DOCUMENT RESUME

ED 177 057 SO 011 993

TITLE	The American Economic System...and Your Part In It.
INSTITUTION	Advertising Council, Inc., New York, N.Y.; Department of Commerce, Washington, D.C.
PUB DATE	77
NOTE	24p.; All "Peanuts" illustrations in this booklet have been removed by ERIC due to copyright law
AVAILABLE FROM	"Economics," Pueblo, Colorado 81009 (single copies, free)
EDRS PRICE	MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	Adult Education; *Concept Teaching; Consumer Education; Economic Change; *Economic Education; *Economic Factors; *Economics; Government Role; Individual Power; Secondary Education

ABSTRACT

The booklet, intended for adult or continuing education, discusses the American economic system, emphasizing definitions of economic concepts and the individual's role as part of the system. The objective is to provide a simple description of the American economic system and to promote better understanding of it. The booklet is presented in six chapters. Chapter I summarizes some of the economic principles upon which America's prosperity has been built and stresses the necessity for being able to make informed decisions in order to meet future economic and social challenges. Chapter II defines an economic system as well as goods and services, offering a brief overview of various economic and political systems. Chapter III explains how the economy works, examining the roles of consumers, producers, governments, and natural and other resources. Chapter IV discusses how economic factors fit together and work, emphasizing the concepts of supply and demand, prices, competition, expansion and recession, fiscal policies, monetary policy, and inflation. Chapter V summarizes what the economy provides, discussing gross national profit; personal, disposable, and business income; gross profit; and international trade, including trade deficit and surplus. Chapter VI emphasizes the need for informed economic choices and the role an individual can play in making those choices. It also lists personal and public economic choices involving opportunity cost. (CK)

The American Economic System... and your part in it.

Contents

Prepared in the public interest by The Advertising Council and the U.S. Department of Commerce in cooperation with the U.S. Department of Labor.

Special appreciation is acknowledged for the voluntary service contributed to this project by Compton Advertising, Inc.

This edition includes 1976 statistics.

Fifth Printing

Foreword

This booklet was prepared following a nationwide survey involving Americans from all walks of life.

The survey revealed a basic faith in our economic system. It also revealed that most of those interviewed had difficulty in describing how our American economic system works and how they were involved in it.

This booklet has been prepared to provide a quick and simple description of the American economic system. It can serve as one step in a journey to better economic understanding—a journey which should be a continuing one for all of us.

HOW IT ALL STARTED

The United States in its over 200 years of existence has grown to be the economic wonder of the world, bringing forth a richness from its farms and factories unprecedented in all history. During this period, we have also enjoyed a unique form of democratic government that has been an inspiration to freedom-seeking peoples throughout the world.

We should be aware of the very important connection between our economic progress and the vitality of our democratic form of government.

This booklet presents some of the economic principles upon which America's prosperity has been built, and upon which we can continue to progress during the years ahead.

Because we have a democratic government,

our country goes where we—all of us together—decide we want to take it. Only if the choices we make are based upon an adequate understanding of our economic system, can these choices be made wisely. And informed decisions are essential if we are to be successful in meeting our future economic and social challenges at home and abroad.

In the simpler days of our country's past, when most Americans lived on farms, much trade was by barter, with exchange of crops, such as corn or tobacco, for cloth or nails or sugar. Now we shop in a variety of stores—some offering more than 7,000 items—and we pay with cash, checks, or charge it. This reflects some of the enormous changes that have occurred in our economy.

Today we live in a time of rapid, challenging and sometimes bewildering changes. To deal with these changes—in jobs, in relations between people, in communications, in technology, in commerce—requires much more knowledge than was needed in the simpler society we once had. Most of these changes involve economics.

Economics may be puzzling to many of us, yet we probably understand it far better than we realize. It is what we put into practice every day when we exchange our work for our wages and again when we exchange our wages for the various things we buy. When we borrow money or buy a car, we are making economic decisions that are just as important in their own way as economic decisions made by businesses and governments. When we vote on bond issues and for political candidates we are actually helping to shape the economic decisions of government.

So although the subject of "economics" may sound a little complicated, it is really an everyday part of our lives. All the parts fit together, from a purchase at a neighborhood store to the sale of shares of stock by a corporation or an order from a foreign country for new jet aircraft.

Yet, our economic lives are always changing, and we are continually faced with new situations. More than ever before, we now have to deal seriously with the problem of limited resources. Where we once thought in terms of unlimited resources, we are now increasingly aware that our own supplies of many vital resources—such as oil—are inadequate to meet our present needs, let alone those of future generations. This means we have a whole set of new decisions to make, and we should learn more about them.

In the pages that follow we will discuss how economics is involved in our daily lives, and we will see how basic economic concepts affect decisions made by consumers, producers and governments. It is these important decisions which will help determine how well our economy meets our needs, now and in the future.

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WHAT IS AN ECONOMIC SYSTEM?

An economic system is the mechanism by which labor, resources and skills are brought together to produce and distribute the enormous variety of things people need and want.

These things include *goods* — food, clothing, cars, factories, and the like — and *services* such as transportation, education, health care and public safety.

Three Basic Questions

Since there are limits to what can be produced, basic choices must be made:

What goods and services will be produced?

How will they be produced — that is, who will produce them and what resources will be used?

Who will use these goods and services?

Comparing Economic and Political Systems

Different countries have developed different ways of answering these questions. Knowledge of economic systems in other parts of the world can help us understand our own American economic system better.

Although economic and political systems in each country are related in important ways, we should be careful not to confuse the economic with the political aspects of different nations.

Capitalism refers to a market economy with resources owned primarily by private individuals and groups.

Socialism refers to an economy which depends heavily on the government to plan and make economic decisions and to own and control important economic resources.

Democracy is a political system based on individual freedoms.

Communism describes a socialist economy ruled by a single political party.

In some nations, including our own, individuals are free to choose their personal goals, and to decide how their work and resources will be used. In other nations, only a small group of leaders have this power.

We have what is called a "market economy." It involves economic decision-making by three groups — consumers, producers, and governments. Their decisions are guided primarily by the interplay of buyers and sellers in the marketplace.

Market economies can be democratic, as in the United States, or somewhat more authoritarian, as in Spain. The same is true of socialist economies. In the case of Sweden, democratic political processes guide a socialist oriented economy; in the Soviet Union, a socialist economy is ruled by a single group, the Communist Party.

In today's world, most major industrial

nations are market economies, while socialism is common among developing nations. To understand and appreciate our American economic system, we need to keep in mind the differences between economic and political systems around the world, the results they achieve, and the individual freedoms they allow.

Decision-making in Our Economic System

Two hundred years ago, our government exercised little control in business matters, and individuals made almost all the economic decisions. Even in those early years, though, there was an active national debate concerned with the extent of government involvement in economic life.

Today, things have become much more complicated. Yet Americans still exercise many freedoms of economic choice. We now have what may also be called a "mixed" economy in which three groups play major decision-making roles:

Consumers, who look for the best value in return for what they spend.

Producers, who seek the best income for what they offer.

Governments—federal, state and local—which seek to promote the safety and welfare of the public, and to provide services in the public interest.

You may think of yourself only as a consumer. But most people are a part of all three groups: as consumers, as producers, and as voters helping to influence decisions made by governments.

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Many of our economic issues today are concerned with the ways these three groups are involved in making decisions. In the next section, we will explore in more detail the roles of consumers, producers, and governments. And we will see how you are involved in each of these roles.

WHAT MAKES OUR ECONOMY WORK?

While members of all three groups—consumers, producers, and governments—make decisions in our economic system, the *key* role that really makes everything work is played by you, in your role as a consumer.

Let's look at this role as it was, and as it is today.

Consumers

In 1776, consumers took care of many of their own needs for the basics—food, shelter, and clothing. Economic matters were simple, although work was hard and hours were long. Rather than worrying about income and prices, people more often thought in terms of how long it would take to weave some cloth, or harvest a crop.

Most important, one could see very clearly the relationship between what was produced and what was consumed. This relationship changed as the economic system became more complex, and making wise choices now has become more difficult. But one thing has not changed—ours is still a "consumer economy."

Today, almost two-thirds of our nation's total economic output consists of goods and services bought by individuals and households for personal use. The remaining one-third is bought by businesses and governments. So you can clearly see the importance of all of us as consumers in today's economy.

Every day, we make decisions to buy or not to buy, and these decisions directly affect our economy. Our willingness and ability to spend our money for certain goods and services is called the *demand* for these things.

This demand is influenced by the prices and quality of goods and services. If the price of something rises, we often decide to buy less of it, or to buy something else. If the price goes down, we may buy more of it.

When our incomes change, our demands are also affected. We buy less or shift to cheaper items when our incomes go down. We tend to choose more expensive items or simply buy more when our incomes go up.

Our demand for goods and services affects the efficiency of producers. Most of us look for good values when we buy, and we are increasingly concerned with product safety and reliability. We try to select goods and services which will serve us best and have the highest quality for the price. This rewards efficient producers, who keep quality up and prices down, and penalizes inefficient ones. To succeed, producers must continue to offer goods and services that consumers want.

Producers

As we have noted, individual self-sufficiency was a characteristic of our economy in 1776. People produced goods primarily for their own survival or for barter, but this changed as the economy became more complex and production became more specialized. Today, we rely on others to produce what we need, and we pay for those needs with our wages and other income.

While the output of producers has changed

dramatically since those early days, the function of producers has not.

Producers are those who work by themselves or in groups to provide goods and services. They have made economic decisions based on what they believe the demand will be for their products or services—and they expect to earn an income from what they do.

Who are these producers in the American economic system? You may think only in terms of large businesses, but, in all probability, you are a producer yourself.

Workers are producers. They apply their basic skills and energies to change resources into goods and services.

What this labor force produces keeps changing with our economy. In 1776 most American workers were farmers. A century later, as the country became more industrialized, only one-half of the labor force worked on farms. Today that figure is down to four percent. There have been so many advances in farming machinery, seeds, and fertilizers that far fewer farm workers are now required to supply a much larger consumer demand.

Other important changes have occurred in more recent times. Our demand for services—for such things as education, medical care, entertainment, and transportation—has outpaced our more traditional consumption of goods. Today, producers of services far outnumber producers of goods in our economy.

How does the work force look today? The total civilian labor force for 1976 was almost 95 million persons, of whom over 87 million had jobs. Of these, over three million were agricultural workers, and almost 6 million were self-employed. This leaves 78 million Americans who were working on an hourly or salary basis in business and in government. Unfortunately, during 1976 unemployment averaged more than seven million. Although the American economy has provided many millions of jobs for a growing labor force, reduction of unemployment remains a critical challenge. This important subject will be discussed later.

Many American workers belong to labor unions. When the United States was just a few years old, workers began to join together to bargain with employers for better wages and working conditions. These were our first labor unions, on a very small scale, to be sure.

The American labor union movement

became an important force in our economic system after the Civil War. The Knights of Labor had 700,000 members in the 1880's. In 1886, the American Federation of Labor (A.F. of L.) was formed, and later came the Congress of Industrial Organizations (C.I.O.). In 1955, the A.F. of L. and C.I.O. joined forces and became what is now our nation's largest labor organization. Today, about one-fifth of all workers belong to labor unions.

Managers are producers. They "produce" when they coordinate, plan, and organize the actual production of goods and services. About one-third of all wage and salaried employees are managers, supervisors, or administrators.

Investors are producers. They supply the money, or financial capital, needed to buy and use facilities, equipment, and raw materials.

You may well be helping to supply financial capital without realizing it. If you have a savings account, own shares of stocks, own life insurance, or are in a pension fund, you are helping to generate funds for investment purposes.

Banks, savings and loan associations, and the stock markets help put the savings of people

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to work. By financing home and business investments and the creation of new jobs, they play a vital role in our economic system.

People who start businesses are producers. These people who start new enterprises or businesses are called "entrepreneurs." Their vision and originality have always played a key part in the growth of our economy by providing new goods, services, and jobs. Some of America's famous inventors have been entrepreneurs.

Investors and entrepreneurs take on the risks of financing and owning on-going businesses and starting new ones. They do this for the chance to earn a return on their investments. The amount they actually earn can vary widely, depending upon such things as consumer demand, business costs, and government policies.

The roles of all these producers—workers, managers, investors, and entrepreneurs—are all combined in businesses, the "producing units" in the private or non-government sector of our economy.

The three basic categories of business are:

Single ownership, or proprietorship. One person owns the business and takes responsibility for all operations and risks.

Partnership. Two or more people share the responsibility and the risks of ownership.

Corporation. The business is owned by all the people who buy shares of stock in it. Owners (stockholders) vote for a board of directors, who appoint managers to run the company. The corporation itself is responsible for the firm's debts or other legal obligations. What the investors risk is their investment. The goal of investors in regular corporations is a share of the income earned. Cooperative corporations are owned and controlled by their members, and are operated for the benefit of their members to market products or obtain goods and services.

So although you may never have thought of yourself as a producer in our economy, you may well be one in ways you did not realize.

Governments

We have seen that consumers and producers make decisions in the American economic system. Now let's see how government gets into the decision-making process.

Almost 200 years ago, the Preamble to our Constitution set forth certain goals that were essential to creating and maintaining a climate in which people could work, invest, and prosper.

"We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America." —September 17, 1787.

Government Activities Today. Since the Constitution was written, the country has grown enormously and so has the government's role and responsibility. There are five major areas in which government units, on the federal, state, and local levels, are involved in the economy.

Protection of the rights and freedoms of individuals—economic, political, and religious—through our courts and the administration of our laws.

Providing goods and services in the interest of all of us—such as highways, national defense, and education.

Regulation—the promotion of fair economic competition and the protection of public health and safety.

Promotion of economic growth and stabilization—through various economic policies and programs.

Direct support to individuals—programs to reduce hardships for individuals who can not meet their minimum needs because of special circumstances or lack of employment.

These functions cost money, and to carry them out in 1976, federal, state and local governments spent about $572 billion ($572,000,000,000 or about $7,800 per household).

EXPENDITURES BY ALL LEVELS OF GOVERNMENT, 1976

	Billions of Dollars	Dollars per Household
Buying goods and services—National defense, education, highways, public safety, etc	$361	$4,900
Direct assistance to individuals—Social Security benefits, welfare payments, unemployment insurance, medical care, food stamps, etc.	185	2,500
Other—including net interest on public debt	26	400
	$572	$7,800

Based upon approximately 73,000,000 households in the United States

All of this must be paid for with money raised in two basic ways: by taxing individuals and businesses, and by borrowing. In some cases we pay more directly for the public services we get. Bridge tolls, postage, and tuition charges at public universities are examples of "user charges," and the money raised in these ways helps pay for some of the costs of these services.

In 1976 governments collected taxes of the following kinds:

	Billions of Dollars	Percent of Total
Personal income and property taxes	$197	37%
Corporate profits taxes	65	12%
Indirect business taxes (including sales taxes and property taxes)	150	28%
Social Security, retirement unemployment collections	124	23%
	$536	100%

Anyone who keeps watch over his or her own budget will see that the total spending by all governments for 1976 ($572 billion) was greater than the taxes collected ($536 billion) by $36 billion. The $36 billion difference is called a *deficit*. The size of this deficit reflects the combined impacts on governments of rising expenditures and tax revenues affected by persistent unemployment. Government deficits are financed by borrowing.

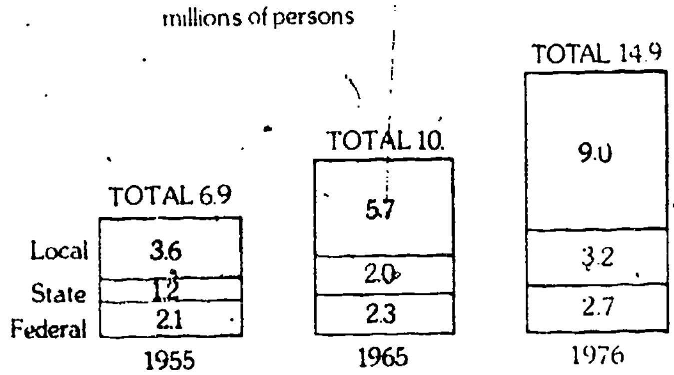
Over the 21 year period from 1956 through 1976, the federal government had deficits in 15 years; state and local governments as a group ran deficits in seven years. However, the reasons for deficits or *surpluses* (taxes greater than spending) at the federal level can differ greatly from those at the state and local levels.

The total debt of all government units at the beginning of 1976 was estimated at almost $748 billion. Seventy percent ($525 billion) was owed by the federal government and the balance ($223 billion) by state and local governments. For comparison, the mortgage debt on private homes was $486 billion, and corporate debt—for such things as additional factories and equipment, raw materials, and operating funds—was $1,287 billion.

With a growing population we have come to expect many more activities from every level of government. More governmental units become necessary as new suburbs, towns, and school districts are formed. Today, in fact, there are some 78,000 local governments in our country. This has resulted in large increases in the number of public employees. The following chart shows the increase in government employment in recent years.

GOVERNMENT EMPLOYMENT (CIVILIAN ONLY)

millions of persons



What should government do? There is considerable debate across the country on just what the scope of government should be. To make sure that government activities best serve the people, all of us need to examine certain issues before we commit our resources and efforts to particular government programs:

Is the program a proper one for government?

Can it be done better by the private sector?

What will the program cost?

Who will pay the costs?

Who will receive the benefits?

Are the expected benefits worth the estimated costs?

These are difficult questions. But we must all think about them, because they affect all of us. Your voice counts in making these decisions. It counts when you vote on such issues as school bonds. And it certainly counts when you vote for public officials who influence policies in such areas as taxes, regulation, consumer and environmental matters, and national security.

Our Other Resources

Our most important "resource," of course, is people. The unique spirit of America is based upon the coming together of peoples from many lands and races to seek freedom and opportunity. We traditionally have responded to new challenges by "getting the job done."

The functioning of our economic system depends upon other resources, too, and how well they are used.

Natural Resources. Some natural resources are *exhaustible*, available to us in limited quantities. Once used, that's it. Examples are crude oil, natural gas, and coal—the so-called "fossil" fuels used to produce energy. Of course, some of these resources are more limited than others. Fortunately, America's coal reserves are the world's largest.

Our nation really runs on energy. With six

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percent of the world's population, we use almost 30 percent of the world's estimated energy production according to the most recent figures available. This reflects our large output of goods and services compared with that of the rest of the world.

Today, almost 94 percent of the energy required by our economic system comes from fossil fuels, primarily natural gas and oil. As a nation, our consumption of oil and natural gas has grown more than 10 times over the past 50 years. Unfortunately, our reserves of oil and gas will not be able to support such high energy usage many years longer.

Concern about the exhaustible nature of our fuel supplies is forcing us to consider a whole series of crucial decisions we must make in the energy area. How can we save energy? Should we encourage exploration for new energy resources? Should this exploration be conducted by private industry or government? Should we increase the use of coal, a relatively abundant fuel in the United States? Decisions we make now will have a great influence on the future of the American economic system.

While our country has vast amounts of natural resources, we are increasingly dependent upon foreign sources for certain critical raw materials besides oil. For example, we had to import from other countries 87 percent of the aluminum, 85 percent of the tin, and 89 percent of the chromium we needed in 1976.

Some resources are *inexhaustible*. They exist in virtually unlimited supply. Energy from the sun is one example; energy from nuclear fusion could be another. However, developing these fuel sources will require new technologies and enormous amounts of dollar investments.

And, it's good to know that some resources are *renewable* with careful planning. Our forests are an example. At present rates of use and with proper management, the nation's forests could assure us of adequate timber resources indefinitely.

Capital Goods and Needs. Factories and machinery needed to convert raw materials into the goods and services we want are called *capital goods.*

The more resources we invest in new capital goods, the less we will have now to use for consumer goods and services. Providing for the future—which is a form of saving—or spending for present needs is a fundamental choice to be made in most economic decisions.

In our early days, when we were primarily a nation of farmers, investments in factories and equipment were not large. But as the industrial revolution spread, and our agricultural economy changed to an industrial economy, more and more investment in capital goods were required.

Factories and equipment wear out, or become out-of date and "noncompetitive." Besides replacing these items, more capital goods are needed if our production is to expand. Without a continuing supply of new capital goods, the economy cannot produce the goods and services and jobs we require now and in the future. And this means large capital investments must continually be made.

The basic incentive for businesses and individuals to invest in new capital goods is the hope of additional future income. Over the years, investment income has been affected by many changes in government policies in the United States, and this has influenced our rate of capital investment. In fact, such policies in several other

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major industrial nations have been more favorable to capital investment than those in this country.

In addition to replacing, modernizing, and expanding existing industrial capacity, our nation will be challenged in the next decade to provide more jobs, expand housing, develop major new energy resources, continue improvements in the quality of our environment, and improve our transportation networks. It has been estimated that our total capital requirements for the next 10 years will be somewhere between $2,000 billion and $4,000 billion, at least double those of the past decade.

Capital goods are important to jobs. In 1976, the investment in equipment and facilities averaged slightly over $41,000 for each production worker in American industry. Over the period 1975-1985, it's now estimated that more than 16 million new jobs will be needed for workers entering the labor market for the first time. Here we face some very important questions. How can business and government best work together to provide these jobs? And how will the necessary capital goods be provided?

In this section on "What Makes Our Economy Work?" we have examined decisions in the American economic system and have seen that they are still basically made by consumers and producers. Yet federal, state, and local governments have become increasingly involved in economic decisions that affect the use of our resources.

HOW DOES OUR ECONOMY FIT TOGETHER?

Our economy can be thought of as a gigantic machine. So far we have been looking at the different parts and what they do. Now, in order to understand the economy more fully, it will be helpful to look at how the whole machine fits together and works. The concept of supply and demand is central to this understanding.

Supply, Demand, and Prices

We have touched on this subject of supply and demand briefly in earlier sections. It is really something we come in contact with every day.

For example, supply and demand affect the wages we are paid; these wages are really the prices we charge for performing work. They also affect the prices of goods and services, the prices of raw materials, and the "price," or interest, paid when we borrow money.

Two factors work together to determine the supply of a product, service, or resource: the cost of producing it and the selling price.

Suppose that buyers are willing to pay more for a product than it costs to produce it. Businesses will usually increase their production to increase their profits (or their return over and above production costs). This "profit margin," if it's large enough, encourages new businesses to enter this field. Now there's more competition among sellers, and this tends to reduce prices or improve products — or both. And it means a larger supply.

There is an opposite side to this point. Consumers may decide by not buying it that a product is not worth the cost of producing it. When this happens, and if the situation continues very long, the product will be forced off the market.

What is going on is a balancing act between the supply of goods and services, and the demand for them in the marketplace. Prices play a role in this process. Look around, and you can see the effects.

When the auto model year is over, last year's models are usually reduced in price to stimulate sales. Department stores hold clearance sales to reduce their inventories.

Food prices go up and down, depending in part on the relative supply of agricultural commodities. However, the costs of such commodities are often a small share of the final retail price for many processed foods. For example, in 1976, it is estimated that prices of farm products accounted for only 16 percent of the price of a typical loaf of bread. The other 84 percent was for processing and distribution.

All these transactions between buyers and sellers are made possible by the existence of money. Using money is a most convenient way to exchange goods and services. Also, by saving money, we can set aside some of our purchasing power for later use. Money makes buying and selling easy, and thus makes our economic life far more productive. That is why money has replaced the barter system in all modern societies.

The marketplace is wherever these transactions occur, where buyers and sellers come together to agree on the exchange of goods and services for money. Money and markets are essential to the American economy. They permit buyers and sellers to influence each other and thereby largely determine what our economy produces and who produces it.

Competition

Competition has always been of key importance in the American economic system.

What Competition Does The vitality of the American economy is based on competition between producers. Those who supply the best goods and services at the best prices generally will be the most successful. And it is through advertising that producers inform buyers about their goods and services.

If, in comparison with similar products, design appears to be inferior, if price is too high in terms of value received, if service falls short, a product will not be "competitive," and its sales could suffer.

Competition is one of the factors which causes our economy to change constantly. Producers tend to move to activities where earnings will apparently be higher and leave those where earnings are lower. This means that workers,

facilities, and raw materials shift to these new areas from former ones.

Production with modern technology frequently requires large factories and very large dollar investments. When this is the case, it may be most efficient for a few big firms to supply the items—at the lower prices that larger production volumes permit—rather than many small ones. Even here competition for sales can still act as a strong stimulus for developing new products and improving current ones.

Government Regulation of Competition. Because consumers obtain benefits from competition, our government has traditionally sought to maintain a competitive environment for business. This has often taken the form of laws or regulations intended to prevent abuses in specific areas. Of course, many government regulations also deal with product standards, environmental impacts, and other matters not directly related to competition.

It's obvious that without competition, prices of goods and services tend to be higher than they would be with competition—and output is lower. When there is little competition, producers can be relatively inefficient without being penalized, and manpower and other resources can be wasted.

As long ago as 1890, Congress passed a major piece of legislation regulating business—the Sherman Anti-Trust Act. The objective was to prevent two or more persons from getting together to "restrain trade." This could involve forming a monopoly, where a single producer dominates an industry so that it can set prices or control supply without regard to competition. It could also involve price fixing, the agreement among several firms to set prices to avoid competition.

There are some cases where competition may not be in the public interest. An example is a public utility that supplies electricity or natural gas or water. Duplication of local power, gas or water lines could result in higher rates. But if there is no competition, how should prices be determined? In such cases, the state or local governments regulate the prices of the services, keeping in mind the interest of the public and the costs involved.

The issue of government regulation of many areas of business, such as food, transportation, and energy, is constantly before us. Are certain businesses over-regulated? Are they under-regulated? How can regulation be used to improve competition? These and other questions must be examined as we look at the role of government regulation in our economic lives.

Productivity. In any discussion of competition, the subject of productivity is likely to come up. Productivity is a relatively new word to most of us, but it is very important to every economic system. Productivity describes how well producers (and governments) use resources—people, facilities, and raw materials.

The most important factors influencing productivity are:

People—their skills, efforts, and motivations.

Capital resources—the availability and efficiency of factories and equipment.

Technology—the application of science to

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industrial needs, involving new materials, new methods, and advanced processes.

Organization— the effectiveness of management in combining resources.

Government regulation— the imposition of standards or restrictions.

Working environment—as it relates to both health and work attitudes.

Improvement of productivity in businesses and industries is essential if we are to maintain competitiveness in selling goods and services both at home and abroad. Since our various governments normally have no competition in providing many of their services, improving productivity in government should be a matter of special interest and concern to us all.

Productivity levels change over the years as economies grow and face new conditions. How does our productivity growth compare with other nations? Before World War II, the United States was the world leader in productivity growth. However, between 1960 and 1976 productivity in manufacturing increased on an average of less than three percent per year in the United States, while in Japan, the figure was almost nine percent for the same period. Japan accomplished this, in part, by using the most advanced technologies in its post-war reconstruction. In fact, all of our major industrial trading partners did better in productivity growth in manufacturing during this period than we did.

Output per worker in the United States is still the world's highest and this reflects our high level of capital investment per worker. But the gap is closing between our country and other industrial nations. This change directly affects the ability of our products to compete in the world marketplace.

We must realize that our future standard of living is tied to productivity growth. As productivity increases, our standard of living increases. With inadequate productivity growth and an expanding population, our standard of living and our ability to compete with other nations could decline.

How do we as producers remain competitive? And how do we increase productivity? Investments in new factories and equipment and improved technology are the answers in many cases. But our rate of investment has been lower than that of all other major industrial nations over the 1960-1975 period. How these needed improvements can be provided will be discussed later.

Balancing the Economy

As you probably realize by now, an important factor making the American economic system work is the "law" of supply and demand. It is not really a law, of course; it is an explanation of the factors determining how much of each product and service is produced, and how those goods and services are distributed.

Remember that when we buy less than our economy is producing, eventually production goes down and unemployment increases. When our purchases increase, this demand results in business expansion and higher employment.

Supply and demand forces ultimately deter-

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mine the levels of production and employment in our economy. But as we shall see, certain steps can be taken to influence what these levels will be. It is now a responsibility of the federal government, as established by the Employment Act of 1946, "to promote maximum employment, production, and purchasing power."

Maintaining both stable prices and high employment, however, is difficult in a free society. Wages tend to increase when available workers are in short supply, and prices of goods tend to rise when demand outstrips supply.

Ups and Downs of the Economy. Over the years, our economy has grown at a remarkable rate. But in this process, there have been periods

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of expansion, and periods of recession. These alternating ups and downs mean that our national goal of high employment is not always achieved.

The economy expands and contracts because our total spending changes. Many factors can cause this, including the introduction of new technologies, the availability of investment funds, changing national economic policies, crop failures, wars, and public confidence in our economic future. There are many more. All these factors directly affect the economy.

Let's consider this matter of public confidence a little further. When economic times are "good," individuals, businesses, and many governments feel more confident about the future, and spend more. An individual might buy a new car or decide to buy a home. A company may decide the time is right to build a new factory or install new equipment. A local government may build a new school.

Expenditures like these are not made every day. When spending occurs in surges because of increased public confidence, this stimulates the economy for a period of time. When such spending slows down, this contributes to a slowing down of the economy.

These economic ups and downs have varied widely in the past, and federal government policies often have attempted to moderate their adverse impacts. However, there are so many complex forces at work in our economy, and the timing of government policies is so critical, that unexpected results can occur.

Fiscal Policies. The taxing and spending policies of the federal government are called fiscal policies.

Federal spending can be increased to keep overall demand at a high level if private spending is low. And federal spending can be restrained to reduce overall demand when demand is higher than our total production.

Government tax policies can also be changed to help balance the economy. Federal tax cuts and rebates can be used to stimulate the economy in a recession—as was done in 1975—or tax increases may be used to help dampen excessive demand.

Whether the federal government has a surplus (spending less than taxes) or a deficit (spending greater than taxes) depends on how fiscal policy is used to meet the needs of the economy and how the economy performs.

Monetary Policy. The Federal Reserve System has responsibility for controlling our nation's "money supply"—the total of all coins and currency in circulation, plus checking accounts held by individuals and businesses. This control is called monetary policy, which is another way to lessen the adverse effects of economic swings.

The supply of money has an important

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influence on spending and production, and banks play a central role in this process. By changing the money supply, the Federal Reserve affects the amount of money that banks can lend to individuals and businesses to spend. In simplest terms, the Federal Reserve generally makes money more available when total spending is considered too low, and less available when total spending is too high. These actions directly influence interest rates throughout our economy.

Inflation. Inflation means a rise in the general level of prices. Nobody wants inflation, but it has become all-too familiar in the world today.

Prices of most goods and services have increased significantly over recent years. Prices often go up as the quality of the goods and services we buy improves. But in general, price increases which are *not* accompanied by improved quality are called inflationary.

When inflation occurs, each dollar we have buys fewer goods and services. In the years

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between 1955 and 1976, the ability of our dollar to purchase these things went down by about 53 percent.

Inflation has at least three basic causes. When consumers, businesses, and governments spend too heavily on available goods and services, this high demand can force prices up. If costs of production rise and producers try to maintain profit levels, prices must increase. The lack of competition between producers can also contribute to inflation.

The burdens of inflation tend to fall more heavily on those who live on incomes that remain the same or rise more slowly than prices. This can include many workers and retired persons. The only way these people can cope with rising prices is to buy less, reducing their living standards.

Employment. The American economy has shown an impressive ability to create new jobs. Between 1950 and 1976, 29 million new jobs were created and total employment rose by 48 percent. During that period female employment almost doubled, as almost 18 million of these new jobs were filled by women.

However, the natural growth and development of the economy has brought major shifts in employment. Some regions of the country grow faster than others. Some industries grow faster than others. The pattern of available jobs keeps changing and the work force must continually adjust to these changes.

Of course, the total demand for goods and services changes during swings in the economy. This change in demand, combined with the regional and occupational shifts in employment just described, causes part of the work force to be unemployed for various periods of time.

Reducing unemployment and the personal hardships associated with it involves efforts by business, labor organizations, government, and individuals themselves. Retraining programs, income assistance, and employment services can all help people adjust to changing job conditions.

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This section has set forth some of the most important economic questions that face our nation today. How can we best encourage competition? How can we best deal with the problems of inflation? In what ways can we broaden employment opportunities for those in need? Each deserves serious thought, since our future progress depends on the answers we provide.

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WHAT DOES OUR ECONOMY PROVIDE?

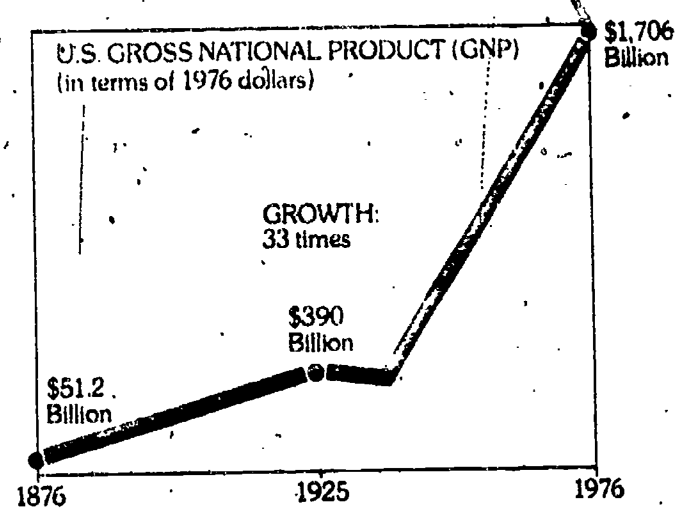
We now have some familiarity with the elements of our economy, with how decisions are made and with how the system works. Now we can look at the extraordinary dimensions of our American economy—the things it provides.

How Big Is Our Economy?

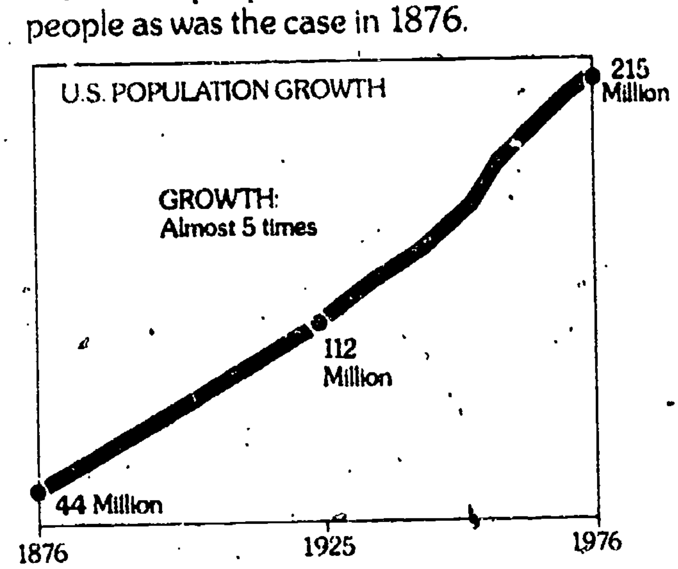
One way to measure the size of our national production is to add together the value of all the goods and services we produce in one year. The total is called the *Gross National Product*, or "GNP." We constantly see and hear references to this total in the news as a yardstick of our production. The GNP does not include do-it-yourself activities, such as housework or home gardening. It also does not measure things like the quality of our environment.

In 1976, our GNP totaled over $1,706 billion. $1,706,461,000,000! Its size was greater than that of the USSR, West Germany, and the United Kingdom combined. This overwhelming figure can be better understood by thinking of it as about $7,900 worth of goods and services per American.

Over the years our GNP has increased astonishingly. The next chart shows the growth in our economy since our Centennial in 1876.



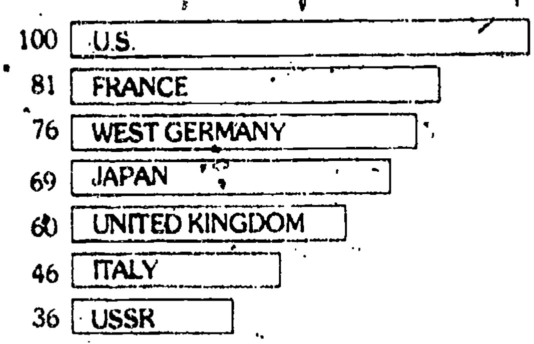
Our population has also increased by almost five times since 1876. This means that in 1976 the GNP was distributed among a population of 215 million people instead of among 44 million people as was the case in 1876.



When population growth is taken into account, the GNP *per person* is still almost seven times its value of 100 years ago.

Throughout all this time, our output of goods and services *per person* has remained the highest of the world's major industrial nations. Below are a few international comparisons for 1976, with the United States assigned a rating of 100.

RELATIVE OUTPUT OF GOODS AND SERVICES PER PERSON – 1976



There are some smaller nations, such as Sweden, Switzerland and Kuwait which did as well or better in national output per person than the major industrial nations listed above.

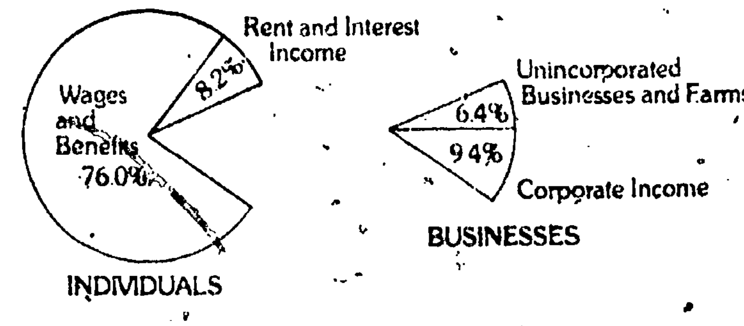
Of course, we have to realize that output per person is simply one of the many things that determine our standard of living. We must also consider things that affect the quality of our lives as well—such as how clean our air is or how much leisure time we have. However, GNP is useful as a measure of some of the things our economy provides that affect how well we live.

Today many questions are asked about our GNP and its growth. Some people feel that we should have little or no economic growth, in order to conserve natural resources. Others say we should continue to increase production and employment even at some cost to our environment. Choices here will determine how well we live in the future.

Income

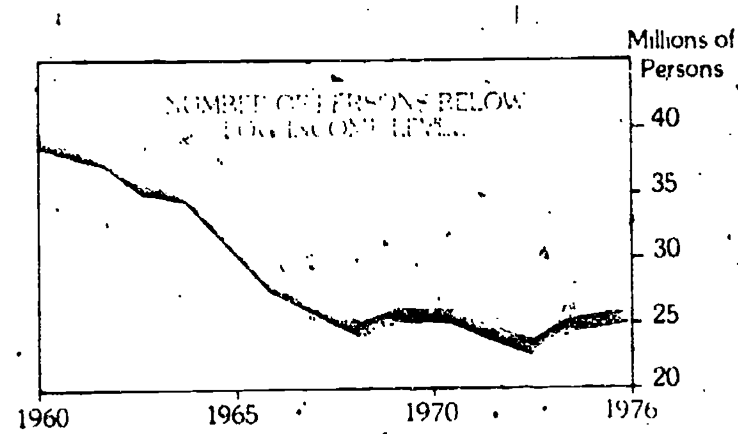
We earn income by applying our skills, efforts, and resources to some productive purpose and being paid for it. In this activity we produce goods and services for others—and income for ourselves. This income, in turn, allows us to buy the goods and services that we want.

If we add up all of the 1976 incomes of individuals and businesses earned through producing goods and services, the total is over $1,364 billion. As you might expect, most of this income went to employees, in wages and benefits, as the following chart shows:



Personal Income. Personal income is the income we receive from all sources—for example, our wages, rent from property we may own, interest on our savings, and profits if we own shares in businesses. Personal income also includes payments, such as Social Security or unemployment benefits, made by governments to individuals. These payments are called "transfer payments" and amounted to about 14 percent of total personal income for 1976. The amount left after we pay taxes is called spendable income or *disposable income*—the money we have left to spend or save in the ways we choose.

Levels of personal income have changed considerably. In 1955, about six percent of all families had incomes over $10,000. In 1975, about 26 percent of all families had an equivalent level of income ($20,000) or higher. Also, the number of people below "low income" levels as defined by the federal government has fallen significantly since 1960.



While incomes in general are rising, it should be recognized that important differences in incomes are associated with differences in race and sex. One way to compare certain income differences is to look at "median family income."

This is the income received by the "middle" family in a particular group. For example, in 1976 median family income of all white families was about

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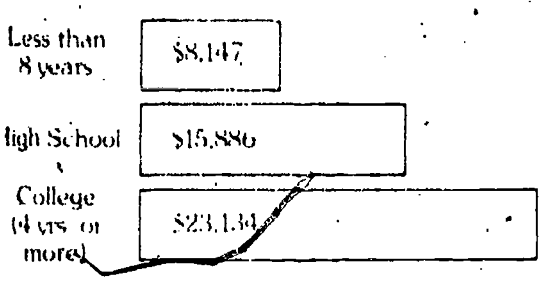
$15,537 while for non-white families it was about $9,821.

There is also a general relationship between the skills acquired through education and the incomes earned later in life, as the following chart shows.

COMPARISONS OF MIDDLE FAMILY INCOME FOR 1976
BY EDUCATIONAL [illegible]



Differences in incomes associated with race and sex are often the result of discrimination and lack of educational opportunity.

There is much public discussion about the incomes of our people. Are we doing enough to improve the lot of the disadvantaged? How can government efforts in this area be made more effective? The decisions we make will affect how the benefits of our American economic system are shared. Here again, your views are important.

Business Income Now let's look at business income, also called *gross profit*. This is the money that is left from sales and other revenues after all costs of doing business (*not* including income taxes) have been paid.

If you lump all American manufacturing corporations together, the average gross profit over the period 1965-1976 was 8.2 cents on each dollar of sales. Of this sum, 3.6 cents went for corporate income taxes, 2.1 cents were distributed as dividends to stockholders, and 2.5 cents were retained by the corporations.

Retained profits are typically used for business expansion, for new plants and equipment, or to repay loans. It is from retained profits that producers can create new jobs and improve their competitiveness by increasing their productivity.

Net profit is the term used to describe what is left from gross profit after business income taxes have been paid. For the period 1965-1976, corporate net profits were less than five cents on a dollar of sales, or about a 12 percent return on stockholder investments.

When a corporation, or other business, does not earn profits, at best only operating costs are covered. The company must then rely more heavily on sales of new stock or borrowed money to expand or bring its production processes up-to-date. But this is difficult, because investors' confidence in the business declines when profits evaporate—and this makes investment money hard to obtain.

International Trade

Trade with other nations is essential to our economic well-being. International trade permits us to apply more of our work and resources to activities where we can do a better job than other nations. It also allows other nations to be successful where they can do a better job than we can.

A country can have a production advantage because of the availability of certain raw materials, a favorable climate, lower wages, or more advanced manufacturing processes.

When goods and services can be produced with relative efficiency, they are competitive in the world marketplace. They offer value which cannot be obtained elsewhere, so other nations buy and import them. This creates jobs and opportunities at home.

In the case of our nation, the products of our agriculture, aerospace, and computer industries are examples of goods that we export because of our superiority in producing them.

International trade also permits us to obtain raw materials and food we need that are not available here in sufficient supply. One obvious example would be petroleum; others are tin, chrome, bananas, and coffee—to cite a few.

The size and mix of our international trade for 1976 are shown below:

1976 IMPORTS AND EXPORTS (in billions of dollars)

Category	Imports	Exports
Fuel and lubricants	$ 34.6	$ 4.7
Other industrial supplies	26.3	27.3
Business and industrial machinery	10.9	38.3
Automotive vehicles, parts, engines	16.1	11.2
Agricultural products	11.2	23.3
All other	21.6	10.2
	$120.7	$115.0

The table shows that in 1976 fuels and lubricants accounted for over one-fourth of our imports, due to pricing actions by The Organization of Petroleum Exporting Countries (OPEC) and increased U.S. imports. Also, agricultural products represented about one-fifth of our total exports, so we can easily see the importance of food production to our international trade.

Even in 1776, the United States was a major trading nation. Today, we are the world's leading trader; West Germany is second, and Japan third.

Our economy has become more and more interrelated with the economies of other nations, and we have seen a dramatic growth of our international trade. From 1972 to 1976, the value of both U.S. exports and imports more than doubled.

When the value of our exports is less than the value of our imports, we have what is called a *trade deficit*. This means extra dollars end up in those countries from which we imported. The reverse is true when we have a *trade surplus*.

A trade deficit or surplus is one of the factors that determine the dollar's value abroad. Other factors include domestic and foreign interest rates, inflation rates, and expectations about the future. In general, the prices we pay for imports change as the supply of and demand for U.S. dollars change in the world's economy.

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What does the American economic system provide? By production at home and by international trade, it provides the goods and services that form the basis of our high standard of living.

ECONOMIC CHOICES

In this brief description of our American economic system, we have tried to answer basic questions: What are the special roles of consumers, producers, resources, and governments? What principles affect how it works? What are the dimensions of our economy?

The Need for Choices

In answering questions like these, it becomes obvious that our economic system is not a perfect one. All of our needs and desires cannot be fully satisfied — nor will they ever be in a world of limited resources.

Throughout history, many societies have attempted to solve this problem by dictating what individual needs and wants should be — and by controlling how these needs and wants are met. Yet economic freedoms and personal freedoms have a way of interlocking. When individuals are told how they must conduct their economic lives, and where there are obstacles to such economic freedoms as spending choices and career choices, personal freedoms are inherently involved.

In the American economic system, decision making is shared by consumers, producers, and governments. Our challenge — and privilege — is to make wise choices in our use of economic resources, to best satisfy our private and public needs and wants, now and in the future.

Considering Alternative Benefits

What benefits do we gain when we make a particular economic decision — compared with the benefits we might have gained by making another? We must always consider the alternatives.

What we are discussing is an economic concept known as *opportunity cost*. When limited resources are used, some benefits are gained, but some are also sacrificed. So there is a "cost" involved in our choice.

This concept applies to all economic choices. For instance, in our own lives we make choices like these:

Spending for things today, or saving for the future.

Balancing spending for food, clothing and shelter against spending for entertainment and recreation.

Undertaking extra work, or spending that time on leisure.

Comparing the potential benefits of higher education with the cost and sacrifices it normally requires.

There are also key public issues that require choices:

How much government involvement in our economy is necessary for its continued well-being? In what areas should there be less involvement? In what areas, more?

How can we balance national growth with conservation of natural resources and protection of our environment?

How can we evaluate the long-term economic and social costs and benefits of various government programs?

How can we hold down inflation and yet stimulate the economy and expand employment?

How can we preserve the benefits of competition in our American economic system and still meet the needs of the less fortunate?

Answers to such questions as these are anything but simple. Yet these issues directly affect our own future, our children's future and our nation's. Under our American economic and political system, such answers depend upon the choices we all make.

For over 200 years, America has prospered, defended individual freedoms, offered hope and opportunity to people from many lands and of many beliefs, and met challenges with confidence and determination.

Our economic system has been a major element in this tradition. The system must continue to be a vital source of strength and achievement if we are to maintain our progress in the years to come.

★★★★★★★★★★★★★

It is hoped that this booklet has given you a better understanding of the American economic system and how you play an important part in it. This booklet will be worthwhile if it has increased your desire to learn more about our economic system and to use that knowledge to make better economic choices for yourself, your family and your nation as it enters its third century.

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Sources of Additional Information

This booklet may have raised some new questions in your mind, or may not have fully covered some issues in which you are particularly interested.

There are many excellent sources of additional information on basic economics and on

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our American economic system. These sources include school and city libraries; labor, farm and business associations; and many agencies of government.

For information on current developments and issues, newspapers, magazines, television, radio, and other news media can be helpful.

Additional Copies

Single copies of this booklet are available without charge by writing: "Economics," Pueblo, Colorado 81009.

For further information about bulk copies contact: The Advertising Council, Inc., 825 Third Avenue, New York, N.Y. 10022.

Statistics

Statistics Contained in This Booklet Are Based Upon The Following sources:

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Contents

Prepared in the public interest by The Advertising Council and the U.S. Department of Commerce in cooperation with the U.S. Department of Labor

Special appreciation is acknowledged for the voluntary service contributed to this project by Compton Advertising, Inc.

This edition includes 1976 statistics.

Fifth Printing