing** How did this Supreme Court ruling affect states' control of economic activities?

Economic Resources

- The four factors of production (natural resources, labor, capital, and entrepreneurs) provide the means for a society to produce its goods and services.
- Gross Domestic Product (GDP) is the total value of all the *final* goods and services produced in a country in one year.

Economic Activity

- Productivity relates to the efficient use of resources, and tends to go up when workers specialize in the things they do best.

Twin sisters check items on sale



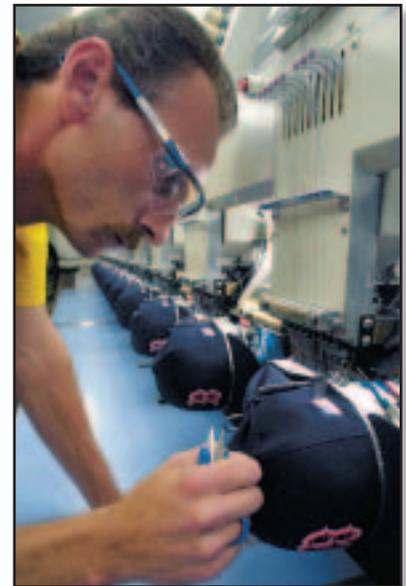
- Resources, goods and services, and money flow in a circular motion among several sectors, and economic growth occurs when a nation's total output of goods and services increases.

Capitalism and Free Enterprise

- The economic system of the United States is based on capitalism and free enterprise.
- Important characteristics are markets, economic freedom, competition, private property rights, the profit motive, and voluntary exchange.



Mother and daughter shop for clothes



Worker stitches American flags onto baseball caps at a Buffalo, New York, factory



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North Carolina End-of-Course Test Civics and Economics Practice

TEST-TAKING TIP

Skim through a test before you start to answer questions. That way you can decide how to pace yourself.

Reviewing Vocabulary

Directions: Choose the word(s) that best completes the sentence.

- Machines, buildings, and tools used to make other goods and services are _____ goods.

A consumer	C factor
B capital	D manufactured
- The total value of all the final goods and services produced in a country in one year is its _____.

A income	C GDP
B VAT	D resources
- Consumers earn their income in _____ markets where productive resources are bought and sold.

A factor	C resource
B product	D consumer
- The _____ between sellers keeps the cost of production low and quality of goods high.

A profit motive	C exchange
B interdependence	D competition

Reviewing Main Ideas

Directions: Choose the best answer for each question.

Section 1 (pp. 516–519)

- The four factors of production are natural resources, labor, capital and _____.

A entrepreneurs.
B services.
C goods.
D specialization.

- A nation's standard of living is a measure of not only the quantity of its products, but also _____.

A the value of its resources.
B of its people.
C the quality of its goods and services.
D of how the products are produced.

Section 2 (pp. 520–525)

- The four sectors, business, consumer, government, and foreign are all part of _____.

A the GDP.
B the factors of production.
C the circular flow of economic activity.
D a nation's standard of living.
- When workers receive additional training for their jobs, this increases _____.

A the cost of production.
B human capital.
C economic interdependence.
D the division of labor.

Section 3 (pp. 527–531)

- In a free enterprise economy, competition is allowed to flourish with a minimum of _____.

A government interference.
B voluntary exchange.
C specialization.
D division of labor.
- In our economy businesses try to produce goods and services that people want most; this is an example of _____.

A private property rights.
B specialization.
C the factors of production.
D consumer sovereignty.

Critical Thinking

Directions: Choose the best answer for each question.

Base your answers to questions 11 and 12 on the chart below and your knowledge of Chapter 19.

Level of Education	Median Income*	
	Female	Male
Not a high school graduate	\$18,938	\$26,468
High school graduate	26,074	35,412
Some college	30,142	41,348
Bachelor's degree	41,327	56,502
Master's degree	50,163	70,640
All full-time workers	\$31,565	\$41,939

Source: National Center for Education Statistics.

*The median income is the middle income in a series of incomes ranked from smallest to largest.

11. If most of the new jobs being created in our economy require a post-secondary education, it is likely that
- A higher education will reduce your chances of unemployment.
 - B the cost of education will continue to fall.
 - C unemployment will continue to decrease in the larger cities.
 - D capital goods production will not keep up with consumer goods production.
12. The chart shows that education improves the earning power of almost everyone, but
- A it benefits all full time workers equally.
 - B advanced degrees are very expensive.
 - C males benefit more than females.
 - D fewer females work fulltime.

Document-Based Questions

Directions: Analyze the following document and answer the short-answer questions that follow.

In 1776 Adam Smith wrote *The Wealth of Nations*, explaining the foundations of capitalism. Here he describes the advantages of a division of labor.

The greatest improvements in the productive powers of labour, and the greater part of the skill, dexterity, and judgment, with which it is anywhere directed, or applied, seem to have been the effects of the division of labour.

... This great increase in the quantity of work, which, in consequence of the division of labour, the same number of people are capable of performing, is owing to three different circumstances; first, to the increase of dexterity in every particular workman; secondly, to the saving of the time which is commonly lost in passing from one species of work to another; and lastly, to the invention of a great number of machines which facilitate and abridge labour, and enable one man to do the work of many.

—Adam Smith

13. According to Adam Smith, what are two advantages that are gained when a task is divided among different workers?
14. Why does the invention of machines depend on the division of labor?

Informational Writing

15. A division of labor also assumes that the workers will produce an excess of goods—more than they can use. Write an essay explaining how this excess production relates to free markets.

STOP

Civics ONLINE

For additional test practice, use Self-Check Quizzes—Chapter 19 on glencoe.com.

Need Extra Help?

If you missed question...	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Go to page...	517	518	521	530	517	518	521	525	528	529	525	525	524	524	524