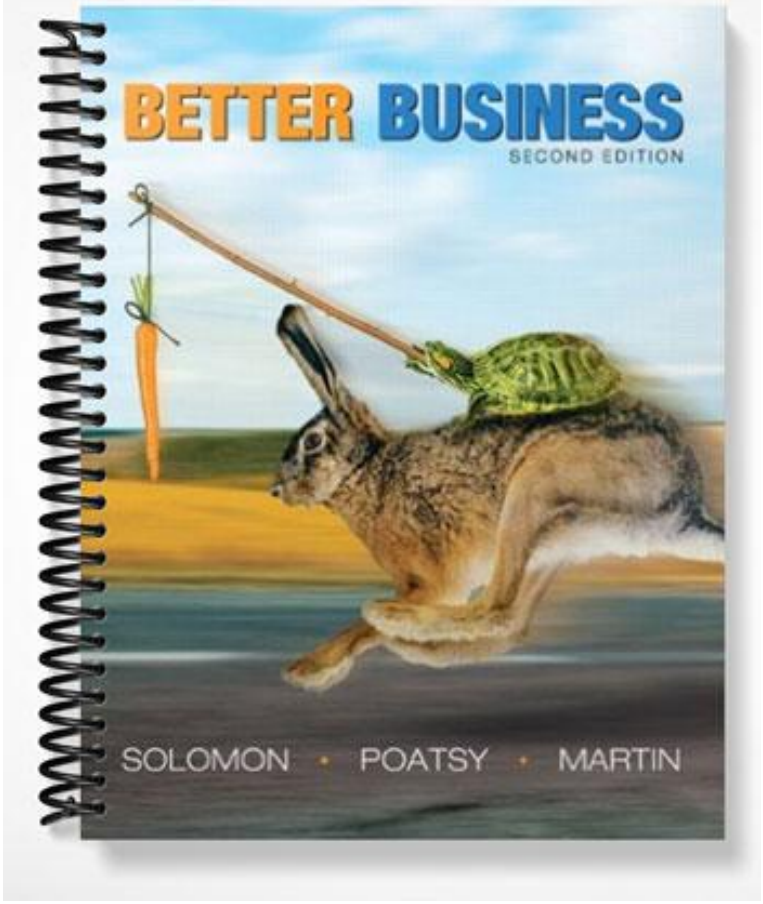
SOLUTIONS MANUAL



CHAPTER 2: ECONOMICS AND BANKING

QUICK REFERENCE GUIDE

IN-CLASS ACTIVITIES

Activity	Description	Time Limit	IE Page Reference
Team Time: The Great Debate	Students divide into groups to debate topics related to economic regulation and control.	45 min.	P48, P58
Ethics and Corporate Social Responsibility: Economic Inequality	Students discuss the idea of economic equality and debate whether or not it is feasible.	20 min.	P31, P59
Web Case: Focus on GE: The Imagination of a Successful Business	Students read a supplemental case study and discuss how it applies to chapter concepts.	30 min.	P37, P59
Video Case: The U.S. Department of Commerce	Students watch and discuss the chapter video.	Video Run Time: 10:33 Question Time: 30 min.	P48, P59
Supplemental In-Class Activity: Comparing Economic Systems	This activity gets students talking about how similar and different the U.S. economic system is to other systems.	30 min.	P31
Supplemental In-Class Activity: Case Study Discussion: Supply and Demand for Pollution Permits	In this activity, students apply their knowledge of supply and demand to a case study about the trading of pollution permits.	30 min.	P35

HOMEWORK ASSIGNMENTS

Activity	Description	Deliverable	At-Home Completion Time	IE Page Reference
Web Exercise: Getting Acquainted with Your Local Federal Reserve	Students check out the website of their local Federal Reserve and identify its latest policies.	Answers to the discussion questions in the activity.	30 minutes	P50, P59
Web Exercise: Buying Your Dream Car	Students research online loan applications and auto loan calculators.	Answers to the discussion questions in the activity.	30 minutes	P47, P59
Web Exercise: Learning More About Supply and Demand	Students play the game at www.lemonadestands.com and identify how the game illustrates the effects of supply and demand.	A brief paper summarizing their experience.	1 hour	P34, P59
Web Exercise: Pro Sports and the Economy	Students play 'Peanuts and Crackerjacks' at: www.bos.frb.org/peanuts/indexnosound.htm and relate their experience to basic economic principles.	A brief paper summarizing their experience.	1 hour	P48, P59
Web Exercise: Monetary Policy: You're in Control	Students play MoPoS (short for: Monetary Policy Simulation) Game— http://www.rbnz.govt.nz/education/readme.pdf	A brief paper summarizing the results.	1 hour	P50, P59

CHAPTER OPENER

Chapter 2 covers the fundamentals of economics — how business decisions are shaped by supply and demand and the degrees of competition.

Students will learn how:

- to interpret key economic indicators, such as the gross national product and price indexes.
- the government can step in to control business cycle swings through taxation, spending, and monetary policy.
- to understand the Federal Reserve, and how its actions influence the U.S. money supply.

DETAILED LECTURE OUTLINE

I. The Basics of Economics

A. Economics Defined
   1. So what is economics?

B. Different Types Of Economic Systems.
   1. What are the different types of economic systems?

C. Business and Economics
   1. Why do business managers need to be concerned with economics?

II. Determining Price: Supply and Demand

A. **Supply** (p. 34) refers to how much of a product or service is available. The amount supplied will increase as price increases.
   1. Supply is affected by technology changes, changes in resource prices, price expectations, price of substitute goods and the number of suppliers.
   2. The **law of supply** (p. 34) says that the amount of a good or service supplied will increase as the price increases - if the price is lower, less of the product is supplied.
   3. A **supply curve** (p. 34) shows the relationship between supply and price.

B. **Demand** (p. 34) refers to how much people want to buy at any given time. The amount demanded increases as price declines.
   1. Demand is affected by changes in income levels, consumer preferences, changes in population, changes in prices of substitute or complementary goods and changes in expectations.

C. Factors That Shift Supply
   1. **Determinants of supply** (p. 35) include technology changes, change in resource prices, price expectations, number of suppliers and price of substitute goods.
   2. Factors That Determine Price
   3. Prices are set at a point where supply equals demand.

D. Factors That Affect Demand
   1. **Determinants of demand** (p. 37) include changes in income levels, population changes, consumer preferences, complementary goods, and substitute goods.

III. Degrees of Competition

A. **Monopolies** (p. 40)
   1. In a monopoly, where only one seller supplies a product or service, supply may be limited.

B. **Monopolistic competition** (p. 41)

1. Monopolistic competition allows for many sellers, increasing the supply and choices for consumers.

C. **Perfect competition** (pp. 41).
   1. Perfect competition occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market increase with an oligopoly, in which a few sellers exist.

IV. Economic Indicators

A. The Gross Domestic Product (p. 43)
   1. The GDP measures the overall market value of final goods and services produced in a country in a year. When the GDP goes up, the indication is that the economy is moving in a positive direction.
   2. The **gross national product** (p. 43) attributes earnings to the country where the firm was owned, not where the product was manufactured.

B. **Consumer and Producer Price Indexes** (pp.43-44)
   1. The **consumer price index (CPI)** and **producer price index (PPI)** (pp. 43-44) are indicators of **inflation** or **deflation** (p. 43). They measure purchasing power and determine the rate at which consumer and wholesale prices change.
   2. The CPI tracks changes in prices over time by measuring changes in prices of goods in services that represent the average buying pattern of urban households.
   3. The PPI tracks the average change in prices of those goods the seller uses to create their products or services such as raw materials, product components that require further processing, and finished goods sold to retailers.

C. **The Unemployment Rate** (p. 45)
   1. Measures the number of workers who are at least 16 years old who are not working and who have been trying to find a job within the past four weeks and still haven't found one.
   2. Unemployment is watched as an indicator of how productive the workforce is, and an increasing unemployment rate generally has a corresponding increase in government spending on social policies (such as welfare and unemployment payments).

D. **Productivity** (p. 46)
   1. Productivity measures the quantity of goods and services that human and physical resources can produce in a given time period.
   2. Increasing productivity means that the existing resources are producing more, which generates more income and more profitability. Overall productivity is an important economic indicator of the economy's health.

V. Government and the Economy

A. **Economic Policies** (p. 48)
   1. Why does the state of the economy change?
   2. How does the government control the swings in the business cycle?

B. **Fiscal Policy** (p. 48)
   1. Why does the government increase taxes to influence the economy?
   2. How does government spending help stimulate the economy?

C. **Monetary Policy** (p. 48)
   1. Besides changes to the fiscal policy, what else can be done to control the economy?
   2. What is the money supply and why is it important?

D. **Open Market Operations** (p. 50)
   1. What are open market operations?

E. **Reserve Requirements** (p. 51)

1. What are reserve requirements?

F. **The Discount Rate** (p. 51)
   1. What is the discount rate?
   2. Is the discount rate the same as the Federal Funds rate?

NOTE: End the lecture by asking students to write down the muddiest points or main points of the lecture. This will allow you to know what might need to be reviewed during the next lecture.

SUPPLEMENTAL ACTIVITIES

Supplemental In-Class Activity 1

2-1.1 Comparing Economic Systems

Activity Overview: This activity gets students talking about how similar and different the U.S. economic system is to other systems.

Time Limit: 30 minutes

What to Do:

1. Divide the class into small groups. Ask the groups to assume they have just overheard a classmate say, "The United States is becoming more socialist every day—with all the government control." Have each group list reasons why the statement could be true and reasons why the statement could be false. (15 minutes)

2. Reassemble the class and discuss each group's thoughts. (15 minutes)

Don't Forget: Remind students that a government's level of control distinguishes capitalism from socialism. If you have foreign students in your class, you may want them to say a bit about the economic system in their native country.

Wrap-Up: Wrap up the discussion by reminding students that the U.S. economic system and a socialist system have certain similarities and many differences. For example, workers in socialist economies often work fewer hours, have longer vacations, and receive more health, education, and child-care benefits than do workers in capitalist economies. On the other hand, the federal government does control some basic services in the United States as well as various aspects of the market through agencies, such as The Food and Drug Administration and The Federal Communication Commission.

Supplemental In-Class Activity 2

2-2 Supply and Demand for Pollution Permits

NOTE: See handout on page 18 of this Instructor's Edition.

Activity Overview: This activity asks students to apply chapter concepts to a case study.

Time Limit: 30 minutes

What to Do:

1. In advance, make copies of the Supplemental Case Study on the following pages and distribute them to students.

2. Divide students into groups and ask them to read the case and answer the questions in their small groups. (15 minutes)
   (a) How does trading in pollution permits at BP demonstrate the laws of demand and supply?
   (b) What would influence the demand for pollution permits if they were traded globally?
   (c) Should companies be allowed to trade permits? Should countries be allowed to? Why or why not?

3. Once students have answered the questions, discuss their answers as a class. As students discuss their answers, make sure they touch on the following points: (15 minutes)
   (a) Those who want to buy permits and those who want to sell them have created a market where the price is set by the action of supply and demand.
   (b) The strictness of government controls on emissions and the individual company's ability to meet the quota, as well as the cost of failure and the price of the needed permit.
   (c) Answers will vary, though there will be much debate about the ethics involved in buying and selling permits.

Don't Forget: Make sure that you keep students on the topic of supply and demand.

Wrap-Up: Wrap up the discussion by asking students for other examples of environmental issues affecting supply and demand.

Supplemental Homework Activity

2-3 Let's Go Shopping!

Homework Assignment: Visit a local shopping mall or shopping area. List each store that you see and determine what degree of competition it faces in its immediate environment. For example, if there is only one store in the mall that sells shoes, that store represents a monopoly. Note those businesses with direct competitors (e.g. two jewelry stores) and show how they compete with one another.

Deliverable: A brief paper reporting on degrees of competition and the tactics stores use to compete with each other. Answers will vary, but students should recognize different levels of competition and how stores respond to competition by advertising, reducing prices, etc.

At-Home Completion Time: 1 to 2 hours.

SUPPLEMENTAL HANDOUT: IN-CLASS ACTIVITY 2

2-4 SUPPLY AND DEMAND FOR POLLUTION PERMITS

When Julie Hardwick, a manager for a division of BP Amoco PLC, checks her computer every day, she's not looking for information about her company's stock. She's finding out whether other divisions of BP are looking to trade their permits to emit pollutants that cause global warming. Units that have leftover permits after meeting their emission-reduction quotas are allowed to sell them to other units that need them to cover shortfalls in their own efforts to meet their goals. The company reports that it is saving millions of dollars through creative reductions in fuel consumption, prompted by the use of permits. Other firms in the developed countries are using permits as well, hoping to reduce pollution before their governments make it mandatory.

Some believe that trading permits between companies or across national borders will prove difficult because of the wide variety of sources of pollution and the problem of maintaining fairness in the use of the permits. For instance, should heavy polluters be made to clean up pollution instead of being able to trade for permits to continue to pollute? Some corporations already use alternatives, called offset rights, which are positive steps that offset the pollution a company can't easily control. Some typical offsets include the use of clean energy, such as solar or wind power, and the planting or protecting of forests and fields that absorb carbon dioxide, a major pollutant.
The Nature Conservancy has used several offset deals to fund rain forest preservation projects, for example.

Others believe that trading can succeed, and that measuring each country's use of fossil fuels will provide a usable gauge of how many permits it should be allowed. Once rules for trading have been established, the cost of complying with pollution controls will drop, and opportunities to come up with creative new sources of energy will proliferate.

Source: Janet Ginsberg, "Letting the Free Market Clear the Air," Business Week, November 6, 2000; 200, 204.

Discussion Questions

(a) How does trading in pollution permits at BP demonstrate the laws of demand and supply?
(b) What would influence the demand for pollution permits if they were traded globally?
(c) Should companies be allowed to trade permits? Should countries be allowed to? Why or why not?

ENHANCING THE ONLINE COURSE

Online Lecture: Define the terms "microeconomics" and "macroeconomics" and use examples to distinguish between the two disciplines. Video tape yourself giving the short "mini—lecture". Many institutions have video cameras for your use in the library or you can use a digital camera with the help of another professor. Load the short video online (using procedures as specified by your online platform). Have your students watch the short video and do a quiz afterward. (Basics of economics, pgs. 29-32)

Economics Model Search: Ask students to search the internet to illustrate each of the boxes in Table 2.1 on page X. Require students to develop and send in a table with graphics and examples in each of the cells to illustrate the differences between the systems of economics. (Different types of economic systems, p30)

Create a Model: Ask your students to use photos or other graphics to show the relationship of supply and demand. Limit the written discussion (in words) to one page to be emailed back to the discussion board. Ask the students to relate the content of their responses to current events posted on the Internet. (Supply and demand, pgs. 32-39)

Price Points: Require your students to check the prices of products for 3 weeks in a row. (Suggested products: bread, eggs, chicken, tomatoes, milk, oranges, coffee, potato chips, and gasoline) What could account for the changes in price? Ask your students to report back on the findings of their "study", to analyze the price differences, and, using the information in the text, to develop some ideas about what has caused the price differences. Students can post the reports via the discussion board. (Consumer and producer price indexes, pgs. 43-44)

Competition: Divide your class into 4 groups. Each group will represent one of the major types of competition (monopoly, oligopoly, monopolistic competition, perfect competition). Have each group prepare a one page summary to be posted online. The summary should include examples from current events over the previous month. Have all groups read all summaries. Determine which group prepared the best summary and provide some extra credit (to enhance the competition!) Post a quiz over all 4 summaries. (Degrees of competition, pg. 39-42)

Chart the Course: Ask your students to create a chart with the GDP of ten lesser developed countries in U.S. dollars. (Suggested countries: Zimbabwe, Cambodia, Chile, Kazakhstan, Pakistan, Uruguay, Paraguay, Mali, New Zealand, and Vietnam). Have your students compare the GDP of these countries with the GDP of the ten most developed countries as shown in the text on page 29. Ask them what could account for the difference. Have them post their responses. (GDP, pg 43)

BIZSKILLS: Supply and Demand

Available at: mybizlab.com

Covers material in Chapter 2

At the end of this exercise, your students should be able to answer the following questions:

1. How do the concepts of supply and demand affect businesses?
2. How are graphs used to describe changing supply and demand?
3. What is an equilibrium price?
4. What factors affect supply?
5. What factors affect demand?

ANSWERS TO END OF CHAPTER MATERIALS:

Self Test

Multiple Choice

1. a
2. c
3. a
4. b
5. b
6. c
7. b
8. d
9. b
10. d

True/False

1. True
2. False
3. False
4. True
5. True

Critical Thinking Questions: Suggested Answers

1. Technology changes in the printing industry have resulted in lower costs of production and higher levels of productivity. Technology advances have also encouraged more companies to enter the print publishing business. These factors increase the supply of printed material. An increase in supply (shown graphically as a right shift of the supply curve) puts downward pressure on the price of printed materials and increases the quantity bought and sold. However, at the same time, the Internet and the availability of immediate news via web-based products, such as Kindle and iPad, have decreased the demand for printed materials, such as textbooks. A decrease in demand (reflected graphically as a left shift of the demand curve) puts downward pressure on the price of printed materials and decreases the quantity bought and sold. The combined effects of a simultaneous increase in supply and a decrease in the demand for printed materials unequivocally decreases the price charged for printed materials, as both put downward pressure on the price. However, we are uncertain about the impact on the quantity traded. This would depend on the magnitude of the increase in supply and the decrease in the demand for printed materials as a result of technological advances.

2. Results will vary, but students should consider that the unemployment rate may be increasing even if we are experiencing an increase in the number of jobs, or people employed. This can happen because as population grows, more people seek jobs in the labor market. Many of these new job-seekers may find work, increasing the absolute number of people employed. However, the *percent* of people seeking a job *and* finding employment may not rise. Therefore, the unemployment rate can rise even though a greater number of people are employed. The unemployment rate is a better measure of economic performance because it is a *relative* measure of economic activity. That is, a falling unemployment rate means the economy is performing better because a greater *percentage* of a growing labor force is able to find work. The trick is to get the economy to grow (increase in GDP over time) at least fast enough to absorb the growing labor force. If this does not happen, then the unemployment rate (the percent of people seeking and unable to find work) can rise even though the absolute number of people working rises.

3. Results will vary depending on the phase of the business cycle currently underway. Although economic indicators are closely watched by many people, the driving force behind changes in these indicators is the amount of overall demand, or total spending, on products. If total spending (the demand for products) rises, then businesses will produce more products to satisfy this increase in demand. More production generates a greater demand for workers and pushes the unemployment rate down. A greater percentage of the labor force employed translates into a higher overall income level for households. This usually means that more people will be out shopping. Increased spending generates still more sales, more production, more jobs and more income to spend. This is what happens during an expansionary phase of the business cycle. On the other hand, a decrease in total spending in the national economy results in fewer business sales. Businesses respond by cutting back on production and laying off workers. Then, the unemployment rate rises. As unemployment rises, people have less income to spend. Spending and sales fall. Businesses produce less, and production falls further, generating still more unemployment and less income to spend, etc. This is what happens during a recession. Economic indicators try to forecast changes in total spending in an economy in an attempt to forecast changes in the business cycle.

4. Monopolies are situations in which there is basically a single seller of the good or service, with no close substitutes for that product. Without competition, the monopoly supplier can charge a higher price and may be less responsive to consumer needs. The NFL (National Football League) and the MLB (Major League Baseball) can be seen as "unofficial" monopolies; for instance, a jury found for a fledging football league, the USFL, stating that the NFL had violated anti-trust laws and made itself a monopoly. Interestingly, the NFL wants to be protected from antitrust suits because it claims that teams act -- in business -- as a single entity.

5. Although GDP is often used to indicate the economic well-being of a country, it really measures only how much we *spend* and, therefore, *produce*. It doesn't really indicate the *well-being* of a society or economy. It's a subtle distinction, but critics point out the GDP includes expenditures that address some of the negative aspects of the economy, such as cleaning up the environment after a bad oil spill, the costs associated with fighting crime, or treating illnesses associated with smoking. These expenditures increase GDP and we may be better off because of them.

   On the other hand, the GDP does not include the economic activity associated with goods produced at home but not sold (i.e., cooking, gardening, crafts), the sale of used goods, or charitable donations and volunteerism. A case in point is Hurricane Katrina in 2005. Oddly enough, if we factor in the increases in the construction, equipment, service, and industrial supply industries used to rebuild New Orleans and the other regions severely damaged by the hurricane, the disaster will end up having a positive impact on the nation's GDP, even though the *well-being* of that region has been negatively impacted. In addition, we do not factor in the massive amounts of donations of money, supplies and volunteer time directed to the region. The positive impact of the volunteer efforts, the significant amounts of donations and grants attributed to Hurricane Katrina and other disasters do not show up in the GDP and do not reflect the activity of our society, since these volunteer and donated activities do not produce a final good or service to be purchased.

   Since these variations are difficult to measure domestically, and to compare internationally, the current method of computing GDP is adequate — a solid economic measure.

Team Time

The Great Debate

Answers will vary. However, the point of the exercise is to help students understand the process of monetary regulation and to discuss who has a right to regulate how money flows in the U.S. economy.

Ethics and Corporate Social Responsibility

Economic Inequality

Answers will vary. However, be sure to have students consider how the type of economy in which they are currently living (capitalism) influences their answers to this question. Would students living in a planned economy, such as communism or socialism, answer the questions in the same way?

ANSWERS TO CASE MATERIALS:

Web Case Solution

To access the Chapter 2 Web case and exercise, visit www.mybizlab.com.

Focus on GE: Standing the Heat, Staying in the Kitchen

Answers to Web Case Discussion Questions

1. Substitute goods for GE's Monogram series (appliances manufactured by Miele, Bosch, and SubZero) were much more expensive than the GE products, which helped to boost the sales of GE appliances.

2. Each of the movements listed increased the likelihood that people would want to remodel their home kitchens. Cooking at home enables people to try out the techniques they see on TV, and to eliminate trans fats from their diets at the same time. Because most of GE's modern appliances are energy efficient, consumers can feel good about switching out their old appliances for new ones.

3. The housing slump hit GE hard, and in May, 2008, the company announced plans to sell off their appliance division.

Video Case Solution

To access the Chapter 2 video case and exercise, visit www.mybizlab.com.

The U.S. Department of Commerce: *Leveling the Playing Field*

Answers to Video Case Discussion Questions

1. In an oligopoly, a market is dominated by a few producers. Because competition is strong and product differentiation is limited in an oligopoly, prices differ only slightly between suppliers.

When a key supplier cuts its prices, its action is usually matched quickly by the competition. If one of the competitors reacts with an even deeper price reduction, another round of price cuts can occur.

2. GDP is an overall measurement of the overall market value of final goods and services produced in a country in a year. It is the most widely used indicator of economic growth by most countries worldwide. When the GDP goes up, the economy is seen as robust, driven by a rise in the production of goods and services and a growth in business activity. In contrast, a downward-moving GDP signals an economic slowdown. Here, fewer goods are being produced, fewer services are being sold, and businesses are feeling the pinch, possibly initiating layoffs or even shutting their doors altogether.

3. Assuming that the food manufacturer passes along some fraction of its higher costs to the consumer in the form of higher prices, then it is likely that demand will drop for the manufacturer's product. This is because people tend to buy more of an item at a lower price than at a higher price. In response, consumers may switch from the food manufacturer's product to a comparable product sold at a cheaper price by another manufacturer, or they might find a substitute product that satisfies the same need.

4. China is a burgeoning market for imported goods and services. Once a socialist economic system, China has moved closer to a market economy. A U.S. exporter should understand regulatory and trading constraints posed by the Chinese government, such as restrictions on foreign investment, a complicated tax system, and a confusing trading system. Also, the exporter should be sensitive to differences in culture and business customs.

Up for Debate Points

Pro: The tax-supported U.S. Department of Commerce should help U.S. companies doing business abroad because companies that generate profits in other countries are likely to buy some inputs, such as physical resources, in the United States. Also, companies that sell abroad help develop markets for new or existing products. Two things can happen here. One, foreign demand for these products increases. Two, the stage is set for other U.S. companies to exploit these markets.

Con: The DOC should not help U.S. companies going outside of the domestic market for two main reasons. First, job losses can happen when U.S. companies move production and sales bases overseas. Second, the tax money should be used to encourage foreign companies to do business in the United States instead and thus create new jobs and boost the domestic economy. usually fairly easy, although access to specialized labor may vary depending on the company's location and nature of its business. Finally, access to entrepreneurial talent is relatively easy, given the drive, creativity, and imagination of many people who start or buy small businesses. With regard to the company's competitive position, cost-savings is always a factor when resources are easily accessible. In addition, proximity to resources provides quicker production times and, thus, quicker delivery to the market.