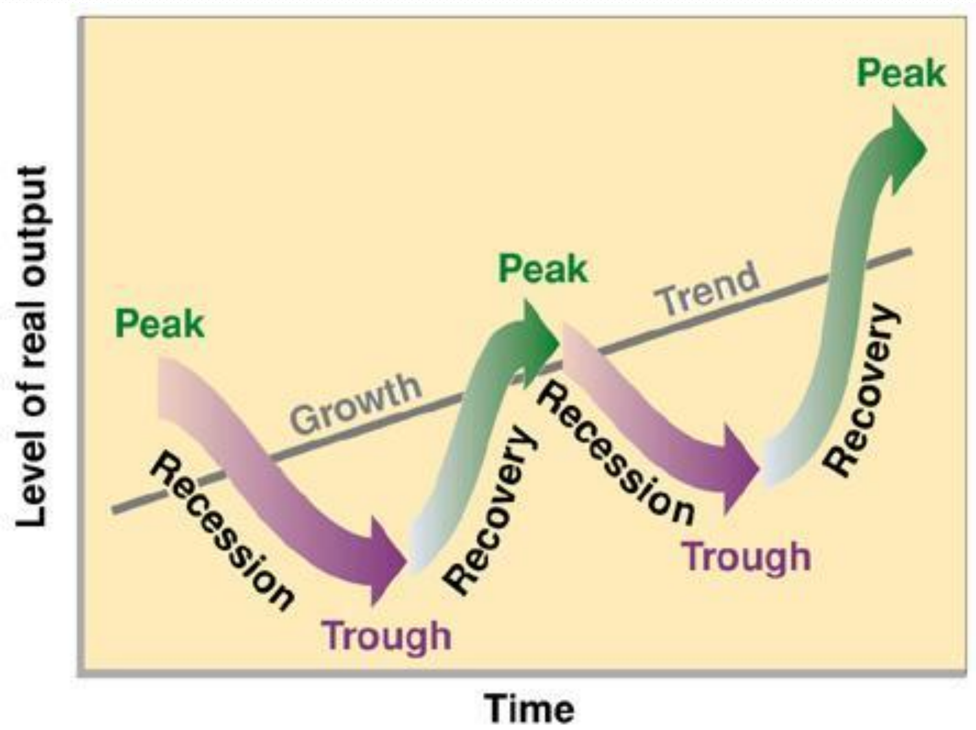
Measuring the Economy and Government Involvement

How can we determine how the economy is doing overall, and what does the government do to try to help when things are not going well?

The Business Cycle

- **<u>Phases of the business cycle:</u>** The economy goes through regular fluctuations where sometimes things are very good, and sometimes they are very bad.
- ***Peak***: highest phase - prosperity and low unemployment. Economy "expands"→more goods and services produced
- ***Trough***: lowest phase - high unemployment / decreased business activity. Economy "Recedes/shrinks"→ fewer goods and services produced



Business Cycle continued…

- Recession: Downward phase; declining GDP for at least 6 months/ 2 quarters.
- Depression: prolonged (several years) period of no growth or decline. No specific definition.

Causes of business cycles

- Political and social upheavals (war, election, etc.)
- Increase or decrease in consumer confidence

Economic Indicators

- **<u>Forecasting business cycles:</u>**
- Gross domestic product: the total value of all goods and services sold in a nation in a year. <u>Does not measure changes in quality</u>

  - 2010 US GDP: $14.62 Trillion

  - China: $5.75 Trillion, Japan: $5.39 Trillion,, Germany: $3.3 Trillion, India $1.43 Trillion

  - Per Capita GDP: GDP per person→ good indicator of Standard of Living. US: $47,100, China: $4,300

  - Real GDP: adjusted for inflation (more on this later)
- Housing starts/ Consumer spending: more new houses means things are good. Less consumer spending means things are bad
- Unemployment rates
- Inflation
- Stock Market

Unemployment

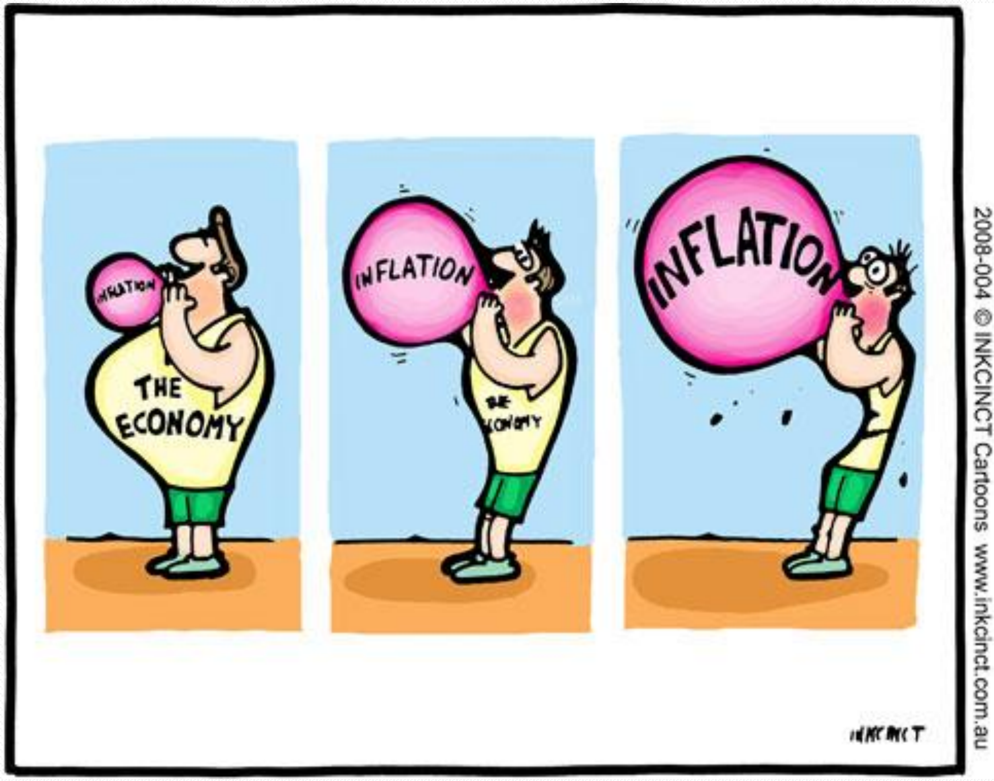
- **Measures of Employment**
  - **employed**: actively working
  - **unemployed**: those who do not have a job and <u>ARE</u> seeking work.
  - **not in labor force**: persons without jobs <u>NOT</u> seeking work
  - **Civilian Labor Force:** All people 16 or older in a nation who are working or looking for work.
- **Unemployment Rate**: Percentage of people in CLF who are not working
  - The unemployment rate tends to rise quickly in recessions and fall slowly in expansions.

Inflation/Deflation

- Measuring inflation - Consumer Price Index→ survey of the change in price of 400 commonly bought products in the country.
- If the price of items has gone up on average, we are experiencing <u>inflation.</u>
- A general rise in prices
- the value of the dollar decreases

Effects of Inflation

- creditors - paid back in devalued dollars (BAD for creditors)
- Wage/salary increases – must match inflation
- cost of living increases
- benefits such as Social Security must be indexed to the CPI



Stock Market

- Individuals buy pieces of ownership in corporations called stocks

  - Stockholders make money two ways

    1) Receive a portion of the company's profits based on their percentage of ownership→ <u>Dividends</u>

    2) Sell stocks at a higher price than they were bought for→ <u>capital gains</u>

- Stocks go up or down in price because people are willing to pay more or less money for them. This decision is based on assumptions about how well the business will do in the future.
- Stock Indexes: look at general trends of many stocks Ex: Dow Jones Industrial Average; S&P 500

  - Stock Indexes tend to be good indicators of how confident people are in the economy.

The Government's Role in the Economy

- Providing Public Goods: the government provides many goods and services to consumers that are not provided by private businesses.
- **Private goods** – consumed by only 1 person, only bought by one person. You must directly pay for it to use it.
  - Pizza, t-shirts, lamps
- **Public goods** – consumed by many. You can use it without paying for it each time. Govt. provides these because they are seen as necessary but it is difficult to get people to pay for them.
  - Libraries, parks, street lights, roads

More Government Involvement

- <u>Government Safety Net</u>

  - **Externalities** – unexpected side effects of economic activity

  - Govt. provides public goods for positive externalities. They also unintentionally cause a positive externality → computer chips

  - Govt. also works to prevent negative externalities, especially pollution caused by businesses

  - Protecting consumers/environment

- Advertising/product safety: ensures that companies are truthful (Federal Trade Commission) and are producing safe products (FDA)

  - **Recall** – removing/changing a dangerous product