

SOLUTIONS MANUAL



Chapter 2

Economics: A Framework for Business

Opening Activity: Break students into groups of five people. Ask them to review the scenario below and work with their teams to answer the questions. Remind them to identify and gain agreement on their assumptions behind each answer. Compare and contrast answers among the groups—you may be surprised at the wide range of ideas. As you move through the chapter, you can refer back to their ideas to illustrate key points.

Scenario: *Your team runs a small gift shop in the main shopping district of a desert resort town outside Los Angeles, California. Your key source of revenue is turquoise and silver jewelry, handcrafted by a large Indian tribe in the local area. The tribe also supplies very similar pieces to many of the other shops in the business district. You and your team just heard that the tribe is planning to open a visitor's center at one of the local natural attractions that they manage. They are sure to sell many similar pieces, at a significantly lower price than you. How should you respond? Clarify your assumptions as you answer each of the questions below.*

- *How do the characteristics of the town impact your business?*
- *How will the visitor's center affect your business? Why?*
- *Should you change your prices? Why? How?*
- *What other steps should you take to increase demand for the jewelry in your store? Why?*

Slide 1

Slide 2

2 Economics: The Framework for Business

third edition
Kelly / McGowen

- **What is economics?**
- **What is driving the current global economic crisis?**
- **How does fiscal and monetary policy impact the economy?**
- **What is the free market system and the supply/demand relationship?**
- **What are planned market systems?**
- **What are mixed market systems?**
- **What tools are used to evaluate economic performance?**

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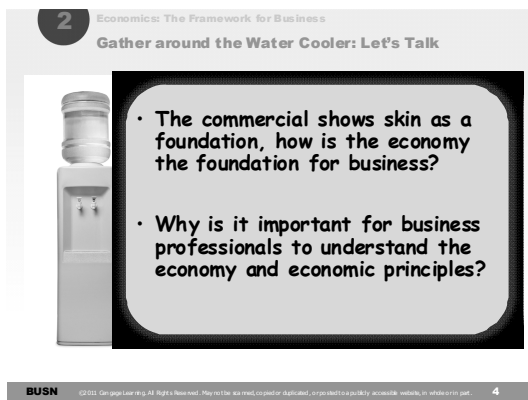
Encourage students to look for the answers to these questions as you move through the lecture.

Slide 3



This commercial shows the skin as a foundation for humans, similar to how economics is the foundation for business.

Slide 4



Use these questions to help students understand the economy and economic principles.

Slide 5



A new federal tax cut has been passed to try to help stimulate the economy during a downturn. Ask students to draw on the points made on the slide and the definitions given in the text and then identify how an economist would study the impact of the tax cut on consumption from a macroeconomic perspective and then from a microeconomic perspective.

Lecture Booster: Share with students the fact that that economics has become the hottest undergrad degree by far at Harvard. In the 2008-2009 academic year, there were 758 economics majors; there were only

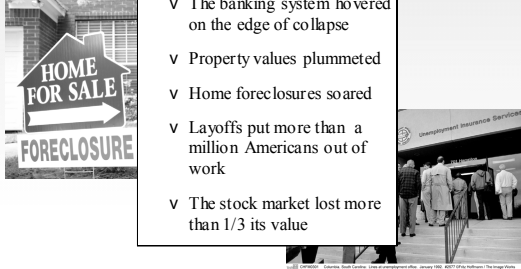
495 government majors, the next most popular. The number of econ majors rose at U.S. colleges approximately 40 percent between 1999 and 2004—and that was before it got a boost from the glamorizing impact of national bestseller *Freakonomics* by Steven D. Levitt and Stephen J. Dubner. ¹

Slide 6

2 Economics: The Framework for Business
Global Economic Crisis: How did the happen?

In late 2008:

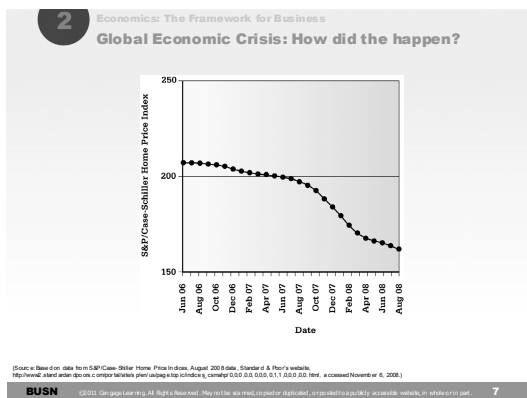
- ✓ The banking system hovered on the edge of collapse
- ✓ Property values plummeted
- ✓ Home foreclosures soared
- ✓ Layoffs put more than a million Americans out of work
- ✓ The stock market lost more than 1/3 its value



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After reviewing the causes of the global economic crisis, make sure that students can explain what subprime mortgages and mortgage-backed securities are and how they set the housing crisis in motion.

Slide 7



This exhibit demonstrates how housing prices peaked in 2006, and in the months that followed, began falling precipitously.

Slide 8

2 Economics: The Framework for Business
A Trillion Dollars?

- If you had started spending a million dollars – every day, without fail – at the start of the Roman Empire, you still wouldn't have spent a trillion dollars by 2010.
- One trillion dollars laid end-to-end would stretch farther than the distance from the earth to the sun.
- You could wrap your chain of bills more than 12,000 times around the earth's equator.
- If you flew a jet at the speed of sound, spooling out a roll of dollar bills behind you, it would take you more than fourteen years to release a trillion dollars.

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Students might have a hard time picturing what a trillion dollars means (well, OK, just about *anyone* has trouble getting a handle on such a huge amount of money). To help them understand share the facts on this slide to make it all at least a little more concrete.

Slide 9

2 Economics: The Framework for Business
Managing the Economy Through Fiscal and Monetary Policy

- **Fiscal Policy – government efforts to influence the economy:**
 - ✓ Taxation
 - ✓ Government Spending
 - ✓ Controlled by Congress/Budget Process
- **Monetary Policy – Federal Reserve actions to shape the economy:**
 - ✓ Supply & Demand of Money
 - Cost of Credit
 - ✓ Controlled by the Federal Reserve (FED)
 - Seven Member Board
 - Chairman

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Fiscal policy: Discuss the thinking behind the approaches to fiscal policy. Many economists believe that lower taxes boost the economy by leaving consumers and businesses with more money to spend. Others believe that more government spending—fueled by taxes—will drive the economy more effectively.

Monetary policy: From a broad perspective, discuss the role of the Federal Reserve in influencing the money supply and the cost of credit. Make sure students know that Ben Bernanke is the current Chairman of the Fed.

Lecture Booster: One way of evaluating tax levels is to measure overall taxes as a percentage of a nation’s GDP. A 2007 study of 30 nations by the Organization of Economic Cooperation and Development found that Denmark had the highest tax-to-GDP ratio at 48.9 percent, and Mexico had the lowest ratio at 19.8 percent. The United States was third lowest at 28.3 percent. A lower level of taxes means more money in the hands of individuals and less money in the hands of the government. ²

Slide 10

2 Economics: The Framework for Business
Federal Reserve



- **Conduct Monetary Policy:**
 - ✓ Changes in the Discount Rate
 - ✓ Changes in Reserve Requirement
 - ✓ Open Market Operations
- Check Clearing Process
- Banking Services for Government and other banks

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Be sure that the students know how the Fed would use each tool in the face of either inflation or recession.

Regarding the check clearing process, explain that the 2003 *Check Clearing for the 21st Century Act* allows banks to process checks electronically, which makes the process more efficient. That also means that if students pay their bills by check, their banks can now deduct funds from their accounts more quickly than in the past, usually in less than a day. So they’d better be sure they have enough money in their accounts *before* writing a check.

Slide 11

2 Economics: The Framework for Business
Unprecedented Action by the FED

In addition to expanding lending and lowering interest rates, since September 2008 the FED has:


- Pumped additional liquidity into the banking industry
- Approved the mergers of several large banks
- Introduced the Term Asset Backed Securities Loan Facility (TALF)
- Introduced the Trouble Asset Relief Program (TARP)
- Purchased mortgage backed securities
- Approved General Motors Finance Company (GMAC) to become a bank holding company

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Explain that the TARP funds are the large loans that were provided by the government to the banks. These loans were discussed extensively in the news. It was when finance company GMAC redefined itself as a bank holding company that it became eligible to receive TARP Funds.

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2 Economics: The Framework for Business
Managing the Economy Through Fiscal and Monetary Policy



M1 Money Supply - all currency—paper bills and metal coins—plus checking accounts and traveler’s checks.

M2 Money Supply - all M1 plus most savings accounts, money market accounts, and certificates of deposit.

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Point out that in actual practice, the term “money supply” most often refers to M2. You may want to also note that credit cards are not part of the money supply, although they clearly play a vital role in the flow of money through the economy. You might also want to remind students that CDs are low-risk savings vehicles with a fixed term.

Lecture Booster: Most people would probably guess that if you just had your fair share of all the currency in circulation you’d be pretty well set. But don’t be fooled! Paper bills and metal coins compose a surprisingly small portion of the U.S. money supply. As of September 2009,

about \$861 billion worth of currency was in circulation. That translates to only about \$2,800 for every American . . . a much smaller fortune than you might imagine. The reason that the amount of currency in circulation is relatively small is that so many of our transactions are now done by electronic fund transfer in the form of credit card and debit card transactions, bill payments done online, or by phone. ³

Slide 13

2 Economics: The Framework for Business
Looking to multiply your money?
Look no further than your local bank

The bank must hold 10% of your deposit based on Federal Reserve Requirements.

You deposit \$5,000

The bank loans Anne \$4,500

Anne buys a car from Jake for \$4,500

Jake deposits the \$4,500


Although you still have \$5,000, the money supply has increased to **\$9,500**

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Explain this concept by using actual students from your class (rather than “Anne” and “Jake” from the slide) and extending the exercise through a number of transactions. After each transaction, ask the students how much money they have, add up the growing “money supply,” and point out that there is still only \$5,000 in cold, hard cash. This will introduce the thinking behind the Federal Deposit Insurance Corporation (FDIC). Students will quickly see that they’d be out of luck if they all demanded their cold, hard cash at the same time. You can then explain how the FDIC could avert such a crisis in the real world.

Slide 14

2 Economics: The Framework for Business
Managing the Economy Through Fiscal and Monetary Policy



The federal government budget outlines revenue and expenses

- When revenue is higher than spending, there is a budget surplus
- When spending is higher than revenue, the government incurs a budget deficit
- The sum of all the money borrowed is the federal debt

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Make sure students are clear on the difference between deficit and debt.

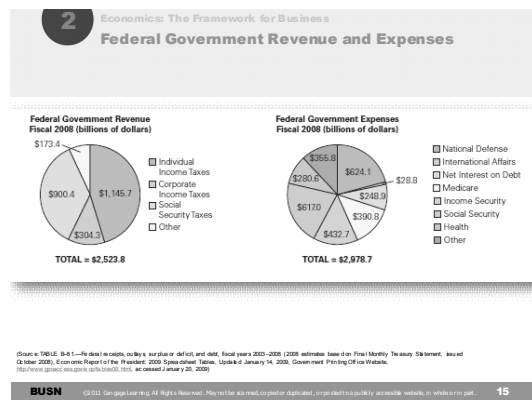
Lecture Booster: Here’s a chance for students to test their understanding regarding just what a trillion dollars looks like. Back in July of 2008, a few months before the financial crisis hit with full force, the Bush Administration predicted a record budget deficit for 2009—\$489 billion, a number that now looks pretty tame. The causes cited were slowing economic growth and the costs of the \$168 stimulus package passed the previous February.

By January 2009, the Congressional Budget Office predicted a “jaw-dropping” deficit of \$1.2 trillion, due to the severe recession and the costs of the various bail-out programs.

As of August 2009, the U.S. Treasury reported a \$1.24 trillion deficit for the first ten months of the federal fiscal year. That, of course, meant that with two months to go in the federal fiscal year, the deficit had already surpassed the earlier projection for all of 2008-2009. The projected deficit for 2009 was increased to \$1.84 trillion, four times 2008’s record high. The year 2000 was the first year that the U.S. government’s entire budget—the total it spent, not the deficit—had ever cleared \$1.8 trillion.⁴

Web Connection: Watch the debt grow by clicking on the icon on the upper right side of the slide to link to the National Debt Clock referenced in the text (http://www.brillig.com/debt_clock). The Debt Clock provides not only the latest debt figures, but also the debt per person, which can galvanize students to see national debt in a more personal light.

Slide 15



You may want to point out that the difference between the total income and total expenses equals the deficit. You could also emphasize that the net interest portion of expenses is likely to grow rapidly as the Federal debt continues to increase.

Lecture Booster: Ask students to imagine the Federal budget as their private budget. What happens when they overspend in a given month? Does that become credit card debt? What is the impact of credit card debt? Most students will quickly see that it limits their flexibility in future months as interest and payments mount. Now ask

them to transfer that thinking back to the Federal level to see how the high Federal debt could potentially impact their lives in the years to come. Some of the possible answers include: lower U.S. workers’ wages and living standards and both businesses’ and homeowners’ experiencing increased difficulty in obtaining credit.⁵

Slide 16


2 Economics: The Framework for Business
Capitalism: The Free Market System

The Free Market:

- Private Ownership
- Economic Freedom
- Fair Competition
- Innovation and Hard Work

Businesses offer Value to:

- Customers
- Employees
- Suppliers



Adam Smith

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Emphasize how free market economies can raise the standard of living for virtually everyone involved. Highlight the role of *free choice*—with limits, of course—for both businesses and individuals. To succeed in a free market economy, businesses must offer value to customers who could choose to go elsewhere, and to employees and supplier who could just as easily serve others.

Another key discussion point: the limited role of government in capitalism.

Slide 17

2 Economics: The Framework for Business
Going Green: Good for the Bottom Line

- Going green is about doing right by the planet, attracting new customers, and reducing costs
- Environmental concerns have become a dominant driver of global corporations
- Wal-Mart began selling concentrated laundry detergent and in 3-years
 - ✓ Saved 95 million pounds of plastic resin
 - ✓ Preserved 400 million gallons of water
 - ✓ Conserved 520,000 gallons of diesel gasoline
 - ✓ Reduced 125 million pounds of cardboard

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Lecture Booster: Recessions, even severe recessions, aren't all bad. Economic slowdown has closed enough heavily polluting operations to make a difference, at least temporarily. Greenhouse gas carbon dioxide is predicted to fall by about 100 million tons in 2009 in the U.S. and Europe. Reduced demand for beef and unavailability of farm credit helped slash the rate of deforestation in the Amazon rainforest by 70 percent over a 3-month period. And closed steel mills around Delhi, India, are probably responsible for the 85 percent drop between 2007 and 2008 in sulfur dioxide levels, an ingredient in acid rain.⁶

Slide 18

2 Economics: The Framework for Business
The Fundamental Rights of Capitalism

1. The right to own a business and keep after-tax profits.
2. The right to private property
3. The right to free choice
4. The right to fair competition

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Discuss the rights listed on the slide:


- Remind students that capitalism doesn't guarantee that anyone will actually earn profits. Nor does it promise that there won't be taxes. But people who *do* earn profits can keep their after-tax income and spend it however they see fit. The impact on motivation is huge!
 - Individuals and private businesses can buy, sell, and use property in any way that makes sense to them (within the limits of the law, of course!).
- Freedom of choice—what to buy and sell, and where to live and work—directly feeds competition. Most importantly, it acts as a strong force in motivating

businesses to offer the best goods and services at the lowest possible prices.

- Capitalism depends on FAIR competition to drive higher quality, lower prices, and more choices. The role of the government is to create a level playing field through regulation and enforcement.

Slide 19

2 Economics: The Framework for Business
Four Degrees of Competition



- Pure Competition
- Monopolistic Competition
- Oligopoly
- Monopoly

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Not all competition works the same. After you explain the different degrees of competition, ask students to name examples of each type of competition. Possibilities:

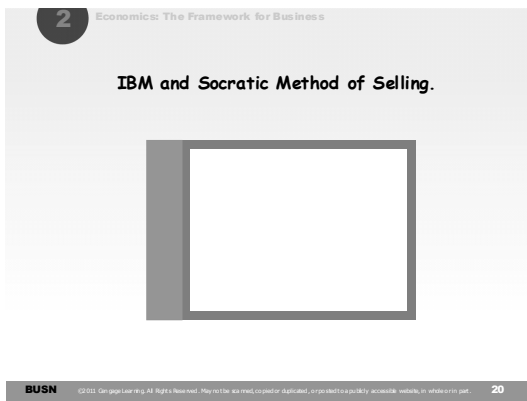
- **Pure competition:** Agriculture and other commodities probably come closest, although true examples are rare in today's economy.
- **Monopolistic competition:** the T-shirt business, the restaurant business.
- **Oligopoly:** soft drink industry, airline industry, computer industry.
- **Monopoly:** Microsoft was convicted of "monopolistic practices" in the mid-1990s.

Lecture Booster: Over the last decade, a number of agricultural producers have broken free of pure competition, creating a meaningful difference—and commanding higher prices—for entire categories such as hormone-free milk and organic produce, and for individual brands such as Dole pineapples and Chiquita bananas. But many other agricultural products, such as carrots and pears, remain undifferentiated.

Break students into small groups. Ask them to choose one example of an agricultural product. Have them create and develop a strategy to differentiate that product in the minds of consumers.

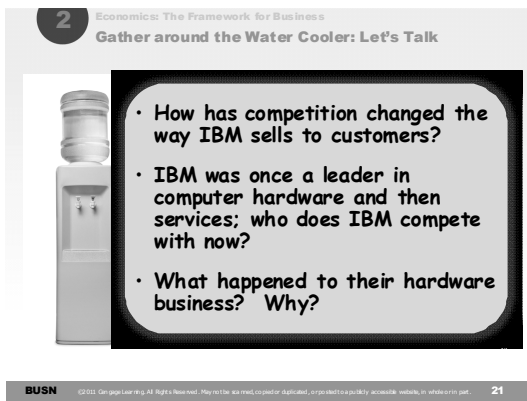
After they present their ideas, ask students if they would be willing to pay more for the newly proposed approaches. Why or why not?

Slide 20



IBM wants to better understand their customer's needs and desires by using the Socratic method of selling their products and services.

Slide 21



Use these questions to talk about how competition has changed the way IBM now sells and meets the need of their customers.

Slide 22

2 Economics: The Framework for Business
Supply and Demand:
 Fundamental Principles of a Free Market

The Foundation of the Free Market

- ✓ How much can we make/sell?
- ✓ How much will consumers buy?
- ✓ At what price?

Interaction of buyers & sellers

- ✓ Impact prices
- ✓ Competition




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Introduce the concept of supply and demand. Help them understand from an intuitive standpoint that the continual interaction between buyers and sellers determines the selection of products and prices available in a free market economy.

Lecture Booster: The theories of supply and demand are based on the assumption that people and businesses make logical, rational choices based on all the information available to them at any given time.

But in the real world, people make silly choices all the time. Ask students, for instance, to think of a time when they overpaid for something without bothering to comparison shop.

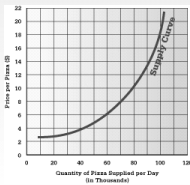
Stanford University researcher Brian Knutson has uncovered at least part of the reason for our logical lapses. His research shows that the rush of buying Google at \$450 a share comes from the part of our brain that lights up in response to other thrills and cravings (think bungee jumping, or chocolate binges) . . . and it's very different from the part of our brain that governs logic!

Our primal pleasure circuits sometimes override the seat of reason as we make economic decisions. Until we can harness our financial thrill seeking, supply and demand theory will be mere guidelines for market behavior, rather than failsafe predictors of how rational people will act.⁷

Slide 23

2 Economics: The Framework for Business
Supply and Demand:
 Fundamental Principles of a Free Market

- **Supply:** the relationship between the price of a good and the quantity sellers are willing and able to offer for sale
 - Sellers tend to supply a greater quantity as the price rises.
- **Supply curve:** a graph of the supply relationship
 - The supply curve slopes upward to the right showing that quantity supplied increases as price rises.



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Ask students to consider why the quantity supplied rises as the prices rise.

Lecture Booster: Ask students to imagine that they are wheat farmers, and they notice that the price of corn is rising. Ask them what they would do. One or two will quickly see that they would be inclined to plow under their wheat and start growing corn as soon as possible. This simple example seems to help many understand the relationship between price and quantity from a producer perspective.

Slide 24

2 Economics: The Framework for Business
Supply and Demand:
Fundamental Principles of a Free Market

- **Demand:** the relationship between the price of a good and the quantity buyers are willing and can afford to buy
 - When price falls, consumers tend to buy more.
- **Demand curve:** a graph of the demand relationship
 - The demand curve slopes downward showing that quantity demanded increases as price falls.

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Help students understand how demand works from an intuitive perspective as well. The pizza example from the text may be helpful. If the price of pizza suddenly doubled, what would they do? Many will point out that they would simply stop buying pizza, especially in light of the many other fast food options.

Slide 25

2 Economics: The Framework for Business
Supply and Demand:
Fundamental Principles of a Free Market

- Forces of supply and demand drive equilibrium price
- The point where supply and demand intersect
- Market price adjusts to the equilibrium price

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Encourage students to see that in the real world, supply and demand don't operate in a vacuum. The constant interaction between the two forces helps determine the market price in any given category.

Lecture Booster: Here's an example of how supply and demand don't always operate in a vacuum. Shortly after Bo, the Portuguese water dog, joined the Obama family, U.S. demand for the once obscure breed soared by 100 percent. You'd think "Portie" breeders would be thrilled since increased demand should mean higher prices. They're not. For nearly 40 years, breeders have

carefully screened potential owners. This resulted in not only in the dogs going to individuals deemed likely to treat their pets well, but also in a limited supply and price tags of around \$2,000 per puppy. Current breeders fret that the increased demand will spark the growth of Portie puppy mills run by people who care more about profit than the dogs' welfare.⁸

Slide 26

2 Economics: The Framework for Business
The Cost of An Ice Cold Coke

- Coke took supply and demand too far....
- They installed thermometers in their vending machines
- Consumers balked at paying more for a cold Coke on a hot day.

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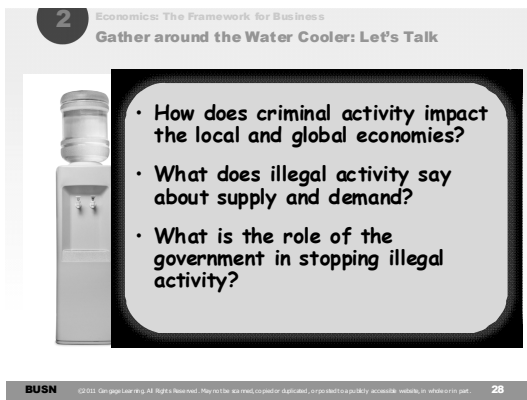
This Coca-Cola example seems to resonate for many students. Ask them what would have happened if Coke had *lowered* its prices on hot days. Would people really have noticed? Would the bump in goodwill have made up for the lost cents per bottle? Why or why not?

Slide 27



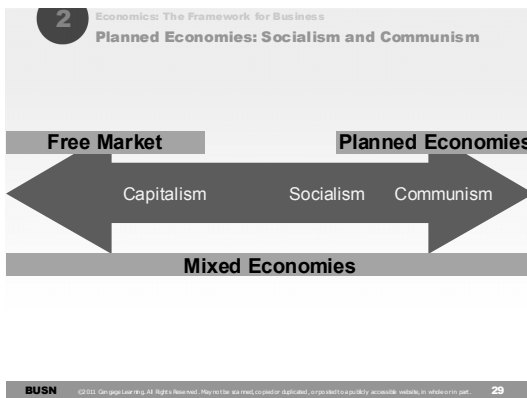
This video clip shows a scene from the movie *Played* in which a heist is about to take place.

Slide 28



Use this clip to spark a discussion about how illegal activities impact the economy, and supply and demand.

Slide 29



Use this slide to introduce the idea that economic systems are necessary in part because we live in a world of finite resources . . . everyone can't get everything they want all of the time. An economic system offers a way to allocate those limited resources to members of society. Also point out that economies fall on a spectrum: planned by the government on one end and controlled by the free market on the other end. This gives students a framework for understanding the discussion on the following slides about each specific system.

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2 Economics: The Framework for Business
Planned Economies: Socialism and Communism

Communism

- Public Ownership of Enterprise
- Strong Central Government

Socialism

- Government Control Key Enterprises
- Higher Taxes

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You may want to point out how *lack* of free choice—too much government control—has played a pivotal role in the lack of success for planned economies. Consider using the Soviet Union and the former Soviet satellite countries to support your points.

Web Connection: Go to the home page of Eurostat, the European Union’s statistical agency, and explore its most popular data bases. The data bases for GDP per capita, real GDP growth, unemployment rates and employment rates include information about not only the entire European Union but also for the United States, Japan,

and Turkey. See its website at <http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home>.

Slide 31

2 Economics: The Framework for Business
Mixed Economies: The Story of the Future

Market and Planned Economies don't meet all needs

- Neither planned nor market economies meet all needs
- Planned Economies will not create enough value

As a market dominant economy, the U.S. government still owns/supports enterprises

- Postal Service
- Universities
- Parks
- Libraries

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Ask students *how* the very old, the very young, and the environment could suffer under a pure market economy. They typically come up with excellent examples, relevant to their local communities. Regarding the lack of value in planned economies, you could point to the skyrocketing poverty level in Cuba and the devastating famines in North Korea.

Slide 32

2 Economics: The Framework for Business
Mixed Economies: The Story of the Future

As Mixed Economies become The Story of the Future, how much government intervention is too much?

What industries should be regulated? Why?



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The questions on this slide typically spark a lively discussion. Consider using China as an example: Will they be able to maintain political control and economic freedom? Why or why not? What do they make of the fact that China has by and large weathered the recent global recession better than the United States? You can introduce the idea of form of “command” capitalism, one that blends a fledgling private sector with state-run companies and a great deal of government intervention. (It will be described in more detail in Chapter 3.) Would such an approach work in the United States? Why or why not? The oil industry also offers a rich example: Should

the oil industry be more highly regulated? Why or why not? Do connections between the oil industry and the federal government make students uncomfortable? Why or why not?

Lecture Booster: How exactly does “command capitalism” in China work? When housing prices rose to unsustainable levels in the United States, banks just kept on issuing mortgages unchecked until the bubble burst with disastrous consequences. In China, when the government realized in early 2008 that a housing bubble was forming, it had the power to tell banks to curb their lending. When the global recession reached crisis proportions, it not only passed a \$600 billion stimulus package and cut interest rates, but it also gave specific orders to state-run industries, such as steel. For example, they were instructed to buy new assets both in China and overseas.⁹

Slide 33



As you discuss each term, you may want to point out that no one measure captures all the dimensions of economic performance. A full understanding requires a range of measures.

Some additional points to consider:

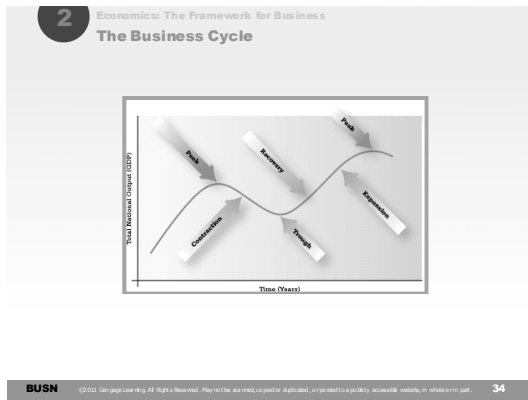
- **GDP:** Remind students that GDP levels tend to be understated since they include neither illegal activities (such as paying undocumented workers) nor legal goods that are not reported to avoid taxation, nor output produced within households. You also might want to point out that the U.S. has the highest GDP in the world.
- **Unemployment rate:** During the global recession, the U.S. unemployment rate has shot up from between 4 percent and 6 percent to close to 10 percent. Distinguish among the different types of unemployment that contribute to the total number: frictional, structural, cyclical, and seasonal.
- **Productivity:** Be sure to cover the productivity equation (output/input=productivity). You may want to also point out that productivity, an excellent measure of efficiency, does not measure quality . . . another good reason to examine multiple measures of economic health.
- **Consumer and Producer Price Indices:** Use these measures as an opportunity to define and discuss inflation. Most students don't seem to realize that mild inflation may be a sign of a healthy economy. You may want to also cover hyperinflation, disinflation, and deflation.

Lecture Booster: While GDP measures the creation of wealth, it falls short as a measure of well-being. This deficiency has led a number of innovative thinkers to evaluate other aspects of economic success, specifically, happiness. Judging by how some people spend money, you might think that happiness is just one swipe of the credit card away. But surveys on happiness show otherwise. While real American incomes have more than tripled since World War II, happiness levels have remained pretty much flat.

The relentless stress of poverty clearly contributes to *unhappiness*, but a number of studies show that once income passes the \$10,000-\$20,000 mark, happiness and income aren't that closely related. In fact, a study of the Forbes 400 richest Americans showed that the wealthiest among us are only a tiny bit happier than the public as a whole. Around the world, a growing number of leaders from different fields are exploring ways to measure societal success beyond the flow of money. The U.S. Bureau of Labor Statistics, for instance, is working with Princeton University to find ways to chart quality of life, with the goal of creating conditions that help people generate personal fulfillment. But since happiness is different for everyone, can it ever really be quantified? Maybe not . . . but the very idea of trying—of measuring gross national happiness—could make a lot of people smile.

Web Connection: Click on the left side of the slide to link to the U.S. Bureau of Labor Statistics (<http://www.bls.gov/bls/newsrels.htm#major>). The latest economic indicators are in the middle of the page. The icon on the right side of the slide connects to CCN Money, which summarizes seven leading indicators on the right side of the page (<http://money.cnn.com/news/economy>).

Slide 34



Point out that the two key phases of the business cycle are expansion and contraction. A contraction is called a recession when GDP decreases for two consecutive quarters. A depression is an especially deep and long-lasting recession.

Lecture Booster: Tell students that there is no official gauge of a depression, but that Harry Truman developed a measure that certainly resonates for many: “It’s a recession when your neighbor loses his job; it’s a depression when you lose your own.”

Slide 35

2008-2009 American Automobile Bailout

- ✓ **After bailing out the financial industry, GM and Chrysler announced they needed a bailout.**
 - Bankruptcy was in the near future
 - 2.5 million auto industry-related jobs were at risk
- ✓ **The Treasury Department infused \$700 billion in a partial auto bailout.**
- ✓ **Under the Obama Administration,** an Automobile Task Force was developed to evaluate the industry.
- ✓ A variety of changes continue in the auto industry as the country rebuilds the economy.

Explain the federal bailout for automakers so students understand the current situation. Both Chrysler and General Motors filed for bankruptcy and then rapidly exited as reorganized companies. Chrysler made deals with Fiat, and General Motors had to make deals with the United Auto Workers, bond holders, banks, and potential litigants as well as its decision to shed several brands. The initial loans were intended to aid the industry in its push to build more fuel-efficient, environmentally-friendly vehicles, with the Detroit 3—General Motors, Ford, and Chrysler as the planned primary beneficiaries.

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Inflation

The rate of price changes across the economy is another basic measure of economic well-being

- Inflation means that prices are rising
- Hyperinflation is when average prices increase more than 50% per month
- Disinflation is when prices increase slow down
- Deflation is when average prices actually decrease.

The government measures prices using the Consumer Price Index (CPI) and the Producer Price Index (PPI)

Point out that deflation is a sign of serious economic trouble because it’s linked with high employment. You might also note that U.S. consumer prices have dropped only slightly during the global recession and that a good part of that roughly 2 percent decline is due to the extraordinarily high energy prices that had plagued the economy during the summer of 2008. Ask students why prices haven’t dropped, despite the high unemployment.

Slide 37

2 Economics: The Framework for Business
Productivity

The relationship between inputs and outputs is productivity

A high level of productivity correlates with healthy GDP.

The U.S. has experienced strong productivity growth due to technology.

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Note that although high productivity usually correlates with high GDP, it doesn't always. Sometimes it isn't the introduction of new technology that increases worker efficiency that boosts productivity, but the slashing of payrolls so that fewer workers are doing the same amount of work.

Lecture Booster: In the second quarter of 2009, productivity rose at an annual rate of 6.4 percent, the highest increase in nearly six years. Economists traced the reason for the increase to the reduction of labor costs by 5.8 percent, the biggest drop in eight years. And, of

course, the main reason for the reduction in labor costs was that an additional 1.3 million jobs were lost during the quarter on top of roughly 5 million shed from the beginning of the recession in December 2007.¹⁰

Slide 38

2 Looking Back

- What is economics?
- What is driving the current global economic crisis?
- How does fiscal and monetary policy impact the economy?
- What is the free market system and the supply/demand relationship?
- What are planned market systems?
- What are mixed market systems?
- What tools are used to evaluate economic performance?

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To review the chapter, ask students to volunteer the answers to these questions.

Closing Activity: This team activity is meant to help students work with their classmates to flex their creative muscles, in line with a key theme of the text—the growing importance of innovation.

Break students into groups of 3-5 people. Ask them to choose a product or service 1) that they're all familiar with, and 2) that they all agree is headed downhill. (Possibilities could include anything from a movie studio, to a local pizza place.)

The Assignment: Write a brief description of how the product is positioned in the marketplace relative to its competition. Then work together to figure out how you can change the product so that it better meets customer needs. Consider changing everything from the product features to the advertising venues. Write a paragraph that describes the revamped product, and draft a new slogan. Share your results with the class.

Sources:

¹ Source: "10 Most Popular Majors at Harvard This Year," *The Boston Globe*, March 30, 2009, http://www.boston.com/news/education/higher/articles/2009/03/30/harvard_pop (accessed August 14, 2009) and Noam Scheiber, "Freakonomizing," *New York Magazine*, October 2, 2005, <http://nymag.com/nymetro/urban/education/features/14642> (accessed September 16, 2009).

² Source: "Revenue Statistics: Comparative Tables," *OECD.Stat Extracts*, August 14, 2009, <http://stats.oecd.org/index.aspx> (accessed August 14, 2009).

³ Sources: "Series: CURRENCY, Currency Component of M1," *Economic Research: Federal Reserve Bank of St. Louis*, updated September 18, 2009, <http://research.stlouisfed.org/fred2/series/CURRENCY/> and "U.S. POPClock Projection," *U.S. Census Bureau*, September 24, 2009, <http://www.census.gov/population/www/popclockus.html> (accessed September 24, 2009).

⁴ Sources: John Ydstie, "Estimated Federal Deficit For 2009: \$482 Billion," *NPR.org*, July 29, 2008, <http://www.npr.org/templates/story/story.php?storyId=93018389>; "Bush Signs Stimulus Package into Law," *msn.com*, February 13, 2009, <http://www.msnbc.msn.com/id/23143814>; Lori Montgomery, "Congress Urges Spending Restraint," *The Washington Post*, January 7, 2009, A2; Mark Trumbull, "US Deficit Forecast to Be Four Times Last Year's Record," *The Christian Science Monitor*, August 12, 2009, <http://features.csmonitor.com/economyrebuild/2009/08/12/us-deficit-forecast-to-be-four-times-last-years-record> (all accessed August 14, 2009).

⁵ Source for Revision: Alan J. Auerbach and William G. Gale, "Deficit: What Caused It, Why It Matters: Effect of Deficits on Interest Rates," *CNNMoney.com*, July 30, 2009, http://money.cnn.com/2009/07/30/news/economy/federal_budget_deficit/index.htm (accessed September 16, 2009)

⁶ Source: Sharon Begley, "The Recession's Green Lining," *Newsweek*, March 7, 2009, <http://www.newsweek.com/id/188200> (accessed September 16, 2009).

⁷ Source: Money Drives Us Crazy: It's Official by Adam Levy (Bloomberg reporter), *The Australian*, February 9, 2006, http://www.theaustralian.news.com.au/common/story_page/0,5744,18084885%255E28737,00.html.

⁸ Sources: Nancy Keates, "Breeders Tell Fans of Water Dogs: Keep Your Paws Off," *The Wall Street Journal*, June 20, 2009, A1; Brian Whitley, "Portuguese Water Dogs Popularity on Rise in New Jersey," *The Star-Ledger*, April 13, 2009, http://www.nj.com/news/mustsee/index.ssf/2009/04/portuguese_water_dogs_populari.html (all accessed June 23, 2009).

⁹ Source: Rana Foroohar, "Why China Works," *Newsweek*, January 26, 2009, <http://www.newsweek.com/id/178810> (accessed September 16, 2009).

¹⁰ Source: *Bloomsberg News*, "Worker Productivity Grows at a Rapid Pace," *New York Times*, August 11, 2009, <http://www.nytimes.com/2009/08/12/business/economy/12econ.html?scp=2&sq=productivity&st=cse>; Louis Uchitelle and Jack Healy, "Job Losses Slow, Signaling Momentum for a Recovery," *New York Times*, August 7, 2009, <http://www.nytimes.com/2009/08/08/business/economy/08jobs.html>; and "Unemployment Jumps to 9.7% — 216,000 Jobs Lost in August," *ABC News.com*, September 4, 2009, <http://blogs.abcnews.com/theworldnewser/2009/09/unemployment-jumps-to-97-216000-jobs-lost-in-august-.html> (accessed September 16, 2009).