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PRINCIPLES OF ECONOMICS

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Prices

CHAPTER 6

GO DIGITAL
It's All Online!

ASKING ESSENTIAL QUESTIONS

- How do prices help determine WHAT, HOW, and FOR WHOM to produce?
- What factors affect prices?

What Will You Learn? You will learn how prices send signals and provide incentives to buyers and sellers, how prices adjust according to market forces, and how government wage and price controls create shortages and surpluses and prevent prices from allocating goods and services.

Why Does This Matter? Have you ever wondered about the cost of an item you want to buy? How does a grocery store determine the price of apples? Why do some apples cost more than others at the same store? Understanding how prices are determined will help you decide if an item is worth the money.

How Will You Know You Learned It? You will be able to explain how prices help individuals, businesses, and markets determine WHAT, HOW, and FOR WHOM to produce. You also will be able to identify problems with rationing, predict how a change in supply or demand may affect prices, and examine the effects of price ceilings and price floors on a market.

Andersen Ross/Digital Vision/Getty Images

ECONOMIC PERSPECTIVES

WHAT'S BEHIND GAS PRICES?

SUPPLY AFFECTS PRICES

The less there is, the more it costs.

OPEC'S ACTION + −

Production decisions by OPEC members can drastically reduce or increase the supply of oil, impacting prices.

WEATHER WOES +

Extreme weather and natural disasters can interrupt the supply chain, limiting supply and raising prices.

MANY MARKETS +

Using oil for other products, like plastics or cleaning products, reduces the supply available for gas production.

TAPPING NEW RESOURCES −

New technology and drilling in new locations is helping keep the cost of gas reasonable.

THE COST OF CONFLICT +

Political instability in oil-producing countries can limit oil supply and cause spikes in gas prices.

THINK ABOUT IT!

PREDICTING *Oil is a nonrenewable resource, which means the more we use, the less will be available in the future. What predictions can you make about the price of gasoline in the future?*

\+ Price increase

− Price decrease

Have you ever wondered what causes the neverending changes in gas prices? Sometimes it seems like you blink and the price is different. The powerful factors of supply and demand, both of gasoline itself and the crude oil used to make it, play a big part in the price you pay at the pump.

DEMAND AFFECTS PRICES

The more people want it, the more they pay for it.

RECESSION REALITIES −

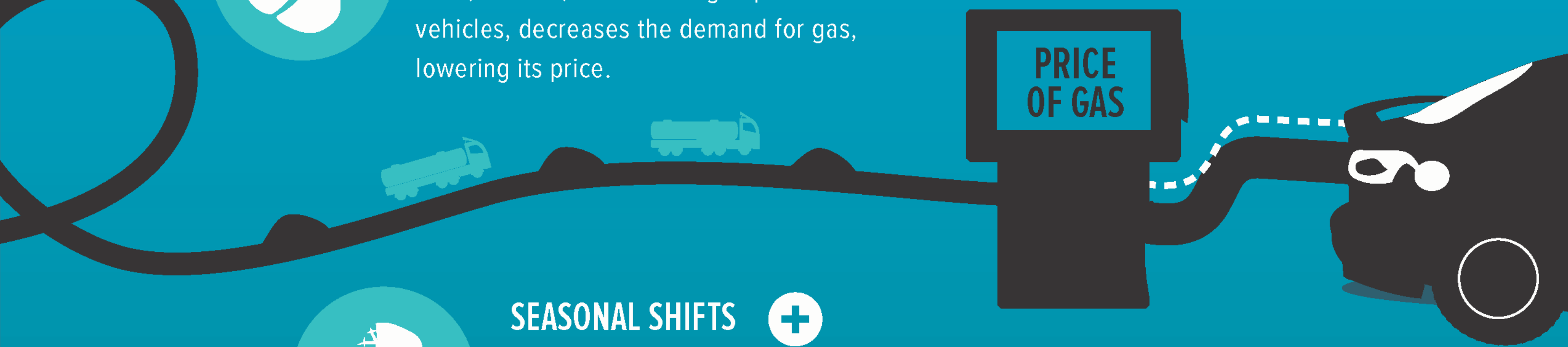
Economic downturns decrease the demand for gasoline, dragging prices down.

DISPROPORTIONATE DEMAND +

The U.S. uses 20 percent of the world's crude oil (but only produces 2 percent of the supply). Importing oil to meet demand raises prices.

GOING GREEN −

The growth in alternative energy, such as solar, electric, and natural gas-powered vehicles, decreases the demand for gas, lowering its price.



SEASONAL SHIFTS +

Gas prices spike on weekends, holidays, and during the warm summer months when more people travel. Prices drop during winter when people stay indoors.

MORE, MORE, MORE! +

Global demand for oil is growing, ensuring prices continue to rise.

THINK ABOUT IT!

***IDENTIFYING CONNECTIONS** We know demand affects gas prices, but how might rising gas prices affect demand?*

EXPLORING THE ESSENTIAL QUESTION

Prices act as signals that help consumers make economic decisions.

LESSON 1

How Prices Work

ESSENTIAL QUESTION

How do prices help determine WHAT, HOW, and FOR WHOM to produce?

How does the price of a product affect how you allocate scarce resources—your money and your time? Make a list of three things you or your family purchased in the last year. For each item, answer the following questions.

a. Was the price of the product clear and easy to identify? Explain your answer.

b. Would you have paid more for the product if you had to? If so, how much more?

c. If the price of the product was lower, would you have bought more of it?

d. Did the price of a competing brand or product affect the decision you made?

e. Would you have gone to another store or website if the price of the product was lower there?

97/E+/Getty Images

ANALYZING KEY IDEAS AND DETAILS

Read closely to learn why prices are important and what we'd use if we did not have prices. Use a diagram like this one to list the advantages of a price system in a market economy.

WHY PRICES ARE IMPORTANT

GUIDING QUESTION *How do prices help us make decisions?*

Suppose you walk into your favorite coffee shop and a sign on the wall says your frozen coffee with extra whipped cream will cost you $4.50. The price seems a little steep, but you're willing to pay it because, after all, you love coffee. But what if tomorrow that coffee costs twice as much? Would you still be willing to buy it?

Price—the monetary value of a product—does much more than simply tell you how much you have to spend when you make a purchase. Collectively, prices act as a system of signals that help us make economic decisions. At the same time, they function as incentives that affect the behavior of individuals, businesses, markets, and even entire industries. In fact, prices have a number of advantages, discussed below, that you probably haven't even thought about.

PRICES AS SIGNALS

There are many signals in life that you are already familiar with. For example, pain is a signal that tells you something is wrong with your body. A traffic light at an intersection signals when to slow down, stop, or go. Similar to pain or a traffic light, prices are signals that give information to buyers and sellers. High prices are a signal for buyers to purchase less, and for producers to produce more. Low prices are a signal for buyers to purchase more, and for producers to produce less.

The signals we get from prices also serve as incentives that cause us to take additional actions. If the price of something goes up, you may decide to shop at a different location, or find a comparable substitute. Likewise, a firm may stop producing other items to free up the labor, capital, and machinery needed to increase production of a product that can be sold for a higher price.

ADVANTAGES OF PRICES

Prices help producers and consumers answer the three basic economic questions of WHAT, HOW, and FOR WHOM to produce. Without prices, the economy would not run as smoothly, and these allocation decisions would have to be made some other way. Prices perform this function well for at least four reasons.

Neutrality In a competitive market economy, prices are **neutral** because they favor neither the producer nor the consumer. Because prices are the

ANALYZING KEY IDEAS AND DETAILS

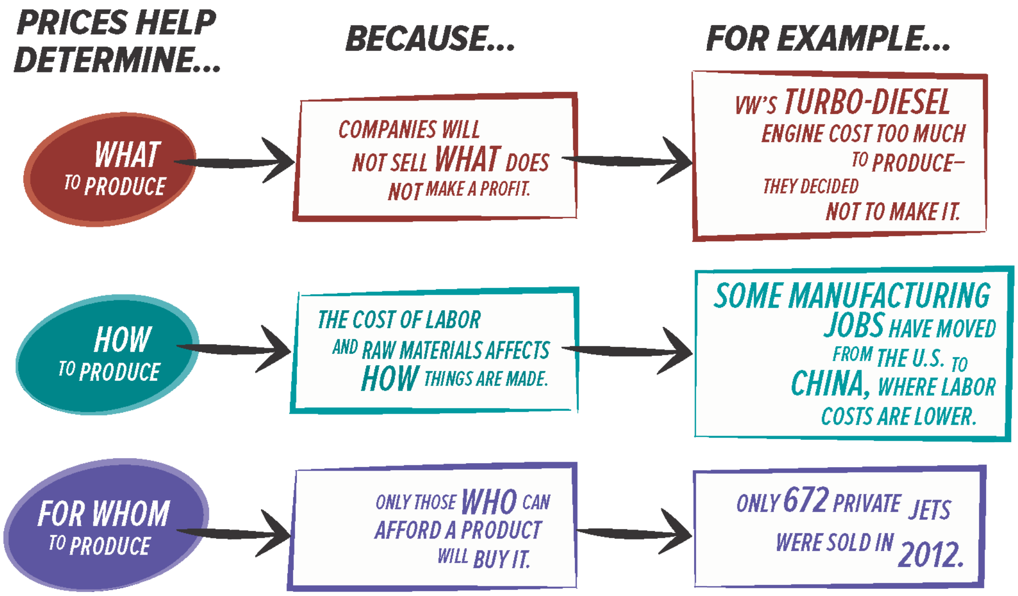
1. **SUMMARIZING** Summarize this section in two or three sentences. Be sure to include all the reasons prices are important.

2. **CITING TEXT EVIDENCE** How do prices determine FOR WHOM to produce?

DETERMINING MEANING

The word ***price*** is commonly used in economics and daily life to express the monetary value of a good or service. What are some synonyms for this word?

PRICES AND PRODUCTION



INTEGRATING INFORMATION What is another example in which price helps determine the WHAT to produce question?

result of competition between buyers and sellers, they represent compromises that both sides can live with.

Flexibility Prices in a market economy help provide flexibility. Unforeseen events such as natural disasters and war affect the prices of many items. For example, when Hurricane Sandy destroyed much of the northeast United States in October 2012, oyster harvesters in the Chesapeake Bay were unable to work for several days. This caused the price of oysters to temporarily spike in places as far away as Georgia. Buyers and sellers then reacted to the new level of prices and adjusted their consumption and production accordingly, helping the system function smoothly again. The ability of the price system to absorb unexpected “shocks” is one of the strengths of prices in a market economy.

Familiarity Most people have known about prices all their lives. As a result, prices are familiar and easy to understand. There is no ambiguity over a price—if something costs $1.99, then we know exactly what we have to pay to get it. This allows people to make decisions quickly and efficiently, with a minimum of time and effort.

Efficiency Finally, prices have no cost of administration. Competitive markets tend to help products find their own prices without outside help or interference. No bureaucrats need to be hired, no committees formed, no laws passed, or other decisions made. Even when prices adjust from one level to another, the changes are usually so gradual that most people hardly notice.

Here, a professor at George Mason University explains why there is a predictability to prices:

> “There’s a certain predictability to prices. An orderliness. It needn’t be that way. Prices could be a random jumble, high one day low the next. On some days, movie tickets could cost more than oxford button down shirts, oranges more than a quart of milk. What is the source of that order? Where do prices come from? The answer at first, seems obvious. The seller sets the price. But if you’ve ever tried to sell anything, you know that it’s not really true. . . . [I]f you choose a price that’s too high, you won’t sell it. . . . Prices adjust to equate how much people want to buy with how much they want to sell. And if people want to buy more than they did before, prices rise. If people want to sell more than they did before, prices fall. Supply and demand. Buyers are competing with each other. Sellers are competing with each other. The prices we observe emerge from this competition.”
>
> —Russell Roberts, “Where Do Prices Come From?”

ANALYZING PRIMARY SOURCES

1. **CITING TEXT EVIDENCE** According to the author, what is the reason for the predictability and orderliness of prices?
2. **DETERMINING CENTRAL IDEAS** What part does competition play in prices?

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** How do prices help us make decisions?
2. **EXPLAINING EFFECTS** How are prices neutral?
3. **ANALYZING ISSUES** How do prices serve as incentives?

WHAT IF WE DID NOT HAVE PRICES?

GUIDING QUESTION *Are prices the best way to allocate resources?*

Have you ever thought about how our economy would function without prices? Without knowing the prices of goods or services, how would we decide WHAT to produce? Without knowing the cost of productive inputs, how would we answer the HOW to produce question? Finally, how would we decide FOR WHOM to produce? Would intelligence, good looks, or even political connections determine the allocation?

These questions may seem far-fetched, but even command economies need **criteria** to answer these questions. For example, when the Baltimore Orioles played an exhibition baseball game in Cuba in March 1999, there

UNDERSTANDING CRAFT AND STRUCTURE

1. **ANALYZING TEXT STRUCTURE** Why did the author organize this section into two subsections?
2. **ANALYZING POINT OF VIEW** How does the text suggest that a rationing system leads to dishonest behavior?

In 1999 the Baltimore Orioles visited Cuba to play against the Cuban national team. The Cuban government rationed the number of tickets made available to the people of Cuba.

PHOTO: Doug Pensinger/Getty Images Sport/Getty Images; TEXT:Roberts, Russell. “Where Do Prices Come From?” Library of Economics and Liberty, June 4, 2007. http://www.econlib.org/library/Columns/y2007/Robertsprices.html.

weren't enough stadium seats for all the local baseball fans who wanted to attend. Cuba's Prime Minister at the time, Fidel Castro, then solved the FOR WHOM question by giving the tickets to Communist Party members—whether they were baseball fans or not. The Cuban government's decision to hand-pick the lucky attendees seemed unfair to many Cuban baseball fans who were not given the opportunity to attend. In contrast, the tickets for a second game, held in May 1999 in Baltimore, were not by invitation only. Instead, prices for the

Rationing in the United States

WARTIME RATIONING 1942–1945

During World War II, the federal government rationed food, gasoline, and even clothing. This was done to ensure that the raw materials or the finished products for these items were guaranteed for military use.

The vast majority of Americans supported U.S. involvement in World War II after Japan attacked Pearl Harbor in December 1941. As a result, most Americans readily complied with the rationing and restrictions the government put in place, even though it eliminated the market-driven forces of supply and demand.

RATIONING TODAY

Modern-day rationing in the United States is uncommon and is usually a temporary response to an unexpected crisis or shortage.

In late 2012 New England states implemented temporary gas rationing after Hurricane Sandy made it difficult to deliver enough gasoline to the area residents. In 2013 a nationwide helium shortage meant the gas was conserved for use in essential medical and manufacturing industries. As a result, party supply stores received only a small ration of helium for use in balloons.

ECONOMIC REASONING

ECONOMIC DECISION MAKING Do you think it is a good idea for the government to implement rationing during a crisis or shortage? What might be the result if the economy relied on the price system instead of rationing?

Mario Tama/Getty Images News/Getty Images tickets were kept the same as any other game and could be purchased by any baseball fan. Baltimore's decision to allow any baseball fan to purchase a ticket ensured that there was not any unfair or preferential treatment. This not only provided fans with an equal opportunity to attend, but also allowed a diverse group of baseball fans to enjoy the game together. You can see how prices allowed more fairness.

RATIONING

Without prices, another system must be used to decide who gets what. One method is **rationing**—a system under which government decides everyone's "fair" share. Under such a system, people receive a ration coupon, a ticket or a receipt that entitles the holder to obtain a certain amount of a product. The coupon can be given to people outright, or the government can charge a modest fee.

Rationing was used widely during World War II, but has not had widespread use since then. This is because the problems with rationing are more extensive than most people realize.

DETERMINING MEANING

The term *ration* comes from the Latin term *ratio*. How is **rationing** related to a ratio?

PROBLEMS WITH RATIONING

In the mid-1970s, the country faced an energy crisis that quadrupled the price of oil. State governments implemented a simple form of rationing to deal with gasoline shortages in 1973. Drivers whose license plates ended in an odd number could buy gas on odd days, while drivers with even-number plates could buy gas on even-numbered days. In 1974 the national government started to make plans for further gasoline rationing involving coupons, but the plans were never implemented, largely because of the following problems.

Perceived Fairness The debate over fairness began immediately. People in small towns thought they should have more coupons than people in big cities, because big cities had better mass transit systems.

People with older cars thought they should have more coupons, because their vehicles were less fuel-efficient than newer ones. However, people with newer cars thought that this would penalize them for having bought more expensive, fuel-efficient ones. Couples with several cars thought they should have more coupons because they had more cars to provide fuel for, but couples with one car thought that would not be fair to them. Consequently, making a distribution system that everyone thought would be fair seemed almost hopeless.

Administrative Expense The administrative cost of rationing is another major issue. Someone has to pay for the printing and distribution costs of the coupons, and that includes the salaries of workers. Every community would also need "review boards" so that someone could listen to those who thought they should have more coupons. In 1974, nearly 5 billion gasoline ration coupons were printed just in case the government decided to go ahead with a rationing program. The tentative plans, never carried out, were to ship the coupons to every post office in every city or town in the country so that everyone would have access to them after the "fairness" problem was resolved.

Distorted Incentives Rationing programs are specifically designed to take the place of supply and demand. The one in 1974 that was designed to keep the cost of gasoline low for consumers would have distorted market incentives in three different ways: Energy companies would have been discouraged from producing more gasoline. Automobile companies would have had less incentive to produce more fuel-efficient vehicles. And, consumers would have had less incentive to reduce unnecessary driving to save gasoline. None of these incentives solved the basic problem of too little supply and too much demand.

Abuse and Misuse Finally, no matter how much care was taken, some coupons would have been stolen, sold, or counterfeited. The 1974 gasoline coupons had another unique problem. To make them difficult to counterfeit, each carried a high-quality portrait of President Washington like the one on a dollar bill. Unfortunately the likeness was so good that a ration coupon could also be used in a dollar-changing machine. This gave anyone with a coupon the option to use it for a gallon of gas that cost about sixty cents, or to use it in a coin changer to get four quarters.

As you can imagine, the problems with rationing are extremely difficult to solve. The many problems surrounding the 1974 gasoline rationing coupons were the reason that they were never issued and later destroyed.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** Are prices the best way to allocate resources?
2. **DIFFERENTIATING** What are the differences between the price system and rationing?
3. **UNDERSTANDING CONTEXT** What are four problems that arise in a rationing system?

PRICES AS A SYSTEM

GUIDING QUESTION *How do prices connect markets in an economy?*

Although the price system is not perfect, most economists believe it is the most efficient way to allocate resources. This is because prices do more than help individuals make decisions; they also help allocate resources both within and between markets.

Consider the way in which higher prices ripple through markets today, causing changes both large and small. Because the demand for gas is basically inelastic, high gas prices mean that people have to spend a greater part of their income on gas, leaving them with less money to spend elsewhere. If enough drivers believe that higher gas prices are likely to be permanent, they may buy more fuel-efficient cars, including hybrids that run on both electricity and gasoline. Many others may instead decide to rely more on their city mass-transit systems, or do without automobiles altogether.

Over time, the impact of higher gas prices will spill over to the farm and consumer food sectors. Farmers will benefit if they sell more of their grain to companies that make gasohol, a blend of 90 percent unleaded gasoline and 10 percent grain alcohol. But, whenever more grain is used in fuels, less is available to make flour—which raises the price of bread. Other companies may make major investments in **biofuels**—fuels whose energy is derived from

INTEGRATING KNOWLEDGE AND IDEAS

1. **INTEGRATING INFORMATION** How does the text suggest that the price system leads to innovation?
2. **EVALUATING EVIDENCE** How does the author tie gasoline prices to food prices?

renewable plant and animal materials, vegetable oils, and municipal and industrial wastes—in hopes of developing adequate substitutes for gasoline.

The ultimate impact of higher gas prices is to cause productive resources, like raw materials and workers, to shift out of some industries and into others: out of wheat production for flour and bread and into wheat production for gasohol; out of gas-guzzling automobiles and into fuel-efficient hybrids; out of other industries and into renewable fuels. Although the adjustment process is painful for many individuals and companies, it is a natural and necessary shift of resources for a market economy.

In the end, prices do more than convey information to buyers and sellers in a market: they also help allocate resources between markets. This is why economists think of prices as a "system"—part of an informational network—that links all markets in the economy.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** How do prices connect markets in an economy?
2. **IDENTIFYING EFFECTS** How do prices help allocate resources between markets?
3. **ANALYZING ISSUES** Why do economist think of prices as a "system"?

LESSON 1 REVIEW

Economic Reasoning

1. **ANALYZING CHANGE** Imagine you run a company that makes and sells skateboards. If the price of skateboards started to increase, would you choose to make more skateboards or fewer skateboards? Explain your decision.

Building History-Social Science Analysis Skills

2. **IDENTIFYING CONNECTIONS** Think of an example of a product or technology that no longer exists or that is not as common as it once was. What do you think happened to the price of this product before producers stopped making it?

3. **ANALYZING ISSUES** A manufacturer of a product that has been in business for more than a century suddenly has few customers. Even lowering prices does not help. What should the manufacturer do?

4. **DRAWING CONCLUSIONS** Do you think it is ever fair for a producer to ration an item? Explain.

Writing About Economics

5. **EXPLANATORY WRITING** Research an example of rationing that took place in either the United States or another country. Under what circumstances was rationing implemented? How was it implemented? What effect did rationing have on the economy? Was rationing an effective way to allocate goods and services in this particular situation? Explain your findings in a two-page essay.

Collaborating

6. **INTEGRATING INFORMATION** With a partner, create index cards with realistic situations that portray either (a) one of the four advantages of prices, or (b) one of the four problems with rationing. On the front side of the card, identify the situation; for example, "no bureaucrats need to be hired." On the back of the card, state the answer; for example, "efficiency of prices." After preparing your cards, quiz another group.

LESSON 2

The Effects of Prices

EXPLORING THE ESSENTIAL QUESTION

ESSENTIAL QUESTION

What factors affect prices?

You are the owner of a general store that sells a wide variety of products. A new employee has just finished putting price tags on several of the products and you are checking his work. For each of the following products, decide whether you think the price is too high, too low, or just right. Explain your decision for each.

a. $7.99 for a new bicycle

b. $1.00 for a can of corn

c. $44 for a Frisbee

d. $99 for a burrito

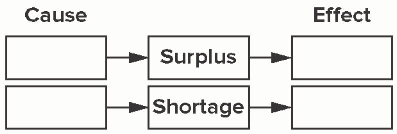
e. $35 for a wristwatch

f. $2 for a pair of socks

moodboard/cultura/Getty Images

Prices vary depending on the supply and the demand for a product.

Cause and Effect of Surplus and Shortage



ANALYZING KEY IDEAS AND DETAILS

Read closely to learn how prices adjust and why prices change. Use a diagram like this one to identify the causes and effects of surpluses and shortages.

HOW PRICES ADJUST

GUIDING QUESTION *How does price affect a seller's decision to produce a product?*

Have you ever tried to buy something and had to haggle over the price? The transaction probably went something like this: the seller started by quoting a price that seemed unrealistically high. You countered with an offer that the seller thought was too low. Then you bargained until you settled on a price that was agreeable to both of you.

Of course you don't have to argue with sellers over the price of every product you buy. However, prices for almost all goods and services in a market economy represent compromises between buyers and sellers to reach a final price.

ANALYZING KEY IDEAS AND DETAILS

1. **SUMMARIZING** Read the text under the subhead "Markets and Prices." What is meant by the statement "neither can get exactly what they want"?
2. **ANALYZING IDEAS** Read the subsequent headings in the lesson. Briefly explain the sequence of events that occur to reach equilibrium.

MARKETS AND PRICES

In a market economy, buyers and sellers have exactly the opposite goals: buyers want to find good deals at low prices, and sellers hope for high prices and large profits. Neither can get exactly what they want, so some adjustment is necessary to reach a compromise. In this way, everyone who participates has a hand in determining prices.

For example, how do we know that the price of a cell phone is fair to both the producer and the consumer? Most economists would argue that as long as the process is competitive and the transaction is voluntary, then the price will be just about right or the sale would not take place. Because transactions in a market economy are **voluntary**, the compromise that settles the differences between buyers and sellers must be to the benefit of both, or the phone would not be sold.

SUPPLY AND DEMAND

So, how does a market arrive at a compromise price that is "just about right"? To see how this process works, we'll put the burrito demand curve from Figure 4.3 and the burrito supply curve from Figure 5.3 together in **Figure 6.1.** This figure is the most popular "tool" used by economists and represents what most people simply call "supply and demand." The figure is also an **economic model** that can be used to analyze behavior and predict outcomes.

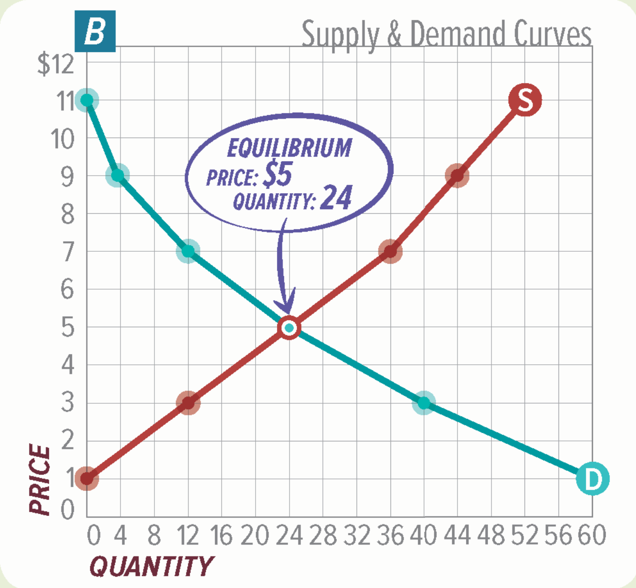
As we know from previous chapters, the data in Figure 6.1 show the market demand for and supply of burritos at various prices. **Panel A** shows this information in the form of a schedule, while **Panel B** shows both the market

FIGURE 6.1 MARKET EQUILIBRIUM

A

Supply & Demand Schedule

PRICE	QUANTITY DEMANDED	QUANTITY SUPPLIED	SURPLUS/ SHORTAGE
$11	0	52	52
$9	4	44	40
$7	12	36	24
$5	24	24	0
$3	40	12	−28
$1	60	0	−60



Panel A shows the quantity of burritos supplied and the quantity demanded at each price. When you plot this information on a graph, as shown in Panel B, you can see that the equilibrium price for burritos occurs where the two lines intersect—at $5.

ECONOMIC REASONING

EXCHANGE AND MARKETS How could it be advantageous for a seller to estimate the equilibrium point of a product?

demand curve and the supply curve that are in the schedule. However, both curves can be combined into one diagram because the vertical and horizontal axes are identical in Figure 4.3 and Figure 5.3.

Note that the supply and demand curves intersect at a specific point. The price associated with this point is called the **equilibrium price**, the price at which the number supplied equals the number demanded. The equilibrium price is also called the *market clearing price* because it is the price at which there is neither a surplus nor a shortage. The **equilibrium quantity** is also associated with this price because the quantity supplied is equal to the quantity purchased. This price, $5 in both Panels A and B of Figure 6.1, helps sellers decide how many productive and financial resources must be allocated to the production of that product.

But how does the market reach this equilibrium, and why does it settle at $5 rather than some other price? To answer these questions, we have to examine the reactions of buyers and sellers to different market prices. When we do this, we assume that neither buyers nor the sellers know the final price, so we'll have to find it by using trial and error.

SURPLUSES—WHEN PRICES ARE TOO HIGH

We start on Day 1 with sellers thinking that the price of burritos will be $9. If you examine the supply schedule in Panel A or the supply curve in Panel B of

Figure 6.1, you can see that suppliers will offer 44 burritos for sale at that price. Buyers, however, only want 4 burritos at that price, leaving a surplus of 40 burritos.

A **surplus** is a situation in which the quantity supplied is greater than the quantity demanded at a given price. The 40-burrito surplus at the end of Day 1 is shown in column four of Panel A in Figure 6.1 as the difference between the quantity supplied and the quantity demanded at the $9 price. It is also shown graphically in **Panel A** of **Figure 6.2** as the horizontal distance between the supply and demand curves at the $9 price.

A surplus shows up as unsold units of the product. Because suppliers have 40 unsold burritos at the end of the day, the suppliers know that $9 is too high. Suppliers also know that they have to lower the price if they want to attract more buyers.

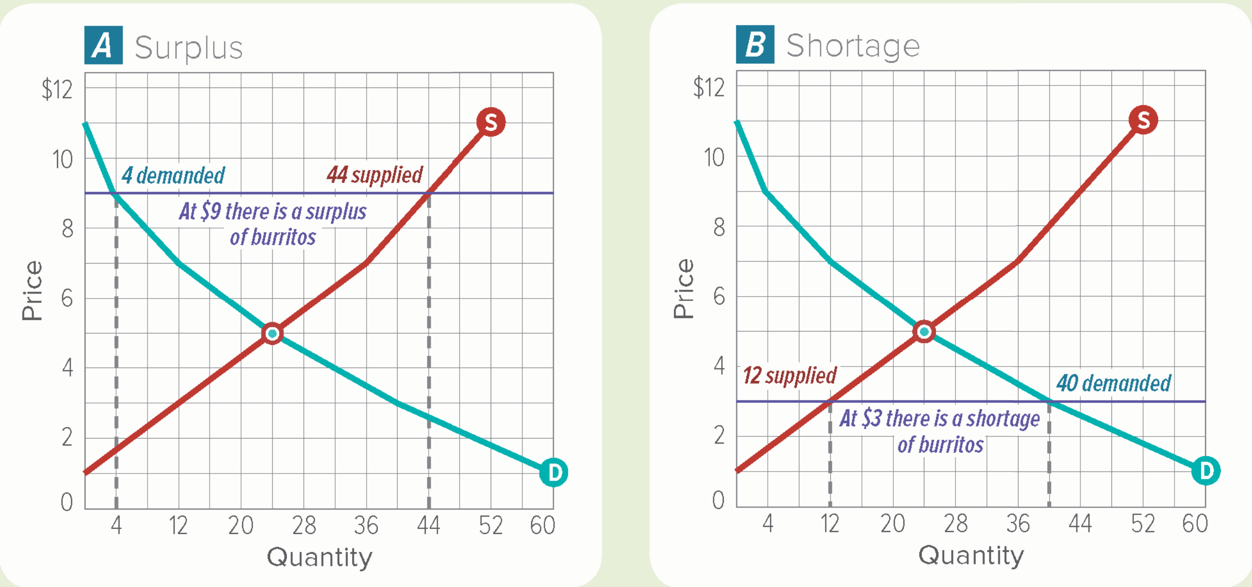
Therefore, the price tends to go down as a result of the surplus. Of course the model cannot tell us how far the price will go down, but we can reasonably assume that the price will go down only a little if the surplus is small, and much more if the surplus is larger.

Surpluses can occur in all types of markets. For example, the clearance section at a department store is full of surplus products. Another example of a surplus happens when the government tries to help farmers by setting a price for a farm product that is higher than the market-clearing equilibrium price. Naturally, farmers respond by producing more than consumers want to buy at that price, and then the government has to decide how to deal with the surplus.

DETERMINING MEANING

The prefix *sur-* means "in addition to" or "excess." A surcharge, for example, is an extra fee often tacked onto purchases such as movie or airline tickets. Other words with this prefix include *surmount, surpass,* and *surround*. How does ***surplus*** fit with these other terms?

FIGURE 6.2 SURPLUS AND SHORTAGE



Because quantity demanded is affected by price, setting the wrong price may lead to too little or too much of a product being produced.

INTERPRETING GRAPHS Why did the shortage in Panel B occur?

SHORTAGES—WHEN PRICES ARE TOO LOW

Burrito sellers are more cautious on Day 2, so they anticipate a much lower price of $3. At that price, the quantity they are willing to supply changes to 12 burritos. However, as **Panel B** in Figure 6.2 shows, this price turns out to be too low. At a market price of $3, only 12 burritos are supplied and 40 are demanded—leaving a shortage of 28 burritos.

A **shortage** is a situation in which the quantity demanded is greater than the quantity supplied at a given price. When a shortage happens, sellers have no more burritos to sell, and they end the day wishing they had charged a higher price.

As a result of the shortage, the price will go up. While our model does not show exactly how much the price will go up, we can assume that the next price will be less than $9, which we already know is too high.

Shortages could happen in any market. Suppose, for example, that hospital administrators decide to decrease the salaries of nurses. At lower salaries, fewer nurses would enter or remain in the profession and the quantity supplied could easily be less than the quantity demanded—leading to a shortage of nurses.

DETERMINING MEANING

The word ***shortage*** is derived from the root *short,* meaning "low in amount." The author states that shortages can happen in any market. Provide an example of a shortage in a labor market and in a product market.

THE GLOBAL ECONOMY & YOU

PRICE DIFFERENCES AROUND THE WORLD

Have you ever shopped for a product online and noticed the price is different from country to country? In addition to taxes, subsidies, import fees, and the cost of doing business, in many cases prices are set on the basis of the amount consumers are willing to pay. In other words, where consumers are willing to pay more, the price will be higher. This perceived value can contribute to drastic price differences from one country to the next. One example is Apple's iPhone. In Japan, the price is more than double what American consumers pay for the same product.

ECONOMIC REASONING

EXCHANGE AND MARKETS In recent years it has become easier to purchase products from other countries through the Internet. How might this affect price differences among countries in the long run?

EQUILIBRIUM—WHEN THE PRICE IS JUST RIGHT

If the new price is $7 on Day 3, the result will be a surplus of 24 burritos. This surplus will cause the price to drop again, but probably not below $3, which already proved to be too low. However, if the price drops to $5, the market will have found its equilibrium price. As we saw earlier, the equilibrium price is the price that "clears the market" by leaving neither a surplus nor a shortage. Also note that Panel B in both Figures 6.1 and 6.2 shows 24 as the equilibrium quantity of output at the equilibrium price of $5.

Although our economic model of the market cannot show exactly how long it will take to reach equilibrium, or if the exact equilibrium price will ever be reached, the **fluctuations** of prices due to surpluses and shortages will always be pushing the price in that direction. Whenever the price is too high, the surplus will tend to force the price down. Whenever the price is too low, the shortage will tend to force the price up. As a result, the market tends toward its own equilibrium.

The supply and demand for burritos affects the price you pay for them, but keep in mind that many different markets are connected in an economy. As a result, price adjustments that take place in other markets play a role in the price you pay for the products you buy. For example, a change in the price of black beans affects not only the income of black bean farmers and distributors, but also the income of the burrito vendor who uses black beans in his product. If the price of black beans is too high, the burrito vendor might raise his prices in order to stay profitable, or he might choose to use a different kind of bean in his product, which would in turn affect the income of his suppliers.

Think of how much more difficult it would be to reach an equilibrium price and quantity of output if we did not have markets to help us. Competitive markets have the advantage of giving us prices that are neutral, flexible, understood by everybody, and free of administrative costs. It would be difficult to find another system that works equally well at reaching the equilibrium price of $5 and the equilibrium quantity of 24 units. When competitive markets reach equilibrium and if nothing else changes, prices and quantities will be stable because there are no surpluses or shortages.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** How does price affect a seller's decision to produce a product?
2. **EXPLAINING CAUSE AND EFFECT** How do surpluses and shortages help establish the equilibrium price and quantity of output?
3. **PREDICTING** What would likely happen to the supply of electricians if their wages suddenly doubled?

INTEGRATING KNOWLEDGE AND IDEAS

1. **EVALUATING INFORMATION** You learned about changes in demand in Chapter 4, and changes in supply in Chapter 5. Why are these two concepts presented again here in this section? What is different about this presentation than in the two earlier chapters?
2. **INTEGRATING INFORMATION** Read the text under the subhead "Changes in Supply." Then study Panel A in Figure 6.3. Which event—a "bad weather" yield or a "bumper crop" yield—gives a farmer a higher price for the crop? Why?

WHY PRICES CHANGE

GUIDING QUESTION *How do changes in supply and demand affect prices?*

Once a market has found its equilibrium price and quantity, things could still change. This is because the market supply curve and the market demand curve are influenced by a variety of factors, any of which could change at any time.

Economists use their market models of supply and demand to explain how prices are determined and why prices change. A change in price can be caused by changes in supply, changes in demand, or changes in both. Elasticity is also important when predicting how prices are likely to change.

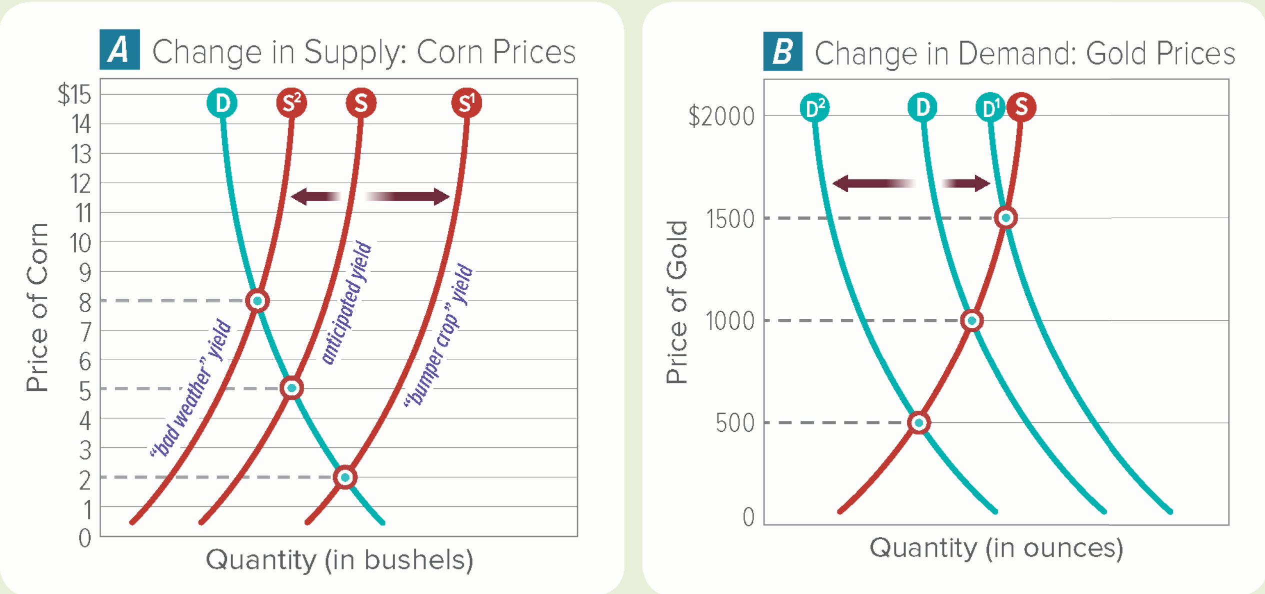
CHANGES IN SUPPLY

An excellent example of how supply changes affect price can be seen in agriculture, which often experiences wide swings in prices from one year to the next. A farmer may keep up with all the latest developments and have the best advice experts can offer, but the farmer can never be sure what price to expect for the crop. For example, a corn farmer may plant 500 acres of corn, hoping for a price of $5 a bushel. However, the farmer also knows that the actual price may end up being anywhere from $2 to $10.

Weather is one of the main reasons for variations in agricultural prices. If it rains too much after planting, the seeds may rot or be washed away and the farmer must replant. If it rains too little, the seeds may not sprout. Even if the weather is perfect during the growing season, rain can still interfere with the harvest. The weather, then, often causes a change in supply.

The result, shown in **Panel A** of **Figure 6.3**, is that the supply curve for agricultural products can shift, causing the price to increase or decrease. For example, at the beginning of the season, the farmer may expect supply to look

FIGURE 6.3 CHANGES IN PRICES



A shift in supply or demand can cause a change in price for a product. Panel A illustrates how a change in supply due to weather can cause a large change in food prices. Panel B shows that a large price change will also take place if there is a change in demand.

INTEGRATING INFORMATION What would happen to the equilibrium price of concert tickets for a band if the band became wildly popular? Explain your answer.

like curve **S**. If a bumper, or record, crop is harvested, however, supply may look like **S**^{1}, giving the farmer a much lower price for the product. If severe weather strikes, supply may look like **S**^{2}, giving the farmer a much higher price for the crop. In either case the price of corn is likely to change dramatically.

CHANGES IN DEMAND

A change in demand, like a change in supply, can affect the price of a good or service. All of the factors that affect individual demand—changes in income, tastes, prices of related products, expectations, and the number of consumers—also affect the market demand for goods and services. One example is the demand for gold.

In **Panel B** of Figure 6.3, a small increase in demand, illustrated by a shift from **D** to **D**^{1}, causes a large increase in the price. This is exactly what happened in late 2012 when uncertainty over economic growth and unstable political situations around the world encouraged people to buy gold. The rapid increase in demand drove the price of gold to over $1,800 an ounce, when 10 years earlier it was about $300 an ounce.

CHANGES IN SUPPLY *AND* DEMAND

In most cases, price is affected by both supply and demand changing at the same time. For example, Hurricanes Katrina and Rita tore through the Gulf of Mexico in 2005, destroying or disabling hundreds of oil-drilling platforms, refineries, and storage facilities. This caused the supply of oil to decrease (or shift to the left), driving the price of gasoline higher.

To make matters worse with respect to gasoline prices, 2006 and 2007 were years of relatively strong economic growth, so the demand for oil and gasoline shifted to the right just after the supply of oil had shifted to the left. The result was a near doubling of oil prices and a sharp increase in gas prices that peaked in 2008.

PRICES AND COMPETITIVE MARKETS

Economists like to see competitive markets because the price system is more efficient when markets are competitive. A purely competitive market requires a set of ideal conditions and outcomes that are seldom found, but fortunately markets don't have to be perfect to be useful. As long as prices are allowed to adjust to new levels in response to the pressures exerted by surpluses and shortages, prices will perform their role as signals to both consumers and producers.

Economist Alfred Marshall underscored the benefit of prices adjusting on their own in competitive markets through both supply and demand:

> “We might as reasonably dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper, as whether value [price] is governed by utility or cost of production. It is true that when one blade is held still, and the cutting is effected by moving the other, we may say with careless brevity that the cutting is done by the second; but the statement is not strictly accurate, and is to be excused only so long as it claims to be merely a popular and not a strictly scientific account of what happens.”

—Alfred Marshall, *Principles of Economics*, 1890

ANALYZING PRIMARY SOURCES

1. **DETERMINING CONTEXT** According to context clues in the excerpt, what term is synonymous with *demand*, and what phrase is synonymous with *supply*?
2. **EVALUATING EVIDENCE** What metaphor does Marshall use to explain the relationship between supply and demand? How does the metaphor emphasize his point?

Trying to achieve the ideal model of a competitive market is the basis for considerable government policy. For example, to increase the number of competitors in a market, laws have been passed to prevent companies from becoming too large. Other laws were passed that require firms to disclose information to help consumers decide if they want to buy something. Further laws have been passed to prevent firms from taking unfair advantage of consumers. All of this is done in order to make markets more competitive.

The great advantage of competitive markets is that they allocate resources efficiently. As sellers compete to meet consumer demands, they are forced to lower the prices of their goods. This encourages them to keep their costs down. At the same time, competition among buyers helps prevent prices from falling too far. This means that both consumers and producers have a role in determining the market's equilibrium price.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** How do changes in supply and demand affect prices?
2. **IDENTIFYING EFFECTS** What would happen to the price of apples in a "bumper crop" yield?
3. **PREDICTING** What would happen to the price of apples in a "bumper crop" yield if a new cure for cancer was discovered that utilized apple cores?

LESSON 2 REVIEW

Economic Reasoning

1. **DESCRIBING** Explain what an economic model is.

Building History–Social Science Analysis Skills

2. **IDENTIFYING CONNECTIONS** How is the equilibrium price of a product related to the equilibrium quantity, and how can these values be determined?
3. **RELATING EVENTS** Describe an example of a surplus and an example of a shortage, including what may have caused them.
4. **ANALYZING ISSUES** Think about the price of a new iPhone. How is the price of the phone the equilibrium price? How does the elasticity of demand for the iPhone affect its price?

Writing About Economics

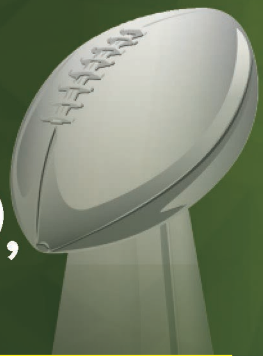
5. **EXPLANATORY WRITING** Your school is planning to hire a band, Glitz, for its spring dance. Glitz has signed an agreement to perform, but it has not quoted a fee. The dance planning committee says it will wait until spring to book the band. You know that Glitz is becoming very popular because it has released an album and getting rave reviews, and the band has started performing in large venues. Using your knowledge about why prices change, write a letter to the planning committee explaining why you think they should book the band now.

Collaborating

6. **MAKING DECISIONS** You and a partner have a new business selling cupcakes. You make 500 cupcakes a day, the maximum for your facilities. After a week in business selling cupcakes for $4 each, you have a daily surplus of 100 cupcakes. You reduce the price to $3, and you sell all the cupcakes every day but customers want more cupcakes and would have bought 50 more a day at that price. Working together, discuss how you would determine what the equilibrium price is for your product. Write a one-page report, including necessary graphs, explaining why you have settled on a particular price.

CASE STUDY

SUPPLY, DEMAND, and the COST of SUPER BOWL ADVERTISING



During 364 days out of the year, the average cost of a 30-second prime-time television advertisement spot is a little over $100,000. But for one four-hour block, on one day, on one channel each year, the price skyrockets to around $3.5 million. That time slot is the Super Bowl.

Like most prices in a market economy, the price for television advertising is set by supply and demand. Advertisers want to reach the largest number of viewers with each ad, so demand is high for ad space during a program lots of people are watching. And few programs are watched by more people than the Super Bowl, which averages over 100 million viewers each year.

Because demand is higher for ads during the Super Bowl, the supplier (the television station airing the game) can charge higher prices than for other programs. The limited supply of ad space also plays a role in sending the price higher. In 2013 there were only 70 slots available to sell.

In the end, all of the ad space available during the game is filled, because the television station won't charge a price so high that advertisers are unwilling to pay. They charge the price that makes them the most profits, given the supply and demand for the available advertising spaces.

ONE YEAR in Super Bowl Ads (2013)

Number of viewers:
108.4 million

Percent of U.S. households tuned in:
46.3%

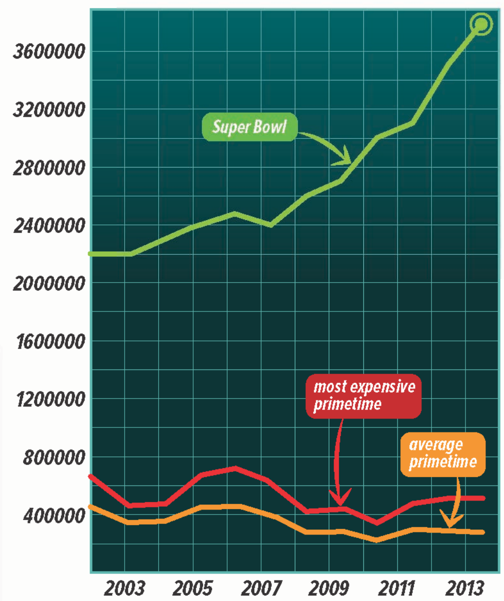
Number of 30-second advertising spots sold:
70

Top price paid for one 30-second ad:
$4 million

Ad space was sold out **3 months** before the game aired

Average cost of a 30-second ad:
$3.5 million

The COST of a 30-second ad



CASE STUDY REVIEW

1. **ANALYZING EVENTS** What makes the equilibrium price for an advertisement during the Super Bowl different from the normal equilibrium price for a television advertisement?
2. **IDENTIFYING CAUSES** What conditions might lead to a shortage of Super Bowl advertisements? What effect might a shortage have?
3. **DRAWING CONCLUSIONS** Do you think pricing for Super Bowl advertising is fair? Explain your reasoning.

EXPLORING THE ESSENTIAL QUESTION

LESSON 3

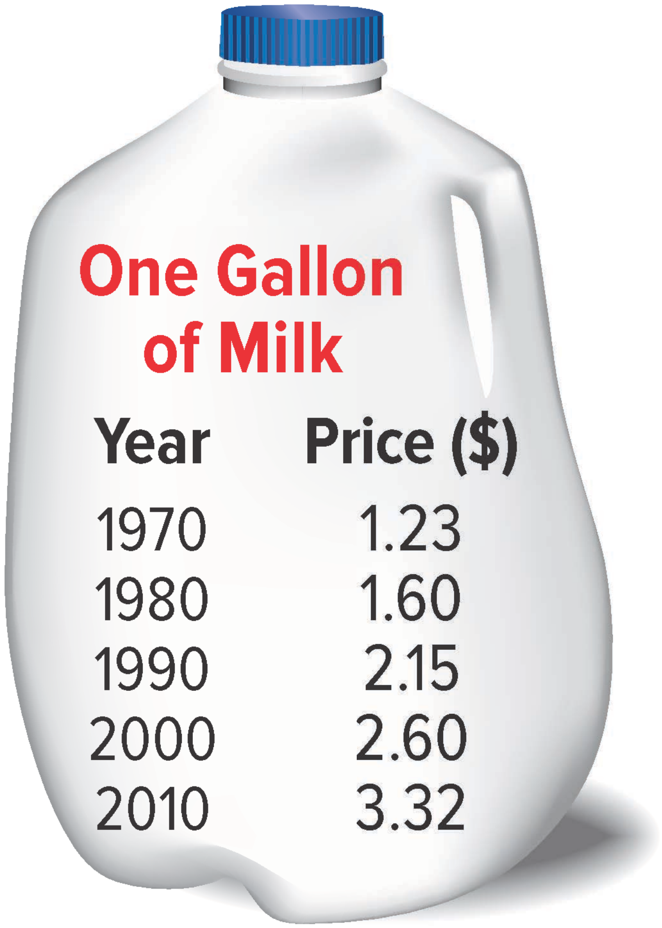
Social Goals, Prices, and Market Efficiency

ESSENTIAL QUESTION

What factors affect prices?

Think about a product with a price you believe is too high or too low. Do you think the government should make a law to change the price of the product to something that is more reasonable?

Write a paragraph explaining why you think the government should or should not adjust the product's price.



The American free enterprise goals of economic growth and price stability sometimes conflict with each other.

Goal of Price Ceiling and Price Floor

	Goal
Price Ceiling	
Price Floor	

ANALYZING KEY IDEAS AND DETAILS

Read closely to learn about price ceilings and price floors, and why the government sometimes steps in with fixed-price policies. Use a diagram like this one to identify the goals or objectives of price ceilings and price floors.

CONTROLLING PRICES

GUIDING QUESTION *What are the costs and benefits of economic policies aimed at creating equity and security?*

In a purely competitive free enterprise system, prices would be determined entirely by the actions of buyers and sellers. The United States, however, is a modified free enterprise economy. This means that the government sometimes interferes in the market in order to achieve a socially desirable goal. One way the government does this is by setting prices for certain goods and services below or above the equilibrium price.

Attempts to fix prices are not new. During World War I and World War II, the federal government locked down the prices of certain foods to ensure that everyone had access to affordable meals. President Nixon tried to combat inflation in the early 1970s by trying to freeze prices for 90 days, but his efforts were largely ineffective. Today the government uses a combination of price ceilings and price floors to fix prices on a number of products.

ANALYZING KEY IDEAS AND DETAILS

1. DETERMINING CENTRAL IDEAS The head of this section is "Controlling Prices." Who is the author discussing as the controller of prices?
2. SUMMARIZING In what two ways are prices controlled? What is the objective for both?

PRICE CEILINGS

When a price is set below its equilibrium level, it is called a **price ceiling**, the maximum legal price that can be charged for a product. The case of a price ceiling is shown in **Panel A** of **Figure 6.4** where the price ceiling of $10 is set below the price that clears the market.

The consequence of the price ceiling in the figure is clear. With a price ceiling of $10, there are 10 units demanded but only 4 units are supplied—leaving a shortage of 6.

Normally the resulting shortage of 6 would be enough to drive the price toward its equilibrium level of $15, but not in the case of a price ceiling. Instead, the shortage becomes permanent and will persist as long as the price ceiling stays below its equilibrium price. A shift in demand or supply could cause the shortage to increase or decrease, but a shortage will always be there as long as the price ceiling remains below the equilibrium price.

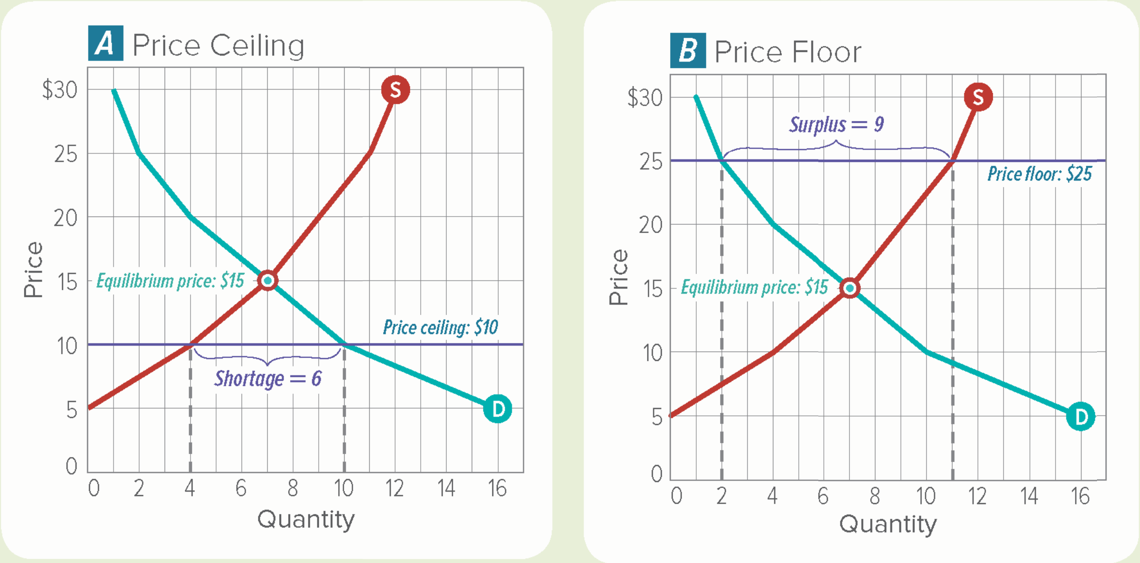
PRICE FLOORS

At other times, lawmakers may think that the market clearing price is too low, so they take steps to raise it by legislating a **price floor**, the minimum legal price that a seller can charge. The consequence of the price floor is shown in **Panel B** of Figure 6.4. With a price floor of $25, 2 units are demanded but 11 units are supplied—leaving a surplus of 9.

DETERMINING MEANING

The words *ceiling* and *floor* both refer to surfaces in a room. How are the terms ***price ceiling*** and ***price floor*** used in economics to describe government-imposed limits on prices?

FIGURE 6.4 PRICE CEILINGS & PRICE FLOORS



Normally shortages and surpluses are enough to drive the price toward its equilibrium. However, as long as a price floor remains above the equilibrium price, or a price ceiling remains below the equilibrium price, a surplus or shortage will exist.

ECONOMIC REASONING

EXCHANGE AND MARKETS In 1971, the federal government put a price freeze on the price of gasoline. Was this a price ceiling or price floor? Explain.

Normally the resulting surplus of 9 would be enough to drive the price toward its equilibrium level of $15, but not in the case of a price floor. Instead, the surplus becomes permanent and will persist as long as the price floor stays above the market's equilibrium price. A shift in either demand or supply could cause the surplus to increase or decrease, but a surplus will always be there as long as the price floor remains above the equilibrium price.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** What are the costs and benefits of economic policies aimed at creating equity and security?
2. **DETERMINING CONTEXT** How are price ceilings and price floors related to the equilibrium price level?
3. **EXPLAINING CAUSE AND EFFECT** What are the negative and positive aspects of price ceilings and price floors?

ANALYZING KEY IDEAS AND DETAILS

1. **SUMMARIZING** Summarize this section in three or four sentences.
2. **CITING TEXT EVIDENCE** What are the seven broad economic goals of the American free enterprise system, according to the text?

EXAMPLES OF FIXED-PRICE POLICIES

GUIDING QUESTION *Whom do price supports benefit, and whom do they hurt?*

Government-imposed price controls are not just something that happened in the midst of a major war. There is a surprising amount of it around today. The minimum wage, discussed more fully in another chapter, along with farm subsidies and rent controls, are major examples of price controls being used today.

USING PRICE FLOORS TO SUPPORT SUGAR PRICES

Historically, prices on almost all agricultural products have fluctuated much more widely than prices on other goods and services. This is because farmers often face periods of boom or bust. In years when crops are plentiful, the extra production drives prices down. In years of drought or flooding, the lower crop yields drive agricultural prices up. Because of this, the government has taken steps to **stabilize** agricultural prices to help farmers and processors of farm products with the use of price floors.

The sugar industry provides just one example of how the government can stabilize farm prices with the use of price floors. Beginning in 1981, and reauthorized by the 2008 Farm Act, the government set target prices on sugar derived from sugarcane. A **target price** is a price floor the government thinks is fair for a particular product. To ensure that farmers receive the target price for their products, the government sets up a loan system.

For example, in 2013 the government set a loan rate of 18.75 cents per pound on cane sugar. A processor of sugarcane could take out a loan from the United States Department of Agriculture (USDA) at this rate as long as it pledged its sugar as collateral, or security, for the loan. After the sugar was processed, the processor had two options:

1. The sugar could be sold on the open market at a higher price than the target price, and then the proceeds of the sale could be used to repay the USDA loan.
2. Or, if the market price of sugar fell below the target price, the processor could keep the proceeds of the loan and let the USDA take possession of the sugar.

Because the loan does not have to be repaid, it is called a **nonrecourse loan**—a loan that carries neither a penalty nor further obligation to repay. Either way, the processor is guaranteed to get at least 18.75 cents per pound for the sugar, which is why it is a price floor that helps to stabilize farm income.

In addition to stabilizing agricultural incomes, price supports in sugar have helped domestic sugar producers compete with foreign sugar producers. The price supports have also saved a number of jobs in the sugar production industry.

Unfortunately, the sugar support policies have also raised the price of sugar for the American consumer. Since the first Farm Act that introduced this type of policy in 1981, U.S. sugar prices have been about twice as high as world sugar prices, something that has cost American consumers billions of dollars. The higher cost of domestic sugar has also been a problem for domestic industries that use sugar, like makers of candy, sweets, and beverages. These domestic industries have lost jobs as a result of higher sugar prices.

Agricultural price supports are just one example of a nation trying to achieve one economic goal—economic security—at the expense of another—full employment. As you can see, setting a legal price too high in order to achieve a socially desirable goal has its consequences.

USING PRICE CEILINGS TO CONTROL RENTS

Rent control is an example of a price ceiling because it sets a maximum price that can be charged for certain types of housing. During World War II the

BIOGRAPHY

MILTON FRIEDMAN

ECONOMIST (1912–2006)

American economist and educator Milton Friedman made enormous contributions to our understanding of income, unemployment, the role of money, free markets, and many other areas of economics. Friedman voiced his opposition to government control of prices, including agricultural subsidies and the minimum wage. He famously said, "We economists don't know much, but we do know how to create a shortage. If you want to create a shortage of tomatoes . . . just pass a law that retailers can't sell tomatoes for more than two cents per pound. Instantly you'll have a tomato shortage." In addition to an influential teaching career, Friedman wrote several prominent books and advised both Presidents Nixon and Reagan on economic policy. Friedman received the Nobel Prize for Economics in 1976.

ANALYZING POINT OF VIEW
Based on Friedman's quote about tomatoes, why do you think he opposed price controls?

country used rent controls to keep housing prices from rising uncontrollably. Today rent controls are used in New York City and some other major cities to make housing more affordable for many middle- and low-income consumers. **Figure 6.5** shows how rent control works.

Let us assume that without rent controls, the free market would establish rents at $1,500 a month, with an equilibrium quantity of two million apartments at that rate. If the government wants to promote the social goals of equity and security for people who cannot afford these rents, it can **arbitrarily** establish a price ceiling at $1,000 a month.

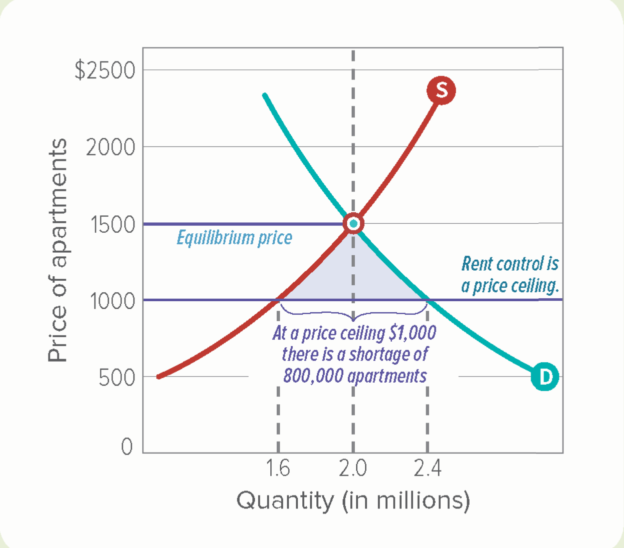
No doubt potential renters would like the $1,000 price and would demand 2.4 million apartments. Landlords, on the other hand, only want to supply 1.6 million units at that price—leaving a shortage of 0.8 million, or 800,000 apartments. This shortage would persist as long as the price ceiling remains below the equilibrium price.

Are people better off? Perhaps not. Clearly the 800,000 potential renters who could not get apartments are unhappy. Also, landlords are unhappy because they are being forced to accept a lower price for their rental units. Because of this, the landlords want to rent fewer units than they would under free market conditions. More than likely, they would convert some of the nicer apartments to high-priced condos or offices—leaving the less desirable apartments to be rented. Landlords would also cut back on basic repairs and upkeep on the units they do rent, which allows the buildings to deteriorate.

The only people who are better off are the 1.6 million renters who were able to get the apartments for $1,000 a month. But even they may eventually become unhappy when they discover that their landlords are neglecting upkeep on their buildings. Meanwhile, there are long lines of people waiting to get the low-cost rental units. All of this results in a situation where prices no longer allocate apartments. Instead, landlords deal with the shortage by using long waiting lists or by resorting to nonprice criteria, such as excluding renters with children and pets.

Is the landlord's behavior unreasonable? After all, what would you do if you owned rental units in a city with rent controls? If you could not increase rents to keep up with repairs and city building taxes, you might do what other landlords do, and that is lower your costs by providing the absolute minimum upkeep. You may even tear some buildings down to make way for more profitable shopping centers, factories, parking garages, or high-rise office buildings. All of this contributes to the gradual movement of productive resources out of the rental market and into other activities. This is just one example of how rent controls distort the economy's allocation of productive assets.

FIGURE 6.5 PRICE CEILING: RENT CONTROL



A price ceiling rental price of $1,000 per month would leave 800,000 people permanently without apartments to rent.

INTEGRATING INFORMATION Which consumers might benefit if a city introduces rent controls?

Most economists argue against price controls:

> "It is quite easy to comprehend how artificially high prices penalize consumers, but the damage caused by artificially low prices is less obvious. Is it not in consumers' interest to pay less for products and services?
>
> Such price controls also have pernicious effects. First, lower prices lead consumers to buy more, thereby raising demand. But lower prices also make production and investment in regulated goods or services less lucrative. Resources and production factors are thereby likely to leave a sector, or a country, where such controls apply.
>
> Unless other measures are imposed, such as subsidizing affected producers or investors, imposing a ceiling price will make a regulated good or service become scarce. Long lineups start to form, preventing consumers from getting as much as they want. Generally speaking, lower prices may benefit certain consumers in the short term but, by penalizing producers, they end up causing consumers damage in the long run."
>
> —Valentin Petkantchin, "The Pernicious Effects of Price Controls," Montreal Economic Institute

ANALYZING PRIMARY SOURCES

1. **DETERMINING MEANING** Given the context clues in this excerpt, what do you think is the meaning of the word *pernicious*?

2. **CITING TEXT EVIDENCE** What evidence does the author give to support his claim that artificially low prices are bad for consumers?

In the end, government attempts to achieve two goals—economic equity and economic security—are in conflict with another goal—economic efficiency. Whether the trade-off is worth it depends on how voters evaluate its costs and benefits, and then express their satisfaction or frustration in the voting booth.

GOVERNMENT AND SOCIAL GOALS

The American free enterprise system has seven broad economic and social goals most people seem to share: economic freedom, economic efficiency, economic equity, economic security, full employment, price stability, and economic growth. Legislation to achieve one goal, however, often conflicts with other economic goals—which makes effective government policy-making difficult.

How does government decide which goal to promote? And, how does government evaluate the costs and benefits of a specific policy to see if it should be supported rather than another?

Unfortunately, the answer is that it doesn't. Although the Congressional Budget Office (CBO) is required by law to produce cost estimates for nearly every budget bill approved by Congress, individual legislators make their own judgments about the likely benefits of a program. Thus, extreme conditions must often occur before all political parties and the president agree to support any one goal. For example, the minimum wage was established during the Great Depression when nearly one worker in four could not

MAKING CONNECTIONS TO TODAY

MINIMUM WAGE

The minimum wage is the lowest wage an employer can legally pay an employee. The federal minimum wage, currently set at $7.25* an hour, is a price floor because it establishes a baseline that must be paid for work. States can set their own minimum wage:

AL *None*	**HI** $9.25	**MA** $11.00	**NM** $7.50	**SD** $8.65
AK $9.80	**ID** $7.25	**MI** $8.90	**NY** $9.70	**TN** *None*
AZ $10.00	**IL** $8.25	**MN** $9.50/$7.75	**NC** $7.25	**TX** $7.25
AR $8.50	**IN** $7.25	**MS** *None*	**ND** $7.25	**UT** $7.25
CA $10.00/$10.50	**IA** $7.25	**MO** $7.70	**OH** $8.15/$7.25	**VT** $10.00
CO $9.30	**KS** $7.25	**MT** $8.15/$4.00	**OK** $7.25/$2.00	**VA** $7.25
CT $10.10	**KY** $7.25	**NE** $9.00	**OR** $9.75	**WA** $11.00
DE $8.25	**LA** *None*	**NV** $8.25 /$7.25	**PA** $7.25	**WV** $8.75
FL $8.10	**ME** $9.00	**NH** $7.25	**RI** $9.60	**WI** $7.25
GA $5.15	**MD** $8.25	**NJ** $8.44	**SC** *None*	**WY** $5.15

Washington, D.C. $11.50

*As of March 2017. Source: http://www.dol.gov/whd/minwage/america.htm

TEXT: Petkantchin, Valentin. "Economic Note: The Pernicious Effects of Price Controls." The Montreal Economic Institute, April 2006.

find a job. Price floors were also widely used in agriculture during that period because farm incomes had reached historic lows.

So why do we still have price ceilings and floors today when economic conditions are much better than they were during the Great Depression? Part of the answer is that once price supports are put in place, they often have enough political support to keep them there. Or, as in the case of sugar supports, so few people know about them there is no effective opposition.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** Whom do price supports benefit, and whom do they hurt?
2. **EXPLAINING EFFECTS** What has been the effect of price floors in the sugar industry?
3. **INFERRING** What is the intended goal of a price ceiling in the form of rent control? What is one of its negative consequences?

WHEN MARKETS TALK

GUIDING QUESTION *How do markets "talk"?*

Markets are impersonal mechanisms that bring buyers and sellers together. Although markets do not talk in the usual sense of the word, they send signals that represent actions of buyers and sellers who trade in them. Markets "talk" when prices move up or down significantly in reaction to a related event.

- **Gold Prices Rise** A rising price of gold is usually not a good sign for the economy. Gold has historically been thought of as a hedge, or protection, against a possible economic or social crisis. Sharp increases in the price of gold capture the attention of other investors and perhaps even encourage

INTEGRATING KNOWLEDGE AND IDEAS

1. **EVALUATING EVIDENCE** How does the text suggest that rising gold prices are a bad sign for the economy?
2. **EVALUATING EVIDENCE** How does the text suggest that stock prices can be an indicator of economic health?

CAREERS COST ESTIMATOR

Is this career for you?

Do you have strong mathematical and analytical skills?

Do you have an interest in engineering and technology?

Do you enjoy working collaboratively?

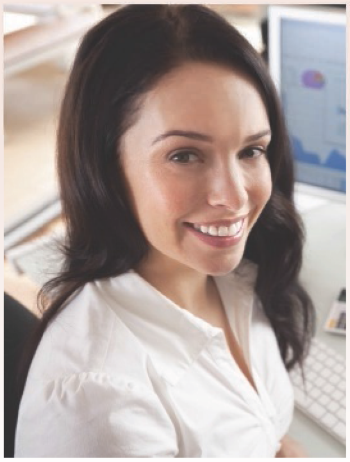
Salary

$55,000–$65,000 per year

$27.82 per hour

Job Growth Outlook

Much faster than average



Interview with a professional COST ESTIMATOR

"You may estimate or analyze the cost of cars, aircraft, ships, software systems, bridges, electronics, satellites. . . . You may also analyze why something is costing more than previously estimated."

—Joe Wagner,
Board of the Society of Cost Estimating and Analysis

Profile of Work

Cost estimators collect and analyze data about the costs required for a project, including labor, resources, money, and time. They may also evaluate the profitability of a project.

PHOTO:Courtney Keating/Getty Images; TEXT: "Best Jobs: Cost Estimator." U.S. News & World Report. Retrieved from http://money.usnews.com/careers/best-jobs/cost-estimator some of them to buy gold as well, driving the price of gold up even further. Gold prices tend to come down slowly when economic news is good, so sharp increases in the price capture the most attention.

- **Stock Prices Fall** Falling stock prices generally reflect a lack of confidence in business conditions or in government policy. Suppose the federal government announced it would raise taxes on investments to pay off some of the federal debt. If investors thought this policy would not work, or that other policies might be better, they might sell some of their stocks, causing stock market prices to fall. In a sense, then, the market "talked" by voicing its disapproval of a new government policy or some other event whenever stock prices go down. If stock market prices had gone up, however, it would be a sign that investors had a more favorable view of the policy or event.
- **Oil Prices Rise** Investors watch the price of oil closely. Oil is a commodity used worldwide, and it has very inelastic supply and demand curves. Even slight changes in the supply or demand for oil can have a dramatic impact on its price. A sharp increase in the price of oil could indicate a modest decrease in the quantity supplied, which the market foresees as a difficult time ahead for the economy.

Each of these market price changes can be thought of as a collective effort by markets to "tell" us something is wrong or is about to happen. As the world's economies are interconnected, markets respond to local and global events.

Economists say that markets "talk" when signals are sent collectively to all of the buyers and sellers in a market. This may cause prices to shift in a different direction.

EXPLAINING CAUSE AND EFFECT Why would the rumor of a government contract change the value of this company's stock?

☑ CHECKING FOR UNDERSTANDING

1 . **ANALYZING ISSUES** How do markets "talk"?

2. **INFERRING** Can you think of any other examples of markets "talking"? Explain.

3. **EXPLAINING CAUSES** What might an increase in the price of oil indicate?

LESSON 3 REVIEW

Economic Reasoning

1. **DETERMINING CONTEXT** Explain how a target price for farm crops is an example of a price floor.

Building History–Social Science Analysis Skills

2. **IDENTIFYING CONNECTIONS** Explain why the government imposes price floors and price ceilings in certain markets.

3. **ANALYZING ISSUES** Discuss how the social and economic goals of economic security and economic efficiency can conflict.

4. **SUMMARIZING** Research a situation in which the government controlled prices of a good or service in order to provide security for consumers. Explain whether the price control was helpful or harmful, and for whom.

Writing About Economics

5. **ARGUMENTATIVE WRITING** The price of college tuition has skyrocketed. You want to recommend a price ceiling to remedy the problem. What would the consequences of such a policy be for both students and the college? Explain your reasoning in a one-page argument.

Collaborating

6. **PRESENTING** With a partner, scan newspaper or online headlines of economic events. Create a slideshow that states each headline, such as "Blizzard wreaks havoc on orange crop," and provide an explanation of how the events will cause markets to "talk."

Pat Lewis

DEBATES

Is it a good idea to raise the minimum wage?

The federal minimum wage, a price floor, is the lowest legal wage that can be paid to workers. As inflation and the cost of living increase, the government reevaluates and increases the minimum wage from time to time. The frequency and amount of the increase, however, is a hotly debated topic.

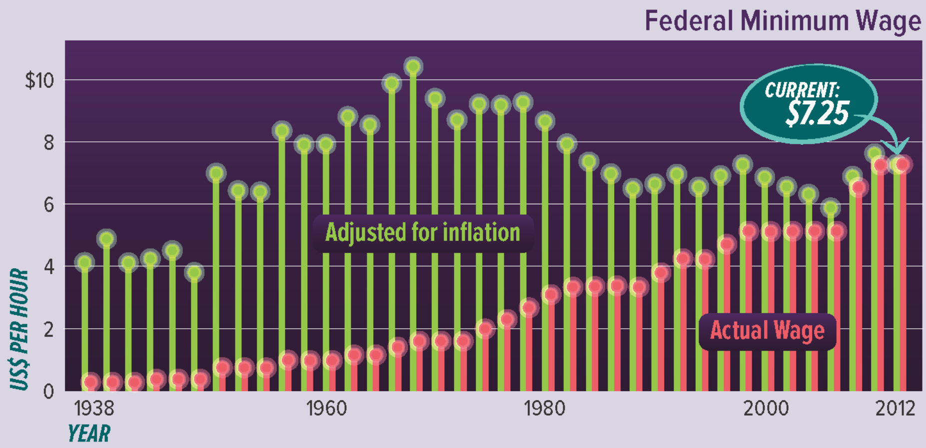
Those in favor of increasing the minimum wage argue that it will help low-wage earners make ends meet, bringing more people out of poverty and increasing their buying power. Those against the increase say that raising the cost of labor hurts small businesses and slows job creation by causing businesses to cut jobs or workers' hours to compensate for increased labor costs.

Like all economic decisions, there are trade-offs when a decision is made to increase or not increase wages. You decide: is it a good idea to raise the minimum wage?

It's a good idea to raise the minimum wage because it...

[Increasing the minimum wage] would raise the incomes of millions of working families. It could mean the difference between groceries or the food bank; rent or eviction; scraping by or finally getting ahead. For businesses across the country, it would mean customers with more money in their pockets. And a whole lot of folks out there would probably need less help from government.

—President Barack Obama, State of the Union Address, February 12, 2013



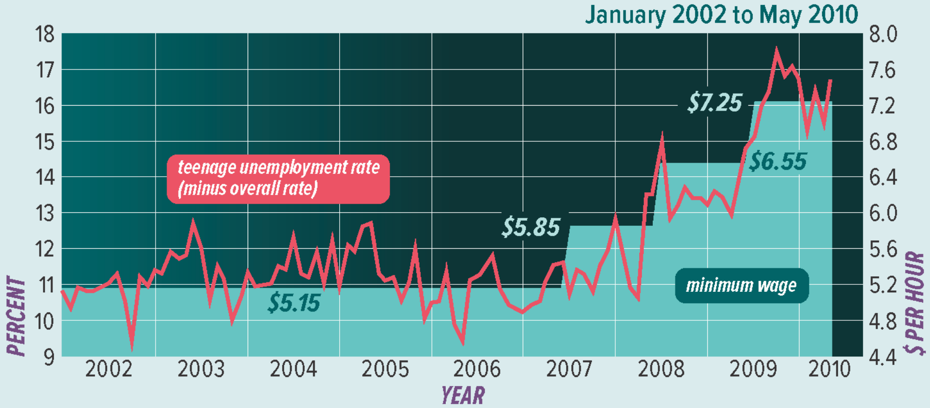
▲ Minimum wage increases have not kept pace with inflation.

TEXT: Barack Obama: "Address Before a Joint Session of Congress on the State of the Union," February 12, 2013. Online by Gerhard Peters and John T. Woolley, The American Presidency Project. http://www.presidency.ucsb.edu/ws/?pid=102826.

"The cost of wages is reflected in the price of the product or service to the consumer. When labor costs go up, employers have two choices. They can attempt to pass the price increases on to customers (and perhaps lose their customers) or find a way to cut costs."

—Ellen Sauerbrey, chairman of Maryland Business for Responsive Government and former minority leader of the Maryland House of Delegates, "SAUERBREY: Raising minimum wage hurts those it claims to help," *The Washington Times*, March 18, 2013

Teenage Unemployment Rate vs. Minimum Wage Increases
January 2002 to May 2010



▲ Increasing the cost of labor forces employers to cut back on jobs.

CHART:Professor Mark J. Perry, Carpe Diem Blog; TEXT:Sauerbrey, Ellen. 18 March 2013. "SAUERBREY: Raising minimum wage hurts those it claims to help." The Washington Times. Retrieved from http://www.washingtontimes.com/news/2013/mar/18/raising-minimum-wage-hurts-those-it-claims-to-help/

ANALYZING THE ISSUE

1. **INTEGRATING INFORMATION** How has the real value of the minimum wage changed in relation to the actual minimum wage? What does this say about workers' buying power?

2. **CITING TEXT EVIDENCE** What two choices does Sauerbrey say employers are faced with when the minimum wage is increased? What impact do these choices have on the economy?

3. **ANALYZING POINT OF VIEW** Which arguments do you find most compelling? Explain your answer.

STUDY GUIDE

Life With Prices

- Prices are a voluntary compromise between buyers and sellers.
- Prices help allocate resources and determine WHAT, HOW, and FOR WHOM goods are produced.

WHAT PRICES DO
LESSON 1

Life Without Prices

- Another system to allocate goods and services must be used, such as rationing.
- Problems arise with fairness, cost of administration, and less incentive for people to work.

THE EFFECTS OF PRICES

LESSON 2

WHEN PRICES GO UP

- CONSUMERS: BUY LESS
- PRODUCERS: PRODUCE MORE

WHEN PRICES GO DOWN

- CONSUMERS: BUY MORE
- PRODUCERS: PRODUCE LESS

HOW PRICES ARE DETERMINED

LESSON 2

Price is found where supply and demand intersect.

SURPLUSES AND SHORTAGES

LESSON 2

PRICES ARE TOO HIGH = **SURPLUS:** MORE PRODUCT IS MADE THAN PEOPLE ARE WILLINGTO BUY.

PRICES ARE TOO LOW = **SHORTAGE:** NOT ENOUGH PRODUCT IS AVAILABLE TO MEET PEOPLE'S NEEDS.

CONTROLLING PRICES

LESSON 3

Price ceiling: maximum legal price

Examples:

- Rent control
- Gas price limits

Price floor: minimum legal price

Examples:

- Minimum Wage
- Agricultural price supports

CHAPTER 6 Assessment

Write your answers on a separate piece of paper.

Short Answer

1. **SUMMARIZING** In what ways do prices help us allocate goods and services?

2. **CITING TEXT EVIDENCE** What alternative exists to the price system? What challenges does this alternative present?

3. **EXPLAINING EFFECTS** What is the result of a price that is set above the equilibrium price? Below the equilibrium price?

4. **IDENTIFYING EFFECTS** How are quantity supplied and quantity demanded affected by changes in prices? Give an example of how these quantities might change if the price decreases.

5. **EXPLAINING CAUSES** Why does a price ceiling set below the equilibrium price result in a shortage?

6. **INFERRING** What is a goal of the federal minimum wage? Who benefits from it?

7. **ANALYZING CENTRAL IDEAS** Explain how non-price determinants can affect the price of a product by impacting the product's supply and demand.

8. **ANALYZING IDEAS** Write a blog post in which you argue whether or not the price system is the most effective way of allocating goods and services in an economy.

9. **TESTING HYPOTHESES** Assume that the price of school lunches has become too high, and you need to set a price ceiling to remedy the problem. What would the consequences of such a policy be?

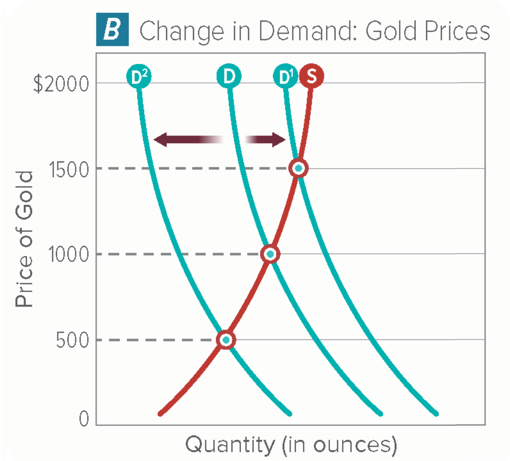
10. **IDENTIFYING CONNECTIONS** Using a price floor or a price ceiling as an example, explain how attempts to achieve one economic or social goal might conflict with another.

History-Social Science Analysis

11. **PREDICTING** How do prices help us make decisions?

12. **IDENTIFYING CONNECTIONS** How are prices neutral?

13. **INTERPRETING GRAPHS** What happens to the price of gold if demand changes from D^1 to D^2?



Research and Presentation

14. **ANALYZING EVENTS** Research to identify and describe a U.S. industry that has traditionally had its prices controlled by the government. Explain why and how the government controls the price.

15. **EVALUATING INFORMATION** Research the rationing of food in the United States during World War II. Describe how the government set up boards to monitor the rationing, as well as which products were rationed. Explain whether the rationing was successful in its goals.

16. **INTEGRATING INFORMATION** Research the price of a product. Using the price you found as the equilibrium price, create a supply and demand schedule, showing how the quantity supplied and the quantity demanded for the product changes at various prices. Graph your results and present it as a discussion of what happens if the price is below or above the equilibrium price.

Need Extra Help?

If You've Missed Question	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Review Lesson	1	1	2	2	3	3	1	1	3	3	1	1	2	3	3	1

CHAPTER 6 Assessment, continued

Write your answers on a separate piece of paper.

Reading and Analyzing Primary Sources

Read the except and answer the following questions.

> "Farmers in Wisconsin, the leading cranberry producer, have been working for years to expand their acreage at the request of Ocean Spray and other processors who expected to see strong growth in overseas sales of juice and sweetened, dried cranberries. Growth has been slower than expected, however, as nations continue to struggle with the Great Recession and its aftermath, said Tom Lochner, executive director of the Wisconsin State Cranberry Growers Association. Growth of 2 percent to 3 percent overseas, coupled with flat demand in the U.S., left farmers with a huge excess of cranberries this fall after an unexpected jump in production in Canada, he said. . . .
>
> The U.S. Department of Agriculture had predicted the 2012 crop would be worth nearly $48 per 100 pounds. It announced last week that it would buy up to $5 million worth of cranberry products for domestic food assistance programs. . . .
>
> Lochner said cranberry farmers understand that while they are getting help from the federal government this year, they have to work to boost sales. The industry's marketing group and processors such as Ocean Spray have worked to introduce the fruit in Europe with good success in sales of sweetened, dried cranberries. Sales of dried fruit and juice also are growing in Mexico and Australia, he said. They plan to focus next on Asia. . . ."

—M.L. Johnson, "Cranberry farmers struggle as surplus drops prices," *Businessweek*, May 6, 2013

17 **ANALYZING EVENTS** Why did an increase in Canadian cranberries negatively impact cranberry farmers in the United States?

- **A.** People prefered Canadian cranberries.
- **B.** It created an oversupply of cranberries.
- **C.** U.S. farmers could not sell cranberries to Canada.
- **D.** It drove up the cost of production.

18 **DETERMINING CENTRAL IDEAS** What was the goal of the U.S. Department of Agriculture's decision to buy $5 million worth of cranberries?

- **A.** To prevent the price of cranberries from falling too low
- **B.** To prevent the price of cranberries from going too high
- **C.** To make sure those on food assistance had fresh cranberries
- **D.** To ensure economic efficiency

19 **EVALUATING INFORMATION** What impact might the government's decision to buy the excess cranberries have for consumers?

- **A.** There might be a shortage of cranberries.
- **B.** The quality of cranberries would improve.
- **C.** The price of cranberries would decrease.
- **D.** The price of cranberries would increase.

20 **SUMMARIZING** If the cranberry industry is successful in making its fruit popular in new markets, what will happen to the price of cranberries? Explain your answer.

Writing About Economics

21 **EXPLANATORY WRITING** A friend complains to you that prices of most goods in a free market are just too high and suggests this must mean that producers in such a system always overcharge consumers. Write an essay in which you explain to your friend that in a free market system, market forces will adjust prices to an equilibrium price.

Speaking and Listening About Economics

22 **PRESENTING** Make a list of three products with elastic demand and three products with inelastic demand. Conduct a survey in which you ask 20 people how they would respond to an increase in prices for each of the products. Create a multimedia presentation to explain how consumers respond to price changes based on your findings.

23 **PRESENTING** Research the history of the minimum wage in the United States. Be sure to explain how the minimum wage is a basic government-imposed price control and explain why it was determined to be necessary when it was first imposed. What are some economic arguments that have been made for and against the minimum wage? Present your findings in an oral report to your classmates.

Need Extra Help?

If You've Missed Question	17	18	19	20	21	22	23
Review Lesson	2	2	2	2	2	1	3

TEXT: Johnson, M. L. "Cranberry farmers struggle as surplus drops prices." CNS News. May 06, 2013. http://www.cnsnews.com/news/article/cranberry-farmers-struggle-surplus-drops-prices.

◀ *Controlling your money means controlling your future.*

Personal Financial Literacy

CHAPTER 19

GO DIGITAL
It's All Online!

ASKING ESSENTIAL QUESTIONS

- How can financial institutions help you increase and better manage your money?
- What are the different types of business organizations?
- How can you take control of your own money?

What Will You Learn? You will learn how to work with financial institutions to manage your money and learn how to make smart personal economic decisions regarding business ownership, investing, funding your education, housing, insurance, and charitable giving.

Why Does This Matter? The earlier you take control over your own money and get the information you need to make smart financial decisions, the earlier you begin to have control over your own future.

How Will You Know You Learned It? You will be able to explain why certain types of savings, checking, and investment accounts are right for you. You will be able to make smart decisions regarding business ownership and how to raise money for a business, as well as explain why you have decided on certain types of insurance, whether you want to rent or buy a home, and how you will prepare for and invest in your continuing education.

ECONOMIC
PERSPECTIVES

FAFSA: Free Application for Federal Student Aid

The process of applying:

The FAFSA is available between January and June of each year, but certain kinds of federal financial aid are on a first come, first served basis. The FAFSA form can be completed online at http://www.fafsa.gov—or a paper version can be downloaded and mailed. Also, some high school financial aid offices have software for completing the application.

Who is eligible for federal financial aid?

STUDENT APPLICANT

- -High School Diploma or GED
- -Acceptance into a degree or certificate program
- -Registration with Selective Service
- -Valid Social Security number
- -Statement of non-default
- -U.S. Citizenship
- -Maintain Academic Progress

1 PIN — Get a PIN from the FAFSA Web site

4 Gather financial/banking information on income, assets and investments for the student applicant and parents

5 Gather student applicant's and parents' tax information and documents

What does federal financial aid pay for?

Federal student financial aid can be used to pay various expenses related to attending school. These expenses could include:

- Tuition & Fees
- Room & Board
- Books & Supplies
- Transportation
- Computers
- Child Care

FAFSA is the application for grants, loans, and work-study funds from the federal government, as well as certain state, institution-based, and private financial aid. The information provided by the applicant enables financial aid officers to determine how much of which kind of assistance students can receive.

2 Gather necessary documents (including Social Security numbers and driver's license numbers)

3 Prepare a list of colleges or universities that will receive FAFSA information

6 Complete the FAFSA form: go to http://www.fafsa.gov

7 Attend College!

Other Financial Options:

grants
(which don't require repayment unless you leave school)

loans
(money lent by the government)

work-study
(students earn money to pay for their education through job programs)

States, colleges, and private organizations also offer forms of financial aid. Check their information to see what types of aid are available, how to qualify, and the proper method for applying.

THINK ABOUT IT!

EVALUATING EVIDENCE *List the items needed to complete the FAFSA. How would you explain the application process to someone else?*

EXPLORING THE ESSENTIAL QUESTION

LESSON 1

Financial Institutions and Your Money

ESSENTIAL QUESTION

How can financial institutions help you increase and better manage your money?

When you turned sixteen, your parents promised that you could get an after-school job to start earning your own money. You have worked at this job, getting regular paychecks for three months. You plan to use the money you earn from this job to buy a used car, but your salary is not high enough to save enough money by the target date of the start of your junior year in high school.

Which of the following methods do you think is the best way to put your money to work for you?

1. Keep all of your money in a shoebox in your closet. Promise yourself that you won't spend any money on other things until you reach your goal.
2. Put your money in a bank savings account. It'll earn some interest and you can withdraw what you need at any point.
3. Place your earnings in a certificate of deposit account. It'll raise higher interest, but you will be limited in the flexibility of withdrawing funds.

Saving consistently will help your money grow.

©KTB Images/Blend Images LLC

Type of Account	Risk	Amount of Interest	Deposit Require-ments

ANALYZING KEY IDEAS AND DETAILS

Read closely to learn how to budget, how financial institutions affect your budget, how to open various bank accounts, and what you should understand about borrowing money from financial institutions. Use a chart like the one shown here to explain the differences among savings accounts.

BUDGETING

GUIDING QUESTION *What is the value of learning how to properly budget your money?*

Nearly everything you do is influenced by money—where you live, how you get around, what you do with your free time, and whether and what kind of job you have. When managed well, money makes your life easier. When managed poorly, it can cause great stress and create significant obstacles. Getting control of what you spend—or budgeting—will prevent a downward spiral into debt that may take decades to overcome.

Many people have no idea what happens to their money. It just seems to "disappear." Here's how to find out where your money goes:

1. List the bills you pay every month (cell phone, Internet access, and car insurance, for example).
2. For one month, list everything you buy, including the price you paid—no matter how little an item costs.

At the end of the month, group everything on your list into categories: Food, Transportation, Entertainment, and Personal Care. Now you can see where your money goes.

Here's how to get a handle on your spending: Write down your income and your expenses into a chart like **Figure 19.1**. Look at each expense in column 2 and think of ways to reduce that payment. Enter the smaller amount in column 3—your New Budget. Total the expenses in column 3 to see if your New Budget matches your income.

You've probably heard again and again about the importance of making wise decisions. This is especially true when you make financial decisions. The wisest financial decision you will ever make is to start a budget now and save a percentage of all money you receive—including cash in birthday cards as well as the pay from your part-time job. The second-wisest decision is to deposit what you save into a financial institution.

ANALYZING KEY IDEAS AND DETAILS

1. **DETERMINING CENTRAL IDEAS** What is central idea of this first section? Write a brief summary of the section in your own words.
2. **CITING TEXT EVIDENCE** Which two sentences suggest people struggle to keep track of their money?

✓ CHECKING FOR UNDERSTANDING

1. **RELATING EVENTS** What is the value of learning how to properly budget your money?
2. **CITING TEXT EVIDENCE** What financial decisions does the text recommend?
3. **IDENTIFYING CAUSES** What is the first step people can take to help them gain control over their spending?

FINANCIAL INSTITUTIONS

ANALYZING KEY IDEAS AND DETAILS

1. **SUMMARIZING** Describe how a financial institution works.
2. **CITING TEXT EVIDENCE** Where can you save money? Where can you borrow money?

GUIDING QUESTION *How do financial institutions affect your own budget?*

A **financial institution** is an organization that channels **savings** to investors. How does this process work? Essentially, financial institutions make money by "selling" money. You deposit money into an account. In return, the financial institution pays you a certain percentage of that money for keeping it in an account. That payment to you is called **interest**. The financial institution then loans a portion of your original deposit to other people. Those borrowers pay back their loans plus interest (at a higher percentage) to the bank, which keeps the profit.

The amount of interest depends on the **interest rate**, a percentage a bank will pay to depositors or charge to borrowers. Interest rates are determined by the demand for loans and the supply of money and credit, which is controlled by the central bank of each country. The **Federal Reserve System (Fed)** acts as our central bank.

FIGURE 19.1 BUILDING YOUR BUDGET

Part-time job: $_____
Monthly allowance: $_____
Total income: $_____

Spending Category	Current Expenses	New Budget
Food: School lunches Restaurants & take-out Snacks		
Transportation: Car payment Insurance Gasoline Maintenance (estimate)		
Entertainment: Movies Music Games Sports and hobbies		
Personal care: Clothes Shoes Haircuts Accessories Cosmetics		
Savings (10–30% of income)		
Utilities: Phones Internet access		
Medical/dental		
Donations to charity		
Miscellaneous		
Total		

Building a budget involves categorizing your income and expenses carefully in order to track how your money is spent. Then you can understand how to accurately plan for the future.

ECONOMIC REASONING

ECONOMIC DECISION MAKING Are there any parts of your budget where you spend more money than you expected? How could you reduce spending in those areas?

COMMERCIAL BANKS

Commercial banks are the most common and safest financial institutions. In addition to accepting deposits and lending or transferring funds, commercial banks help their customers manage day-to-day transaction needs such as paying bills, withdrawing cash, and paying for purchases via debit cards or by check. Many commercial banks have online services, and some charge fees for services such as Automated Teller Machines (ATMs). What makes commercial banks safe? The money deposited in a single bank—up to $250,000—is insured (or guaranteed) through an independent agency of the federal government called the **Federal Deposit Insurance Corporation (FDIC)**.

CREDIT UNIONS

Credit unions typically are not-for-profit banks that have been organized for a specific group of people. State employees, school districts, or big companies, for example, might have their own credit union. The benefit of a credit union is that its goal is to share its profits with members (customers) by offering perks such as lower fees and lower interest rates on loans. Because of government laws regarding nonprofit organizations and income tax exemption, credit unions often can offer certain benefits that larger banks cannot.

NONBANK FINANCIAL INSTITUTIONS

Some financial institutions do not accept deposits, yet still channel savings to borrowers. *Finance companies*, for example, make loans directly to consumers who want to pay for large items—such as vehicles or appliances—on an installment plan. *Life insurance companies* also lend their surplus funds. *Investment banks* buy and sell stocks and bonds, also known as "securities." At one time, investment banks and commercial banks existed together in the same bank. After the stock market crash of 1929, Congress passed the Glass-Steagall Act to separate them.

✓ CHECKING FOR UNDERSTANDING

1. **EXPLAINING EFFECTS** How do financial institutions affect your own budget?
2. **SUMMARIZING** What is the goal of a financial institution?
3. **CITING TEXT EVIDENCE** The Federal Deposit Insurance Corporation (FDIC) guarantees a single deposit in a bank up to what dollar amount?

DETERMINING MEANING

The word *institution* comes from the Latin word *institus*, which means "to set up." but the noun *institution* has come to mean something established, dependable, and long lasting. A university, a large hospital system, and a church are examples of institutions. How does this knowledge help you to understand use of the term ***financial institution*** and the trust depositors place in it?

YOU AS A DEPOSITOR

GUIDING QUESTION *What is the value of learning to save your money at an early age?*

It is true that you have the right to keep your savings in a box under your bed. If someone steals it or if your house catches on fire, however, your money is gone forever. It is safer to deposit your savings in a bank. Earning interest on savings carries no **risk** and requires no extra effort on your part beyond making the deposits. Having a savings account also improves your credit rating, which is vital if you want to borrow money in the future. In addition, your savings are your only safety net in financial emergencies.

INTEGRATING KNOWLEDGE AND IDEAS

1. **INTEGRATING INFORMATION** Use the text, primary source, and figures to summarize the overall message of this section.
2. **EVALUATING EVIDENCE** How does Figure 19.2 "Simple vs. Compound Interest" support the author's claim that compounded interest is better for savings?

WHY START SAVING NOW?

Saved money grows, and with an early start you can amass huge amounts of money over time. How? Through a very important concept: compounding. This process results in your interest earning interest.

As you can see from **Figure 19.2**, compound interest is different from simple interest. For example, if you deposited $10,000 and earned simple interest of 5%, you would earn $500 a year for a total of $1,500 interest in 3 years.

In contrast, if you deposited $10,000 and earned *compound* interest of 5% annually, you would earn $500 the first year. But in the second year, you would earn interest not on $10,000 but on $10,500—your original deposit *plus* the first year's interest—which would total $525. In the third year, you would earn interest on $11,025, which is $551.25. With compound interest, then, your initial $10,000 would grow to $11,576.25 in three years, instead of $11,500 with simple interest. That may seem like a minor difference, but it can become a major difference as your balance grows over the years.

Interest for some accounts is compounded more often than annually. Some accounts are compounded semi-annually, quarterly, monthly, daily, or even continuously. The more frequently an account is compounded, the more interest you earn.

DETERMINING MEANING

The word *credit* comes from *creditum*, a Latin word meaning "something entrusted to another." What are some synonyms for the word *union*? How do these words add to your understanding of a **credit union**?

And the longer you leave your money in an account, the better compounding works—especially in an account with frequent compounding. For example, if you left $10,000 in an account for 10 years, with interest compounded *quarterly*, you'd have almost $16,500—without ever adding another cent!

Benjamin Franklin bequeathed money to the cities of Philadelphia and Boston with strict instructions to leave it alone for 100 years, compounding interest. Franklin's small bequest had grown to $6.5 million 200 years after his death. Franklin's money now pays for, among other public works, vocational scholarships and the Benjamin Franklin Institute of Technology in Massachusetts.

> "I devote Two thousand Pounds Sterling, which I give, one thousand thereof to the Inhabitants of the town of Boston, in Massachusetts, and the other thousand to the Inhabitants of the city of Philadelphia, in Trust to and for the Uses, Interests and Purposes hereinafter mentioned and declared. . . . If this Plan is executed, and succeeds as projected without interruption for one hundred Years, the Sum will then be one hundred and thirty-one thousand Pounds of which I would have the Managers of the Donation to the Town of Boston, then lay out, at their discretion one hundred thousand Pounds in Public Works. . . .The remaining thirty-one thousand Pounds, I would have continued to be let out on Interest.. . for another hundred Years, as I hope it will have been found that the [trust] has had a good effect on the conduct of Youth, and been of Service to many worthy Character and useful Citizens. . . ."
>
> —"The Will and Testament of Benjamin Franklin (1789)," published in 1897

ANALYZING PRIMARY SOURCES

1. **CITING TEXT EVIDENCE** The managers of the trust were instructed to lay out a significant portion of the money earned to pay for "public works" in 100 years. What was to be done with the rest, and how would that increase the savings?
2. **INTEGRATING INFORMATION** Why were the actual results of compounded interest in 100 years different from Franklin's projected amounts?

OPENING AN ACCOUNT

People choose a particular bank for various reasons. Some decide to go to the bank their parents use, or they might choose a bank because it's convenient or has a good reputation. Some banks offer better service or lower fees than others. Whatever bank you choose, there are a number of questions you can ask to make sure the bank is right for you.

- **Does it require a minimum balance?** Some banks charge you a fee if you do not keep a certain dollar amount in your account; other banks do not.
- **What are the fees?** It's good to know up front what services you will and won't be charged for.
- **What interest rates does the bank offer?** Even though the Fed determines the initial interest rate, banks have the ability to offer a particular range for various accounts.

You might already have a bank account that someone opened jointly for you (for your education, for example), but you must be age 18 to open an account of your own. Other items you will need to open an account at a bank include:

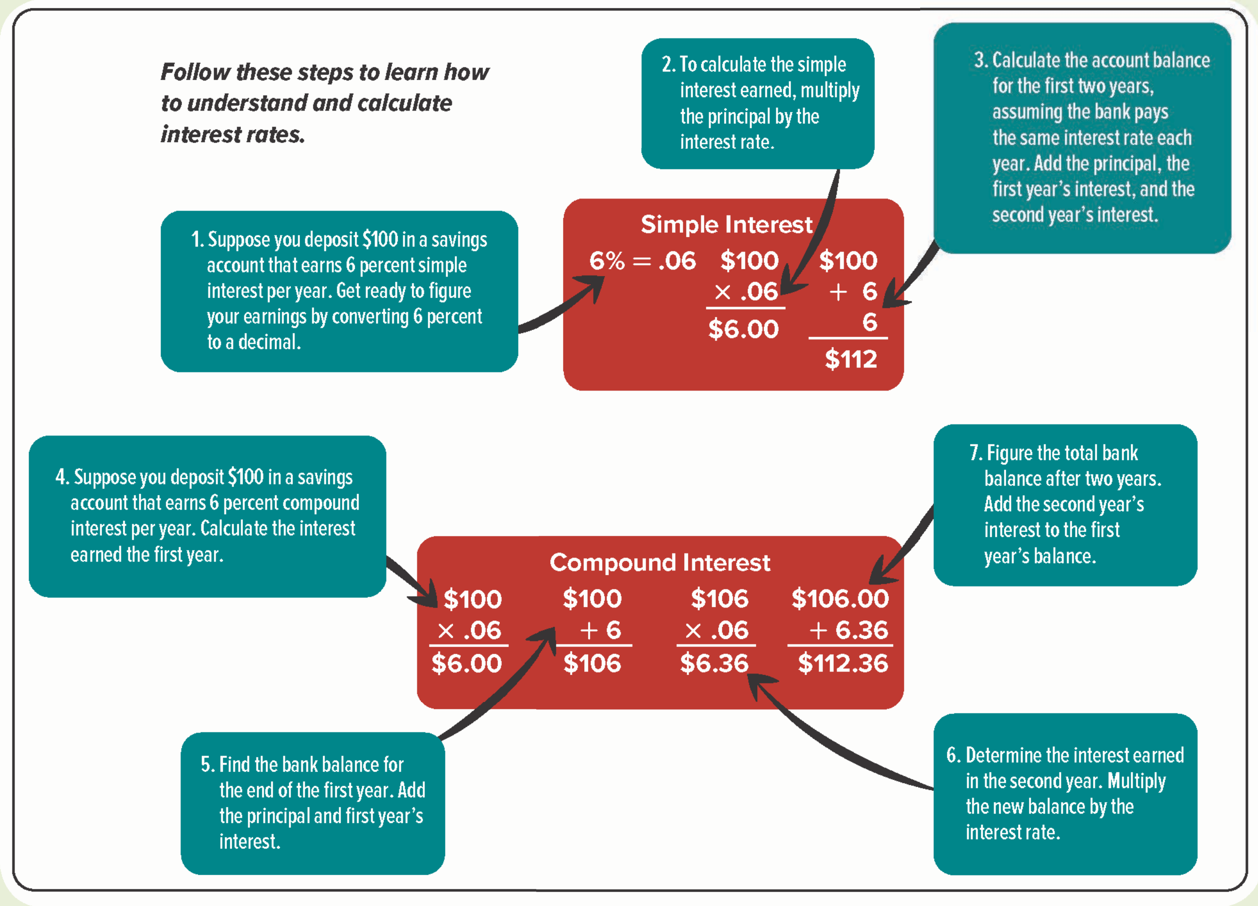
- a photo ID, proof of address (this can be on your driver's license; a utility bill with your name and address is also acceptable), your Social Security card, and money to deposit.

SAVINGS VEHICLES AND RISKS VS. RETURNS

As its name suggests, a savings account is intended to be a place where customers can save their money and earn interest. Banks offer different types

The Will of Benjamin Franklin and Proceedings of Trustees and Courts Relating Thereto. Boston, MA: Rockwell and Churchill, City Printers, 1897.

FIGURE 19.2 SIMPLE VS. COMPOUND INTEREST



Interest rates come in two different varieties: simple and compound. Even if the interest rate itself is the same, simple interest will affect your savings differently than compound interest.

ECONOMIC REASONING

ECONOMIC DECISION MAKING Which rate would you prefer to save with? Which rate would you rather have for a loan?

of savings accounts on the basis of how much money you keep in your account (your *balance*), the number of times you deposit or withdraw funds (your *transactions*), and the length of time you keep the money in the account. Your goals should determine which savings methods you choose.

Passbook Account The most common savings account is sometimes called a "passbook account," named after the booklet that originally came with it. This type of account usually allows a low minimum balance, and it is ideal for "emergency funds" because you have fast access to cash. Savings accounts typically have a fixed interest rate, which means the rate will not change. But these fixed rates are usually low because savings accounts have no risk. Therefore, you also need to utilize other accounts—including investments—to receive enough interest to offset the taxes you'll pay on any interest earned, and to remain ahead of the inflation rate.

Money Market Deposit Account This type of account is similar to a savings account in that it is safe (FDIC-insured), with easy but infrequent withdrawals.

These accounts pay slightly higher interest because they have various deposit requirements, usually requiring a higher minimum balance. The interest rate on money market deposit accounts can change on the basis of the markets.

Money Market Mutual Fund These accounts are relatively low risk because deposits are invested in a pool in short-term financial vehicles. Terms—or the amount of time you cannot withdraw your deposit—are from 90 days to 13 months. Interest rates on these accounts are comparable to money market deposit accounts.

Certificate of Deposit (CD) This type of account has higher interest rates than a traditional savings account. Depositors "purchase" a CD of a certain amount ($100, $1,000, $5,000, $10,000, etc.) with a fixed rate (3.5%, 5%, etc.) with a set time period (1 year, 18 months, etc.). Making an early withdrawal before the "maturity date" can result in a penalty charge.

CHECKING ACCOUNTS

DETERMINING MEANING

A **demand deposit account** sounds as if the bank demands that you make a deposit. In fact, who can make demands on those funds?

A checking account is a **demand deposit account (DDA)**. This kind of account allows customers the easiest access to their money for daily and monthly use. If the account earns any interest at all, it is usually minimal because the balance can change so much.

Ways to deposit money into your checking account include:

- Go to the bank, endorse checks (personal checks or paychecks) by signing your name on the back, fill out a deposit slip, and hand to a teller.
- Put endorsed checks and a deposit slip into an ATM. Tellers will make the deposit during banking hours.
- Transfer funds online from a savings account to a checking account.

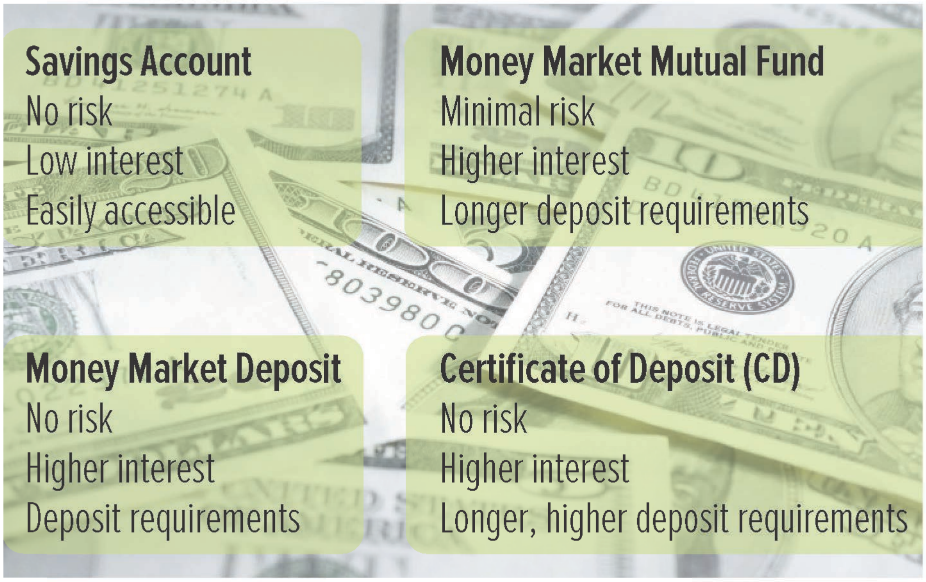
Ways to access the money in your checking account include:

- Withdraw cash from an ATM.
- Use a debit card at a store.
- Write a paper check, or read numbers from a paper check to a vendor over the phone. (See **Figure 19.3**)
- Go to the bank, fill out a withdrawal slip, and receive cash from a teller.
- Pay bills with a bill-paying service through your bank online.

Keep a personal record of every transaction you make—deposits, checks written, and ATM withdrawals. Each month, your bank sends you a *statement*, which is a record of all of the transactions (deposits and withdrawals) you have made in a month. Many bank websites also allow you to view your activity online.

Included in your bank statement is a form allowing you to "reconcile" your account each month. You compare your own personal records with those of the bank to make sure there are no errors. If you find a discrepancy, contact your bank's customer service right away to determine the problem. If you fail to report a discrepancy on your statement within 60 days, you could be held responsible.

It is important to pay attention to your account balance. If you write a check for more than the amount you have in your account, you will have "insufficient funds," also called "bouncing a check." This can happen if you write a number of checks and lose track of your balance. Bouncing checks can be very costly. Vendors to whom you write a bad check will charge you a fee on top of the amount you already owe them. And your own bank will also charge you a fee.



There are many different types of savings methods available to depositors. Each method has its own set of advantages and disadvantages.

ECONOMIC REASONING

ECONOMIC DECISION MAKING You have saved up $1,000, and now you wish to use a savings account to earn interest. Consider what your needs are and discuss what options you have for your money.

If your debit card is lost or stolen, report it to your financial institution immediately and check to see whether there has been any unauthorized activity on your account. If any unauthorized purchases are made within two business days after your card is stolen, you are held responsible only for $50.

✓ CHECKING FOR UNDERSTANDING

1. **SUMMARIZING** What is the value of learning to save your money at an early age?
2. **PREDICTING** Which type of savings vehicle is likely to earn more money over the same amount of time: a passbook account or a money market deposit account? Why?
3. **ANALYZING ISSUES** What happens if you bounce a check?

YOU AS A BORROWER

GUIDING QUESTION *What should you understand about the rules of borrowing money from financial institutions?*

Our society depends more and more on credit, or borrowing, to pay for purchases, which is why it is important to establish and then maintain good credit. Paying cash for everything does not make you a good credit risk. To prove you're responsible enough to get credit, you have to establish a credit history and a credit score. About 15% of a credit score is based on how long you've had credit, so it's important to establish credit as soon as possible.

ANALYZING KEY IDEAS AND DETAILS

1. **SUMMARIZING** Summarize in three or four sentences what you need to know as a borrower.
2. **CITING TEXT EVIDENCE** Why are payday loans and rent-to-own businesses sometimes called predatory lending?

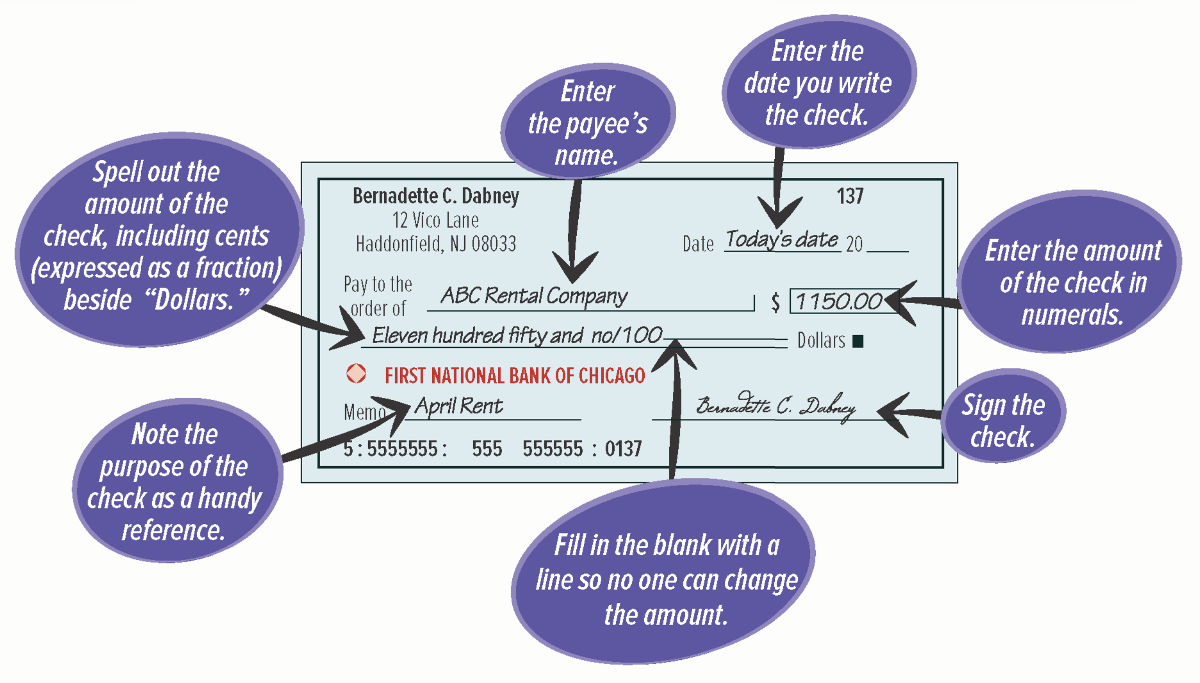
ARE YOU CREDITWORTHY?

Creditors decide whether to lend you money and how much interest to charge by looking at three things:

1. **Can you pay them back**? Add your monthly income to your bank account balances to find your total assets. Then total your monthly expenses. Compare the two to see if you're able to take on more debt.
2. **Do you have a good credit rating**? Lenders want to know if you've repaid previous debts on time.

Art Vandalay/Getty Images

FIGURE 19.3 HOW TO WRITE A CHECK



One of the many ways you can access the money in your checking account is by writing a check, and it is easy once you know how. This figure shows you how to fill out a check.

INFERRING Why might you use a check rather than pay with another method?

DETERMINING MEANING

The adjective *collateral* means "additional but supplementary" or "secondary." How does this help you understand the noun **collateral** when it is used in financial vocabulary?

3. **Do you have collateral**? **Collateral** is used mostly to buy homes or cars. If you don't make the payments, the lender takes back the house or car.

CREDIT CARDS

When you use a credit card, you're borrowing money from a creditor that must be paid back—*plus interest*. Lenders make their profits on the interest their customers owe. Unlike a friend who loans you money and would prefer to have it all back at once, credit card companies set a low "minimum monthly payment" amount. The longer it takes you to pay off your balance, the more they are able to charge you. This is good for the lender, but ultimately detrimental to you.

Recall that you can earn money on your savings through compounding interest. Most savings accounts earn a low percentage (1% to 3%). In contrast, lenders charge much higher compounding interest (15% to 25%). If you run up a balance of $1,000 on a credit card and pay only the minimum payment each month (around $25.00), it will take 22 years to pay off the credit card, and you will end up paying $3,000 total, which is three times the amount you borrowed.

Not all banks and credit cards are the same. If you have good credit, you can negotiate a lower interest rate, or annual percentage rate (APR). Be careful that it's not just an "introductory rate," which increases after a certain period of time. Credit card companies often set up booths at campuses to attract college students. These can be great opportunities to establish your credit, but ask about the interest rate. If it is too high, keep shopping for a lower APR.

Every month, you'll get a statement listing everything you bought with your credit card the previous month, the payments you made, and the balance. Be sure to pay your credit card bill on time. And do not fall into the trap of paying only the minimum payment.

BUILDING CREDIT AND YOUR CREDIT SCORE

Every time you buy something with a credit card or pay a bill, your activity is being recorded by a credit bureau, which issues each person a credit rating. Companies and banks that loan money can access that credit rating and use it to determine how likely you are to repay a loan.

Three major credit reporting companies (also called *credit bureaus*) assign credit scores. They are Equifax, Experian, and TransUnion. Each tracks a person's credit history, or whether you've paid previous debts on time. Your credit score is a number between 300 and 900. The higher the number, the better your credit and the lower the interest rate you'll be charged for borrowing. Here's how to build credit and improve your credit score:

- Open an account in a bank or credit union and apply for a **secured** credit card. You'll have to make a deposit—usually about $300—and you'll get a credit card to make purchases up to the amount you deposited. Buy something each month with the card and be sure to make the monthly payments on time. After a year, if you've paid off the balance, you can get your deposit back and switch your secured credit card to an **unsecured** one. Unsecured cards are not limited to the balance of your account.
- Apply for a retail store credit card. The store will ask for your current bank credit card number and expiration date. Buy something on credit at the store and make the payments on time. Retail credit cards are easier to obtain than a major credit card, such as Visa® or MasterCard®, because the borrowing limits are much lower on retail cards. But retail credit cards often have much higher interest rates, so pay off your balance each month.
- Get a job and keep it. There is a section on your credit report that identifies your employment history. Potential creditors look at this information and determine whether you are a good candidate for credit if you have been at the same job for a while and your income has increased steadily.
- Pay service providers (cell phone, Internet, electric company, etc.) on time. The history of your payments to them often appears on credit reports—especially if you pay late.

FIGURE 19.4 CAPACITY TO REPAY DEBT

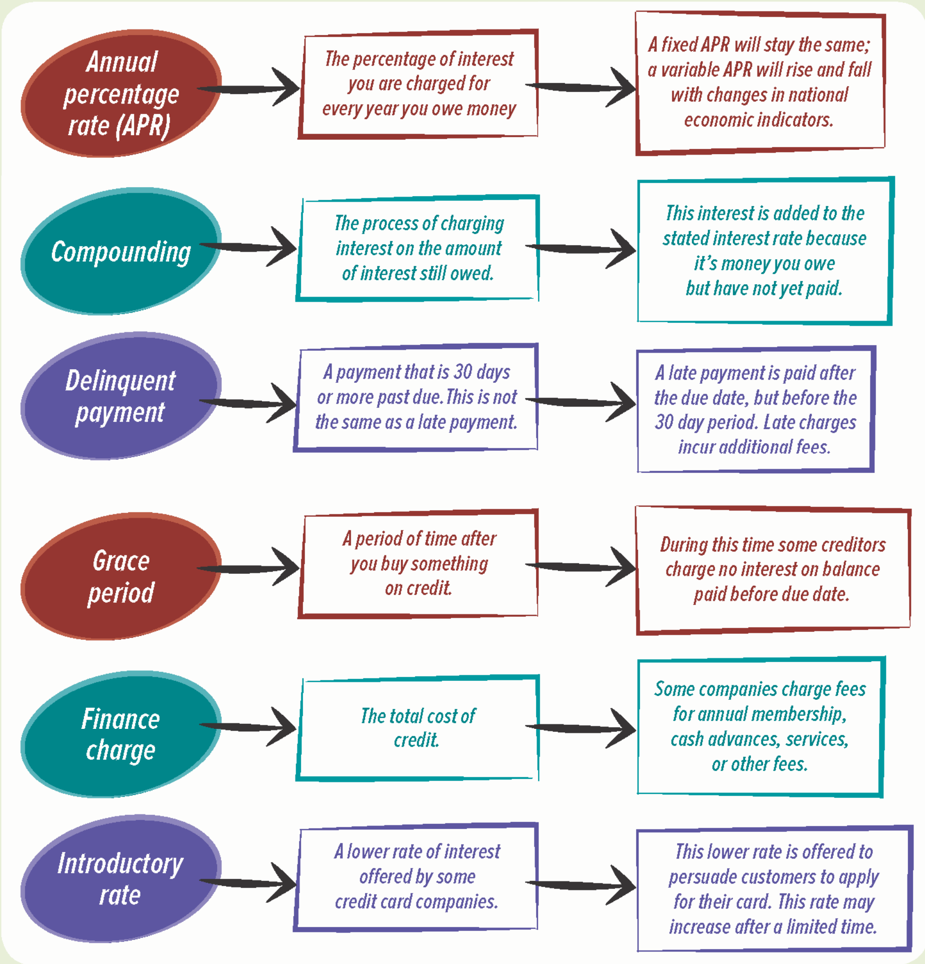
Before you can begin to effectively and reliably repay debts, you need to assess your assets and compare them to your obligations. Repayment of debts can begin when your assets are greater than your obligations.

EXPLAINING CAUSE AND EFFECT If your monthly expenses were to increase without an increase in your assets, what effect could it have on your ability to effectively and reliably repay debt?

FIGURE 19.5 CREDIT BASICS

Some of the most common problems in managing your finances correctly comes from not understanding how credit works. Mastering the basics of credit can prevent many financial headaches.

EXPLAINING EFFECTS Why is it important to pay your credit card on time?



OBLIGATIONS OF BORROWING

When you borrow, you are contractually obligated to the lender. It is your responsibility to understand the details of any document before you sign it, as you will be bound by law to the terms laid out in the contract. Be sure to read the fine print on all contracts. Failure to meet the terms of a loan can lead to legal action, including taking you to court. Lenders can "garnish your wages," meaning your employer will pay the creditor out of your future paychecks. If the loan is for a piece of property, such as a home or a car, the creditor can *repossess* them, or take them from you.

AVOIDING "PREDATORY" LENDING PRACTICES

Try to avoid payday loans, which are illegal in some states. A payday loan company lends money in return for a signed and dated check from the borrower for the loan amount plus a substantial fee. If the borrower does not repay the loan upon his or her "payday," the lender cashes the check. Other places to avoid if possible are rent-to-own businesses, which often have high annual percentage rates (APRs). By the time you pay all the "rental" fees, the item's price may have doubled or tripled. Because the borrowing costs are so high on payday loans and rent-to-own products, they are sometimes referred to as being "predatory business practices" even though they may be legal.

DECLARING BANKRUPTCY

If you have trouble repaying a loan, there are things you can do to get help. Contact your creditor right away. Many creditors are willing to work with you if you lose your job. Credit counselors also are available. There may come a time when income cannot keep up with the accumulation of monthly bills. A person can "declare" bankruptcy by filing a petition with the courts. Some people view bankruptcy as a "clean slate," but it stays on a credit record for a long time and can make moving forward very challenging. It should be the option of last resort.

Bankruptcy rules vary by state. There are two main parties in a bankruptcy, the *debtor* (the party who owes) and the *creditor* (the party that is owed). Most bankruptcy cases involve one debtor (or two if married) and multiple creditors.

Several types of bankruptcies exist. The circumstances determine which "chapter" of the Bankruptcy Code a person should file under. Most personal bankruptcies are one of the following:

Chapter 7 This is the most common form of bankruptcy. A court trustee is appointed to evaluate the debtor's assets and use them to pay part of the debt. Money owed on student loans, child support, and taxes will not be dismissed, however. Those with lower incomes and few assets typically choose this option.

Chapter 13 Chapter 13 bankruptcy allows the debtor to keep some or all property. An appointed trustee creates a repayment plan with lowered payments. The court collects future payments from the debtor to pass onto creditors.

After the debtor has completed the requirements spelled out by the court, he or she is relieved of the debt previously accumulated.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** What should you understand about the rules of borrowing money from financial institutions?
2. **EXPLAINING CAUSES** Why is a good credit score important?
3. **EXPLAINING EFFECTS** Why do most financial advisors suggest you pay off your credit card balance every month?

LESSON 1 REVIEW

Economic Reasoning

1. **COMPARING AND CONTRASTING** Explain how compound and simple interest work using a deposit of $5,000 and a 5% interest rate. How long will it take you to have $45,000 in your account? You may round up.

Building History–Social Science Analysis Skills

2. **SUMMARIZING** Use your notes to explain the methods available for depositing money into a personal checking account.
3. **DETERMINING CONTEXT** Explain the differences between a secured credit card and an unsecured credit card.
4. **EXPLAINING CAUSES** How are the interest rates determined for savings and lending?

Writing About Economics

5. **EXPLANATORY WRITING** Write a full-page essay explaining the concept of bankruptcy. When does bankruptcy occur? What benefits does bankruptcy provide to the person or institution? What risks come with declaring bankruptcy?

Collaborating

6. **EVALUATING** When you turned 16, you started a job with a take-home pay of $8 per hour. You can only work 10 hours per week because you are still in school. Your goal is to buy a car for $10,000 when you turn 18. Work with a partner to brainstorm ways to meet your goal. Think about how you can use a budget and a financial institution to help you. How can you save money? Should you borrow money?

LESSON 2

Business Organizations and Your Money

EXPLORING THE ESSENTIAL QUESTION

ESSENTIAL QUESTION

What are the different types of business organizations?

Have you thought about what occupation you want to enter after you complete high school and college? Briefly describe what type of business you are interested in, as well as the type of business organization in which you'd like to work (sole proprietorship, partnership, or corporation, for example).

©RTimages/Alamy

Depending on what career interests you, you may work alone (sole proprietorship), in a partnership, or in a corporation. You have these same choices when you're ready to invest.

Financial asset	Advantages	Disadvantages
Preferred stock		
Common stock		
Mutual fund		
Corporate bonds		
Municipal bonds		
Treasury instruments		

ANALYZING KEY IDEAS AND DETAILS

Read closely to learn how different types of business organizations change the amount of risk investors assume. Also read to learn about raising capital, and you as an investor. Use a chart like the one shown here to describe the advantages and disadvantages of the financial assets listed.

BUSINESS ORGANIZATION AND RISK

GUIDING QUESTION *How do the different types of business organizations change the amount of financial risk assumed by the individual investor?*

Capital formation is a term used by economists to describe the transfer of money from individuals or households to businesses and government through investments and loans. Capital formation depends on savings and borrowing, and the smooth flow of these funds through the financial system benefits everyone. How so? Financial institutions turn the collective savings of customers into investments that result in more jobs, which result in more goods and services being produced as well as demand for those goods and services. Countries with good capital formation experience economic growth.

Capital formation helps many of the nearly 600,000 new businesses in the United States get started each year. For many people—and perhaps you in the future—owning a business is a way to fulfill a lifelong passion. For others it is a way to have more control over their professional goals, the people they work with, and personal life balance. Just as there are different motivations for starting a business, there are different ways to organize a business.

SOLE PROPRIETORSHIPS

A **sole proprietorship** is a business owned by one person. It is the most common form of business organization. To get started, the owner needs to obtain all of the required permits, registrations, and licenses, which vary depending on the state and the kind of business. The U.S. Small Business Administration (SBA) website has a listing of these requirements.

Sole proprietorships are easy and often inexpensive to set up, and they have the lowest tax rate of the different types of businesses. All of the decisions are made by one person, who gets all of the profits. Because the business is not separate from the individual who owns it, however, he or she holds **unlimited liability** for debt and other obligations. It may be difficult to raise money from investors. Sole proprietorships also have **limited life**.

PARTNERSHIPS

A **partnership** is a business owned by two or more people. Together they divide all profits, and they are responsible for all debts. To get started, the partners sign an agreement as to how they will run the business. A partnership must register with the state, establish a business name, and register with the Internal Revenue Service (IRS) to obtain a tax ID number. The partners also must

ANALYZING KEY IDEAS AND DETAILS

1. **SUMMARIZING** Describe capital formation, and explain how it relates to business organizations and ownership.
2. **CITING TEXT EVIDENCE** What are three different types of partnerships?

DETERMINING MEANING

The word *liability* comes from the Latin word *ligare*, which means "to tightly bind or knot." If the word *liability* in legal use means the "state of being legally responsible for something," then what does it mean to have **unlimited liability** in a business?

obtain required permits, registrations, and licenses. Many law offices or doctors' practices are partnerships. Essentially three types of partnerships exist:

General Partnership In this type of partnership, management of the business, liability, and profits are split equally among partners.

Joint Venture This type of partnership is like a general partnership, but it is typically set up for a single project or for a limited time span.

Limited Partnership A **limited partnership** allows for certain partners to have less input—less money invested or fewer decision making powers, for example—in exchange for less profit.

Partnerships hold certain advantages. They are relatively easy to form. They utilize the resources and strengths of the partners, and additional partners who have specialized skills may be added. Disadvantages of partnerships mirror the struggles common whenever people work together. There may be disputes over the direction of the company, day-to-day duties, and the amount of effort. In addition, all partners are liable for the mistakes of the other partners.

CORPORATIONS

A **corporation** is legally separate from its owners. **Stockholders** (shareholders) invest money and, in return, receive profits the corporation earns. Setting up a corporation requires a number of complicated and costly legal prerequisites. Corporations must register with the state, establish a business name, and register with the IRS to obtain a tax ID number. They must acquire permits, registrations, and licenses. Shareholders create a *board of directors*, a group of people who oversee the management of the corporation.

Advantages of a corporation are many. It provides limited liability, meaning that the corporation itself, not its owners, is fully responsible for its obligations. Shareholders are not responsible for the debts of a corporation, and they file their personal taxes separately. Ownership of a corporation can change easily from person to person and outlive the original shareholders. Corporations can raise money for the business, including offering stock, which can be a way to recruit high-quality employees. Disadvantages also exist, however. Start-up costs can be very high. Because corporations require more regulation, recordkeeping and other obligations can be burdensome and time-consuming.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** How do the different types of business organizations change the amount of financial risk assumed by the individual investor?

2. **EXPLAINING EFFECTS** Why is limited liability advantageous for a business organization?

3. **INFERRING** When would you want to use the joint venture form of partnership?

RAISING CAPITAL

GUIDING QUESTION *How can small business owners find ways to raise the investment capital they need to start a business?*

All business organizations face a similar need: obtaining capital to develop their business. As you will see, corporations have several options unavailable to sole proprietorships and partnerships.

MAKING CONNECTIONS TO TODAY

FAMILY PARTNERSHIPS

If you have an idea for a business and need one or more partners, look to your family first. Forbes states that more than 90% of all U.S. businesses are family owned or controlled by a family. Who can forget the Wright brothers and the start of aviation? Sibling partnerships are a very common way for businesses to start. However, families must establish clear expectations for each family member's role in the business and clear up any personal issues first. Agree on goals and keep channels of communication open. Express yourself respectfully and make decisions together. Because family businesses are so common, there are many resources available explaining how to set one up.

UNDERSTANDING CRAFT AND STRUCTURE

1. **ANALYZING TEXT STRUCTURE** The author states that "All business organizations face a similar need: obtaining capital to develop their business." How does the author organize the text in this section to develop that idea?
2. **ANALYZING TEXT STRUCTURE** Why do you think the author placed the section on business organization and ownership before this section on raising capital? How does this organization help you understand the text?

SMALL BUSINESS LOANS

Small businesses such as sole proprietorships and partnerships may obtain *start-up loans* to establish their businesses. These funds typically are used to purchase property and inventory, or to pay start-up fees. Another type of loan for small business owners is a *Small Business Administration loan*. These are funded by the U.S. Small Business Administration and administered through participating banks. *Lines of credit* are loans designed to help with cash flow during slow periods or negative growth. They allow a business to draw from a set amount of funds without having to go through the loan application process over and over again.

CORPORATE CAPITAL

There are four general ways corporations raise capital: selling bonds, issuing stocks, borrowing directly from financial institutions, and converting profits.

Selling Bonds Bonds are like loans from individuals. A corporation offers bonds for sale, and then pays installments of interest to the bondholders. Eventually, the bond itself is repaid. Bondholders do not have any say in how the company is run, yet investors like bonds because they are not very risky; corporations must pay bondholders even if the company has not made a profit. Corporations like bonds because the interest rate is lower than that of a bank loan. The interest paid to bondholders is also tax deductible for the corporation.

Issuing Stocks **Stocks** are also like loans from individuals. Unlike bondholders, purchasers of stock receive **dividends** representing a portion of corporate profits. There are generally two types of stock. Purchasers of **preferred stock** receive dividends after bondholders are paid but have no say in how the company is run. Purchasers of **common stock** earn dividends last but are allowed a certain say in how a company is run. For instance, they are allowed to vote for the board of directors who manage the corporation.

Borrowing Directly Businesses can get loans from banks or other lenders. The interest rates typically are higher than those for bonds and stocks.

Converting Profits Some corporations use all of their profits to pay their shareholders. Other corporations, called "growth companies," put their profits toward expanding the business in new directions or investing in research that relates to their industry.

DETERMINING MEANING

The connotation of the word ***dividend*** is a reward, bonus, or windfall that is earned. You might receive a dividend from doing a good deed. In financial terms, it is the distribution of a portion of a company's earnings to its stockholders, which could be taken or reinvested. What could be the "good deed" a shareholder is being rewarded for doing?

Sole proprietorships and partnerships have several means of raising capital, including start-up loans, SBA loans, and credit.

INTEGRATING INFORMATION
What is a start-up loan typically used for?

✓ CHECKING FOR UNDERSTANDING

1. **CITING TEXT EVIDENCE** How can small business owners find ways to raise the investment capital they need to start a business?
2. **DETERMINING MEANING** In general, how is a bond different from a stock?
3. **DETERMINING MEANING** Describe the differences between preferred and common stockholders.

YOU AS AN INVESTOR

GUIDING QUESTION *Why is the role of an investor an important part of the economy?*

Investing is not just for the rich. A little extra is all it takes to begin using your money to make more money. All investments, however, involve two unknowns: the possibility of making money—the return—and the risk of losing it. In deciding to invest, you are always balancing these two factors.

INVESTMENT RISKS VS. RETURNS

There are two types of financial risk involved when investing:

Undiversifiable Risk Undiversifiable risk is also called "systematic" or "market risk." This type of risk affects all companies. Situations like inflation, interest rates, political instability, natural disasters, exchange rates, and wars are examples of undiversifiable risks.

Diversifiable Risk Diversifiable risk is also called "unsystematic." This type of risk is specific to each company or industry. A company being poorly managed, a factory burning down, or new technology replacing another technology are examples of diversifiable risks.

The riskiest investments usually provide the highest returns. The best way to reduce risk is to practice **portfolio diversification**, which means investing in a wide range of assets that would not all be affected in the same way. This is especially wise advice when dealing with stock market investments.

INVESTING IN STOCKS

As you learned earlier, stocks are shares of a company's assets and are considered a good long-term investment. However, stocks are also the investments with the largest amount of risk. A company might suffer any number of setbacks, and you could lose some or all of the money you invested. To reduce risk, many people buy a collection of stocks called a **mutual fund**. This is a pool of money from many people and invested together in a variety of stocks and bonds. It is administered by an investment manager.

To purchase stock, you need to establish an account with a **stockbroker**, either in person or online. There are "full-service" brokers who offer investment advice but also charge higher fees or work on "commission," receiving a percentage of what you earn. Online brokers are becoming more and more popular. They also charge fees, but the fees can be less than those of full-service brokers. Before setting up an account and making any transactions, it is important to research the broker and know what fees are charged.

To set up an account, you must be 18 years old, or you can set up a custodial account with your parents. Similar to setting up a checking account, you need two sets of identification, a Social Security number, a W-9 form, and the initial deposit.

Tell your broker your short-term and long-term goals, which will affect the risks and returns on your investments. If you want to select your own stocks, be sure to do your homework: What does the company produce? How profitable is it? What is its earnings history? How has its stock fared recently and over the past year? Join an investment club to help you answer these questions—and to learn what questions to ask.

INTEGRATING KNOWLEDGE AND IDEAS

1. **INTEGRATING INFORMATION** What information does Figure 19.6 provide? How does it help you understand the text in this section?
2. **EVALUATING INFORMATION** Review Figure 19.7. Using what you learned in this section, in which company would you invest? Why?

DETERMINING MEANING

We use the word *portfolio* to describe the collected work of an artist, professional, or student. It comes from the idea of a portable folio, or file of papers. You may have heard the terms *biodiversity* and *cultural diversity*, or the idea of having a diversity of views. Considering this information, what can you infer about the term ***portfolio diversification***?

DETERMINING MEANING

The word *broker* is from the Anglo-French word *brocour*, which meant "negotiator." Today a broker is also a mediator or representative. A real estate broker represents the buyers and sellers of real estate. There are insurance brokers and even brokers of peace. Who does a **stockbroker** represent?

Patience is the key to successful stock investing. The stock market (where stocks are bought and sold) may go up and down, but the return on stocks over the past 50 years has been consistently higher than for other types of investments.

Are you interested in buying a car? Do you want to pay for college? Damon Williams was able to start early by learning investing from his mother, but today anyone can learn, and it is never too early to start. In addition to investment clubs, look for legitimate online classes and local workshops:

> "When Damon Williams bought his first share of Nike stock (NKE), he was just 6 years old. . . . [A]fter buying him one too many pairs of the $70 shoes, his mother, April, closed her wallet. She told her son that if he wanted another pair of Jordans, he would have to save his money and buy a share of Nike stock first. "I was determined to get the Jordans. I really didn't care too much about the shares," he admits. Williams had no idea that a single $30 stock purchase would be the foundation of a $55,000 portfolio 13 years later. Besides accruing the capital appreciation, he learned a valuable lesson. "Anybody can do this. It's not just for the affluent," he says. . . . "My mom taught me about ownership and investing . . . ." In addition, Williams participated in the Ujamaa Junior Investment Club. . . . Today, at age 19, Williams describes himself as a long-term investor; he likes to hold stocks for seven to 10 years. "I'm not really into quick trades or guessing or gambling. I look for stable companies that have been growing in earnings for five years consistently," he says."
>
> —Emerald S. Morrow, "Teen Investors Take Charge," *Black Enterprise*, 2012

ANALYZING PRIMARY SOURCES

1. **ANALYZING INDIVIDUALS** How did Damon Williams's views change from the time he bought his first share of Nike stock to now? Cite evidence from the text to support your answer.
2. **INTEGRATING INFORMATION** Based on what you read in this lesson, what do you think Damon Williams learned about risk that caused him to decide he didn't want to gamble with his money?

FIGURE 19.6 COMMON INVESTMENTS

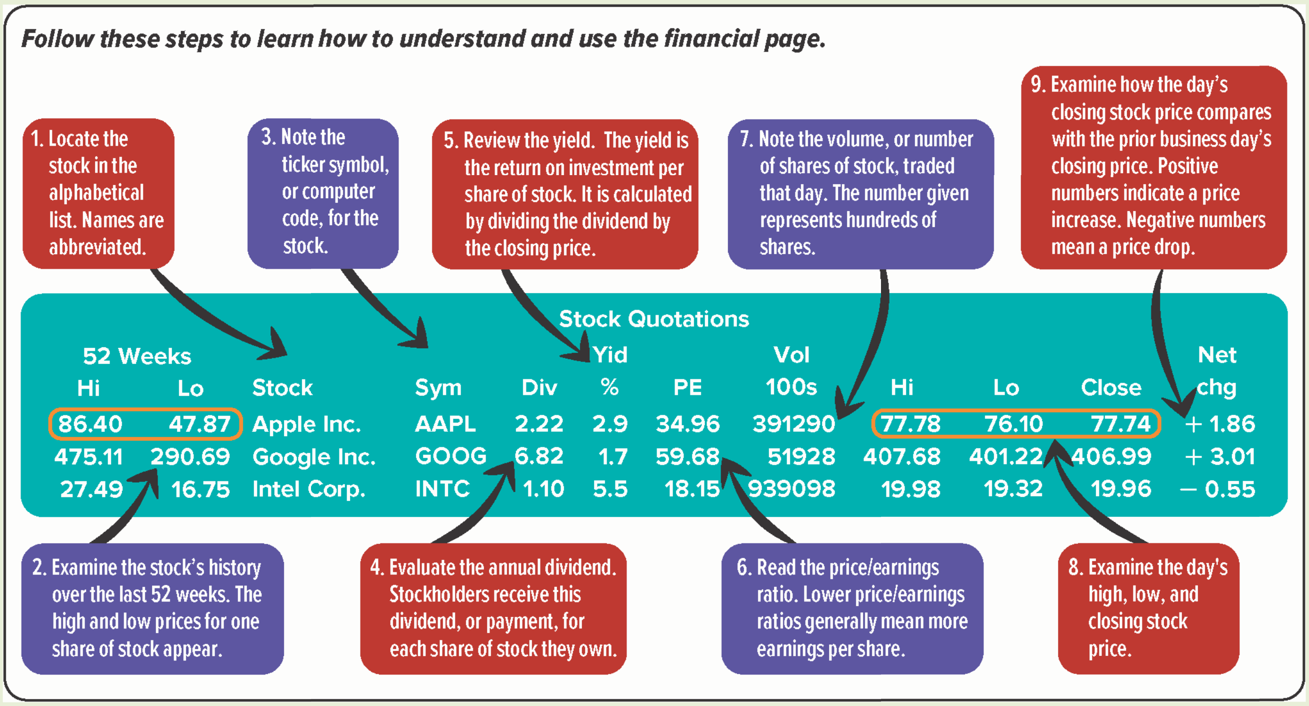
Stocks	Stock mutual funds	Bonds	Bond mutual funds
Advantage: *High earnings potential*	***Advantage:*** *Some risk, but less than buying stock individually; Professional investment manager*	***Advantage:*** *Good earnings potential;* ***Federal:*** *no default risk;* ***Municipal:*** *low risk, no federal tax;* ***Corporate:*** *moderate risk*	***Advantage:*** *Professional investment manager; less risk than individual bonds*
Disadvantage: *High risk; need broker to buy and sell*	***Disadvantage:*** *Need fund company or broker to buy and sell; minimum investment usually $1,000 or more*	***Disadvantage:*** *Federal tax on federal and corporate bond interest*	***Disadvantage:*** *Need broker to buy and sell*

Corporations have more opportunities than proprietorships and partnerships to raise capital through these different investment methods. Each one has advantages and disadvantages.

INTEGRATING CHARTS What form of investment method described in this chart carries the highest risk?

TEXT: Morrow, Emerald S. "Teen Investors Take Charge." Black Enterprise. February 06, 2015. http://www.blackenterprise.com/mag/teen-investors-take-charge/.

FIGURE 19.7 READING STOCK MARKET REPORTS



52 Weeks Hi	52 Weeks Lo	Stock	Sym	Div	Yld %	PE	Vol 100s	Hi	Lo	Close	Net chg
86.40	47.87	Apple Inc.	AAPL	2.22	2.9	34.96	391290	77.78	76.10	77.74	+ 1.86
475.11	290.69	Google Inc.	GOOG	6.82	1.7	59.68	51928	407.68	401.22	406.99	+ 3.01
27.49	16.75	Intel Corp.	INTC	1.10	5.5	18.15	939098	19.98	19.32	19.96	– 0.55

When picking which companies you want to invest in, it is important to research the performance of those companies. Stock market reports can help you figure out what companies make for good investments.

INTEGRATING CHARTS Which stock reported the biggest change for the day reported? Which stock traded the largest volume of stocks for the day reported?

INVESTING IN CORPORATE & GOVERNMENT BONDS

Like stocks, bond transactions can be completed through full-service brokers as well as online brokers. Recall that corporations offer bonds to raise capital for developing or expanding a business. Governments, too, sell bonds. They offer the bonds to raise money for particular projects, such as building bridges.

In general, as a bondholder you will receive scheduled interest payments as well as the repayment of your loan at a specified time in the future—the bond **maturity** date. Maturity dates vary widely, however.

State and local governments sell **municipal bonds** known as munis. *Treasury instruments* are loans you make to the federal government. They include **Treasury bills** (T-bills), **Treasury notes** (T-notes), **Treasury bonds**, (T-bonds), Treasury Inflation-Protected Securities (TIPS), and several series of **savings bonds**. They have various interest rates and maturity dates. These types of federal bonds offer different payment plans depending upon the maturity date. Because they are issued and backed by the government, Treasury instruments offer low risk. They can be bought directly from the government online, or through banks or brokers. Minimum investments for most are $100–$10,000, but some savings bond minimums are much lower.

Standard & Poor's and Moody's rate bonds on their level of risk. Most bonds are considered less risky than stocks, and government bonds are less risky than corporate bonds. In addition, the interest payments on munis are tax-exempt, whereas the interest payments from corporate bonds are taxed.

INVESTING IN "YOURSELF" WITH IRAS

Individual Retirement Accounts (IRAs) can be considered both investments and savings. They are savings accounts because you deposit money into them, which you do not access until you reach retirement. They are investments because you (or financial advisors) select the stocks and bonds into which you want your deposits directed. Again, do your homework before you invest your IRA funds. When you're young, you can choose riskier assets to get a higher return because if you lose your investment, you still have many years to recoup your losses. As you near retirement age, you want to transfer your deposits into safer assets.

Some employers offer IRAs. Banks also offer IRAs for those who don't have access to employer-sponsored accounts or who want to save independently for retirement. There are many different types of IRAs. The most common are Traditional and Roth. The differences are in how you pay taxes on the deposits.

Traditional IRA In a Traditional IRA, you can make yearly contributions (deposits) into the account up to a certain limit determined by the government. These contributions are not taxed when they are deposited, but you have to pay tax on the whole amount (as income) when you withdraw the funds upon retirement. In theory, by then you might be in a lower tax bracket and won't pay as much in taxes.

Roth IRA The Roth IRA was created as part of the Taxpayer Relief Act of 1997. With this type of account, you have taxes taken out before you make deposits so you do not have to pay taxes when you withdraw the money at retirement.

✓ CHECKING FOR UNDERSTANDING

1. **EXPLAINING CAUSES** Why is the role of an investor an important part of the economy?
2. **IDENTIFYING CAUSES** What are ways to reduce the risk of buying stocks?
3. **DETERMINING MEANING** What are munis, and why are they sold?

LESSON 2 REVIEW

Economic Reasoning

1. **ANALYZING ISSUES** Explain the reasons to think about a retirement account early, and the differences between a traditional Individual Retirement Account (IRA) and a Roth IRA.

Building History–Social Science Analysis Skills

2. **DETERMINING CONTEXT** What makes a proprietorship unique?
3. **DRAWING CONCLUSIONS** If you suddenly had $1,000, what would you do with it? Describe the ways you could use that $1,000 to make more money.
4. **ANALYZING ISSUES** Compare the different types of Treasury instruments that can be used to invest in government.

Writing About Economics

5. **INFORMATIVE WRITING** Write a one-page essay explaining the advantages a corporation has over a sole proprietorship or partnership.

Collaborating

6. **USING MULTIMEDIA** With a partner, research possible business investments by visiting investor.gov and clicking on the "Research before you invest" tab. Make a list of at least three ways to do business research. Use those strategies to create a slideshow titled "Promising Businesses" for two or more businesses you are interested in knowing more about. Include stock market reports and two questions you still want answered before investing in that company. Cite your sources.

LESSON 3

Personal Money Decisions

EXPLORING THE ESSENTIAL QUESTION

ESSENTIAL QUESTION

How can you take control of your own money?

It is unavoidable that we must spend the money we earn. But learning how to spend it carefully and effectively is the important trick that you should learn. One of your biggest expenses is paying for your own place to live.

What are the financial benefits of buying a home?

Funding your college education and paying off a mortgage are two of the biggest expenses you'll face. Are you ready for the challenge?

Ariel Skelley/Blend Images LLC

Method	Description

ANALYZING KEY IDEAS AND DETAILS

Read closely to learn different methods of paying for college, the costs and benefits of renting versus owning a house, the types of insurance you need, and the benefits of giving to charity. Use a chart like the one shown here to describe various methods available to pay for college.

FUNDING YOUR EDUCATION

GUIDING QUESTION *Why are there so many different methods available to help you fund more education?*

You graduate from high school. Then what? Although the workplace has changed over the years, one fact remains constant: what you learn determines what you earn. Workers with bachelor's degrees have greater lifelong earning power than do workers with only a high school diploma, and are less likely to be unemployed.

FINANCIAL AID

Many families cannot afford to pay cash for students to go to college. Instead, they acquire loans and other financial aid. To be considered for financial aid—including low-interest loans, grants, and work-study programs—you must complete a FAFSA form. FAFSA stands for the Free Application for Federal Student Aid. It is the form created by the U.S. Department of Education and managed by the Office of Federal Student Aid. It is used by nearly every college and university to determine eligibility for financial aid and how much you or your family must contribute. Around 14 million FAFSA forms are submitted each year and account for about $80 billion in financial aid. Deadlines vary from college to college, but the form should be filled out in January, as soon as you and your parents receive all tax information from the previous year.

To qualify for financial aid, you must:

- Be a U.S. citizen
- Have a valid Social Security number
- Have a high school diploma or GED
- Be registered with the U.S. Selective Service (if you are a male 18 to 25 years old)
- Promise to use federal aid only for educational purposes
- Not owe refunds on any federal student grants
- Not have **defaulted** on any student loans
- Not have been found guilty of the sale or possession of illegal drugs

Documents you need to complete the FAFSA form:

- Most recent income tax return (or your parents' tax return if you are a dependent)
- Current bank statements
- Investment records

INTEGRATING KNOWLEDGE AND IDEAS

1. **INTEGRATING INFORMATION** After you read about the different ways to fund an individual's higher education, examine the unemployment information in Figure 19.8. Why do you think the government and private companies help pay for education?
2. **EVALUATING EVIDENCE** Read the text in this section and Figure 19.8. Does the figure support the author's claim that a college education improves an individual's chances of getting a good job? Explain.

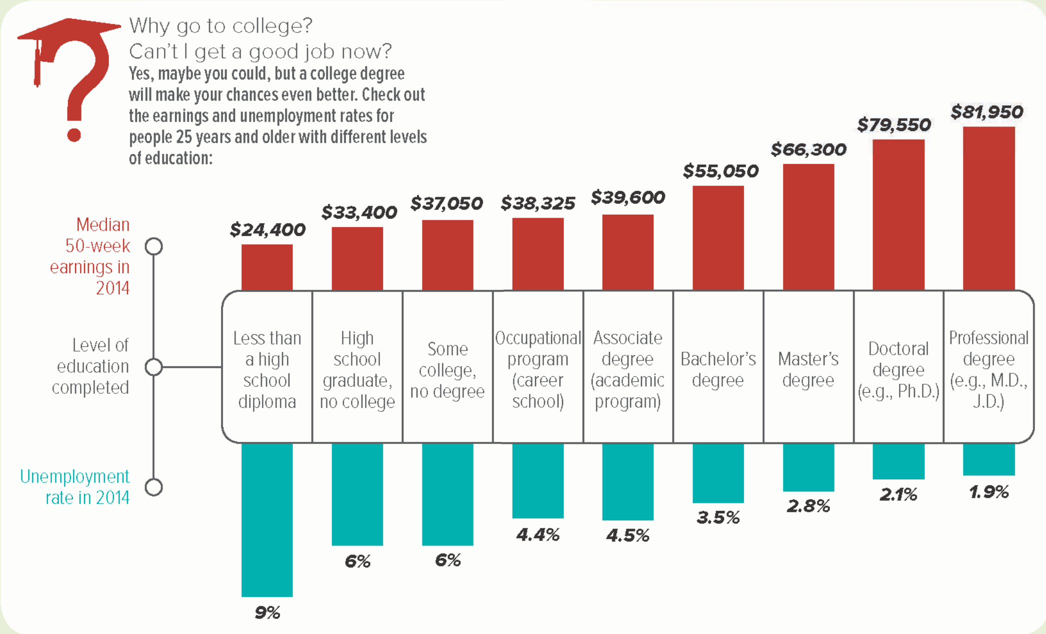
DETERMINING MEANING

The word *default* means "failure to fulfill an obligation." Why would it hurt your credit and financial reputation to have **defaulted** on a student loan?

FIGURE 19.8 UNEMPLOYMENT AND EARNINGS

While education can be expensive, it is an investment that can pay off. Statistics show that education has a marked impact on both earnings and employment.

EXPLAINING CAUSE AND EFFECT Why do you think the unemployment rate decreases as education increases?



- Records of any untaxed income
- Driver's license
- Social Security number
- Alien registration or permanent resident card (if not a citizen)

STUDENT LOANS

About half of all financial aid is in the form of loans, which must be repaid—with interest. For most student loans, you must start paying them back nine months after you graduate from college. A few of the most common federal student loans include:

- **Direct Subsidized Loan**
- **Direct Unsubsidized Loan**
- **Direct PLUS Loan (Parent Loans for Undergraduate Students)**
- **Direct Consolidation Loan**
- **Federal Perkins Loan Program**

Go to studentaid.ed.gov to learn how to apply for federal student loans. The advantages to student loans offered by the federal government are lower interest rates and flexible repayment plans. Private loans are available from banks and other financial institutions. And some colleges sponsor loans. Interest rates are generally higher for these loans than for federal loans.

SCHOLARSHIPS AND GRANTS

Unlike loans, scholarships and grants are outright gifts that you do not pay back. Both vary in the requirements, dollar amount, and expectations of the recipient. There are key differences between the two, however. A grant is tax exempt and not always related to academics. It is often given on the basis of financial need alone. Scholarships almost always are related to academic scores. They are typically more selective and competitive.

Your high school, your parents' employers, your state government, local companies, and even some nonprofit organizations offer grants and scholarships. Go online to research what is available, and begin reading about the requirements necessary for you to apply. Many applications ask you to submit a short essay about yourself and why you believe you deserve the grant or scholarship.

WORK-STUDY PROGRAMS

Work-study programs are part-time employment at the university you attend. The benefits of these types of jobs are that the employers typically are more understanding of your college life and are more likely to consider your class schedule when assigning work hours.

There are two general types of work-study programs:

Federal Work-Study (FWS) The FWS is based on financial need. Jobs can be either on campus (in one of the administrative offices, for example) or off campus. Jobs that are off campus are typically in community service in fields related to your major. You can sign up for these programs by filling out a FAFSA form and checking a box asking for interest in student employment. The employer will pay up to 50% of your wages, and the government will pay the rest. The amount of money you earn cannot exceed your financial aid award. Average work hours are 10–15 a week.

Non-Federal Work-Study (non-FWS) This type of work-study is not based on financial need. Most schools offer student employment opportunities in places like the dining halls, library, and offices of academic departments. These jobs offer more convenience and flexibility than do off-campus jobs.

NONTRADITIONAL METHODS TO PAY FOR COLLEGE

There are ways to obtain college credits before you enroll in a university. In addition, other avenues may pay for most if not all of your college education.

- **Take an Advanced Placement (AP) course.** These are college-level courses you can take in most high schools. Every spring, AP students may sign up for the AP exam for certain courses and receive college credits by scoring high on the test.
- **Sign up for the College-Level Examination Program® (CLEP).** Like AP exams, the CLEP consists of standardized tests that determine your knowledge of subjects at a college level. You may obtain college credits if you pass a test for a particular course. Passing several tests could save you a year or more in college tuition.

Federal Work-Study is based on financial need. You may be employed in administrative offices or libraries on campus, or in the local community off campus.

INTEGRATING INFORMATION
Which work-study program is based on financial need?

There are many ways to acquire the money needed to pay for a college education. Scholarships, tuition-free schools, work-study programs, and many forms of financial aid are possibilities. Earning a college degree can mean significant improvements in job options and earnings potential.

RESEARCHING FOR INQUIRY
Research some of the options available to you to help pay for education, and then write a paragraph on the results.

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- **Apply for employer reimbursement.** As part of workplace benefits, some employers offer tuition reimbursement to their employees. This process requires the worker to pay upfront for college classes, but then he or she is paid back later by the company. The employer may require proof of good grades for one to receive the reimbursement.
- **Join the military.** Each of the Armed Forces offers a number of ways to pay for college.
- **Attend a tuition-free school.** Although the number of schools that do not charge tuition is small, they do exist. Many have strict requirements.
- **Enroll in a Public Service Loan-Forgiveness Program after graduation.** This program allows borrowers to work off their loans after college by getting hired as public service employees. Some examples of public service programs are the National Health Service Corps, National Association of Public Interest Law, Peace Corps, AmeriCorps, and Volunteers in Service to America.

UNDERSTANDING CRAFT AND STRUCTURE

1. **ANALYZING POINT OF VIEW** The author begins this section with the statement “buying a house will probably be one of your biggest expenses.” What assumption does the author make about people’s housing decisions? Do you think this is a reasonable assumption?
2. **ANALYZING TEXT STRUCTURE** The author used bullet points throughout this section on housing. How does that structure encourage practical action steps?

✓ CHECKING FOR UNDERSTANDING

1. **INFERRING** Why are there so many different methods available to help you fund more education?
2. **CITING TEXT EVIDENCE** What is the first step you should take when applying for financial aid for college?
3. **ANALYZING ISSUES** Why are college grants and scholarships preferable to loans?

HOUSING

GUIDING QUESTION *What information do you need to be aware of when preparing to rent housing?*

After paying for college, buying a house will probably be one of your biggest expenses. It makes sense that you should put some serious thought into the details. One of the first decisions is whether you will rent or buy.

COSTS AND BENEFITS OF RENTING

Moving into an apartment can be exciting. Finding and renting one takes work, however. Before you begin searching for an apartment, consider these items:

- **How much should you pay?** In general, what you spend each month on rent should equal what you earn in one week. For example, if you earn $300 a week, you should consider having a roommate or two who can help make up the difference on an apartment that rents for $800 a month.
- **Add other expenses.** Some apartments include utilities (gas, electric, water) as part of the rent payment, but many do not. In addition to your monthly rent, you may be responsible for monthly utility bills, including cable, phone, and renters insurance.
- **Consider location and amenities.** There are many factors to consider about location: how close the apartment is to your job, school, family, and friends. Also consider whether the landlord, or property owner, provides security and amenities (laundry, storage, access to a pool or gym). Ask about the pet policy and perhaps handicap accessibility.
- **Save for the security deposit and first and last months' rent.** Many landlords require that you pay a security deposit, which is a set amount of money paid up front that goes toward any repairs for damages you might cause. If you cause no damage, you will get your deposit back. Many property owners also ask for the first and last months' rent.
- **Read the lease carefully before signing.** This is the legal contract that all landlords require before you move in. It lays out the terms of your rental agreement. Particularly note the length of the lease. If you sign a one-year lease and then lose your job after 10 months, you are still responsible for two months' rent. Some leases are for 18 months or two years, while some are month-to-month. The landlord cannot raise your rent within the term of the lease.
- **Select the right roommates.** If you plan to share an apartment with others, make sure they can afford the rent. They should sign the lease to ensure legal responsibility, and understand that everyone is responsible for paying their share of the rent until the lease is up. It is also a good idea to have house rules about chores, parties, overnight guests, and so on.
- **Understand your rights and responsibilities.** Even though a rental is where you live, it belongs to the property owner. Both of you have particular rights and responsibilities. Landlords are responsible for keeping the property structurally safe and sanitary. Prospective landlords are allowed to check your references (the names of people who know you and can vouch for you), your employment history, and credit history. They are allowed to enter your apartment to make repairs and to show the apartment to prospective renters if you are moving out. They are not allowed to discriminate on the basis of race, nationality, religion, gender, or disability. You are responsible for paying your rent on time, not causing damage to the property, being considerate of your neighbors, and following any other terms that are spelled out in the lease.

BIOGRAPHY

OPRAH WINFREY

ENTREPRENEUR (1954-)

Oprah Winfrey emerged from an underprivileged and abusive childhood in rural Mississippi to become one of the wealthiest and most powerful women in the United States. An entertainment giant, Winfrey hosted The Oprah Winfrey Show from the 1980s to 2011. It became the highest-rated talk show in U.S. history. She founded HARPO Productions—a movie, television, and video production company headquartered in Chicago—in 1986. In the 2000s, she attained success with her own magazine, titled O, and television network, OWN. The net worth of her media empire is believed to be about $3 billion. Oprah believes her success can be attributed in part to her philosophy of helping others. She fulfills this philosophy through generous donations to charities. For example, she has given millions of dollars to universities, such as Morehouse College, Spelman College, and Tennessee State University. She used her show to encourage her viewers to "practice random acts of kindness" to make the world a better place.

CITING TEXT EVIDENCE
Identify ways Oprah contributes to others.

Renting provides many benefits. The money you save on not paying property tax and perhaps utilities can be saved or invested. You do not have to perform maintenance or upkeep on the property. And if your circumstances change (you find a better job in another state, for example), it is easier to move because you don't have to worry about selling a house, only trying to negotiate out of a lease.

Renting also has several negative aspects. By renting, you are not investing in the equity, or value, of a piece of property. You have less control over your living situation. Because the property does not belong to you, you are limited in remodeling. A landlord can raise the rent on your next lease or balk at making repairs. Although you have rights that protect you, you may need to hire an attorney to assert them.

COSTS AND BENEFITS OF BUYING A HOUSE

Owning a house is a good investment but a big commitment. There are different types of properties to choose from when you're looking to purchase: single family homes, condominiums (condos), or cooperatives (owning a share of a building).

A loan undertaken for the purchase of a home is called a mortgage. In general, your monthly mortgage payment—including property tax and homeowners insurance—should be about 30 percent or less of your gross monthly income. Making sure you understand the basics of your mortgage is important. Types of mortgages include:

Fixed Rate Mortgage On these loans, the interest rates don't change, and the mortgage is issued typically for either 15 or 30 years. The advantage is that your monthly payments stay the same.

Adjustable Rate Mortgage (ARM) The interest rates on an ARM vary over time. Although there are greater risks, some people prefer these interest rates because it is typical for the first few years to have lower rates.

Hybrid This type of mortgage combines features of both a fixed rate and an adjustable rate.

Buying a home provides many benefits. In general, houses are a good investment because their values go up. Sometimes they go down, as they did

Glow Images

Renting provides many benefits. The money you don't spend on property taxes and perhaps utilities can be saved or invested.

INTEGRATING INFORMATION
How much should you save before renting?

This image displays in the product.

Houses are a good investment but also require a great deal of upkeep. If you enjoy do-it-yourself projects, you can keep home expenses down.

ANALYZING What is the difference between a fixed-rate mortgage and an adjustable-rate mortgage?

during the collapse of the "housing bubble" of 2007, but houses overall are worth considerably more than they were 50 years ago. Buying a home also helps you build equity, which can be used to borrow money for other large purchases when you are ready. In addition, you receive tax deductions. The interest you pay on your mortgage and your property tax can be applied to your income tax return. And finally, you can make whatever renovations, alterations, or maintenance to your property you wish (as long as it's legal).

Home ownership also has several negative aspects. First, it is a huge financial responsibility. There are many costs beyond the mortgage. Application and appraisal fees, inspections, real estate agent commissions, and title insurance are some of them. Don't forget property taxes and homeowners insurance. Second, houses require a great deal of upkeep, which may be time-consuming. There might be rules about maintaining your property if you live in a neighborhood with a homeowners' association (HOA). And finally, you have less mobility. If you want to move, the process of selling your house is much more involved than giving notice to a landlord.

TRANSITION FROM RENTING TO BUYING

When you're ready to consider home ownership, there are ways to prepare yourself to go from renting to buying.

- **Start saving money.** Having money for a down payment lowers the amount you'll need to borrow.
- **Establish good credit.** Recall that good credit lowers your interest rates.
- **Research the market.** Knowing what you want, what's available, and how much you can afford will help you make the right choice at the right time.
- **Consider roommates.** Buying a house could become more affordable if you had an extra room that a friend might be interested in renting until you become more financially stable.

John Lund/Blend Images/Getty Images

• **Consider federal programs,** such as “Good Neighbor Next Door”:

> “Law enforcement officers, pre-Kindergarten through 12th grade teachers, firefighters and emergency medical technicians can contribute to community revitalization while becoming homeowners through HUD’s Good Neighbor Next Door Sales Program. HUD offers a substantial incentive in the form of a discount of 50% from the list price of the home. In return you must commit to live in the property for 36 months as your sole residence.
>
> **How the Program Works:** Eligible Single Family homes located in revitalization areas are listed exclusively for sale through the Good Neighbor Next Door Sales program. Properties are available for purchase through the program for seven days.
>
> **How to Participate in Good Neighbor Next Door:** Check the listings for your state. Follow the instructions to submit your interest in purchasing a specific home. If more than one person submits an offer on a single home a selection will be made by random lottery. You must meet the requirements for a law enforcement officer, teacher, firefighter or emergency medical technician and comply with HUD’s regulations for the program.”

—“About Good Neighbor Next Door,” U.S. Department of Housing and Urban Development

ANALYZING PRIMARY SOURCES

1. **CITING TEXT EVIDENCE** What is the incentive for obtaining a home through the Good Neighbor Next Door program?
2. **SUMMARIZING** What are the requirements for taking part in this program?

☑ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** What information do you need to be aware of when preparing to rent housing?
2. **ANALYZING ISSUES** What are the costs and benefits of renting? How do these compare to owning a home?
3. **INFERRING** Why might an adjustable rate mortgage (ARM) be an unwise choice for a prospective homeowner?

INSURANCE

GUIDING QUESTION *Why do we purchase insurance?*

Insurance is like a life raft—you don’t want to need it, but you’re glad it’s there in an emergency. You pay an insurance company monthly or quarterly **premiums** for a policy detailing what items are covered and under what conditions. Then if something bad happens—such as a traffic accident, an illness, or an apartment fire—the insurance company will pay a portion or the entirety of what is covered in your policy.

Many policies include a **deductible**, or an amount you pay before the insurance company pays. Deductibles are ways for insurance companies and customers to negotiate the premium. For example, if you have car insurance with a $1,000 deductible and you’re involved in a collision, you will have to pay the first $1,000 to fix the car. The insurance company will pay the rest, up to the amount of insurance you’ve purchased. If you had chosen a $500 deductible, you’d pay only the first $500, but your premiums would be higher.

ANALYZING KEY IDEAS AND DETAILS

1. **CITING TEXT EVIDENCE** Read about the six types of insurance described in this section. Put them in a personal order of importance. Explain your reasoning using evidence from the text.
2. **ANALYZING IDEAS** How does automobile liability insurance protect you?

DETERMINING MEANING

When you learned subtraction, you were told to deduct one amount from another. An insurance policy specifies a **deductible** amount. How does this help you understand what a deductible is?

HEALTH INSURANCE

Health insurance pays for hospitalization, visits to the doctor, surgery, exams, and preventative care such as physicals. Many businesses offer to pay for

“About Good Neighbor Next Door.” HUD.gov. May 18, 2017.
https://portal.hud.gov/hudportal/HUD?src=%2Fprogram_offices%2Fhousing%2Fsfh%2Freo%2Fgoodn%2Fgnndabot

some of the cost of insurance for their employees and their families. By doing so, the business can get a discounted rate for being a part of a group. Some policies include co-pays (a small payment) for services such as doctor visits. Insurance companies allow children to be included on their parents' health insurance to the age of 26.

If you are not covered on a parents' policy or through your employment, you must purchase health insurance. You can do this through any private insurance company, but you may also purchase insurance from the Health Insurance Marketplace at www.healthcare.gov. You may decide to choose a policy with a low monthly premium. In exchange, you will accept a higher deductible, taking the chance that nothing will harm your health.

AUTO INSURANCE

You have the option of buying various types of auto insurance—see **Figure 19.9**. At minimum, you must purchase basic liability insurance, which covers damage you might do to others. It is illegal in most states to drive without it. But having a policy that also covers you and your car is a good idea, too. If you are hurt in an accident you caused, and you don't have enough coverage, you could be required by law to pay for damages out of your own pocket.

PROPERTY INSURANCE

What would it cost to replace everything you own: computer, TV, clothes, furniture? If it's more than you can afford, you should insure your possessions against theft, fire, and other dangers. Renters insurance covers the contents of

FIGURE 19.9 TYPES OF CAR INSURANCE

Collision: *Damage to your car, regardless of who caused the accident.*

Comprehensive: *Damage to your car not caused by an accident, such as theft, vandalism, and natural disasters.*

Liability: *Bodily injury and property damage to others, plus legal costs. State laws determine how much coverage you must have.*

Medical: *Medical expenses for everyone injured, regardless of fault.*

Personal injury protection: *Medical expenses for the insured driver, regardless of fault.*

Uninsured motorist: *Damage to your car in an accident caused by a driver with no liability insurance.*

Underinsured motorist: *Damage to your car in an accident caused by someone with insufficient liability insurance.*

Rental reimbursement: *Car rental if your vehicle cannot be driven after an accident.*

At minimum, car operators must purchase basic liability insurance, which covers damage you might do to others. It is illegal in most states to drive without it. Purchasing a car insurance policy that also covers you and car repairs is also a smart use of your money. If you are hurt in an accident you caused, and you don't have enough coverage, what you would be required by law to pay for damages could really hurt your personal finances.

ECONOMIC REASONING

ECONOMIC DECISION MAKING What types of car insurance would you consider for yourself? Explain your answer.

rented property. Homeowners insurance covers belongings as well as damage to the home itself. Both types cover injury to visitors. Separate insurance is needed for flood or earthquake damage.

OTHER INSURANCE

Insurance companies offer a variety of different types of insurance policies to meet the specific needs of their customers. The most popular types of coverage include:

- **Disability** This insurance partially replaces income for those who can't work due to an illness or injury.
- **Long-term Care** This insurance pays expenses for the care of those living in nursing homes or similar facilities.
- **Life** This type of insurance provides financial support to the loved ones of a person who dies. Some types of life insurance offer lending or retirement income features.

SHOPPING FOR INSURANCE

Comparison shop among different insurance companies. Low premiums are usually the goal, but this may mean less coverage than you want. Always read the fine print before signing a policy. Maintain a good credit rating—an insurance company may give you a better rate. Ask about and take advantage of discounts for which you might qualify, such as "good student," "nonsmoker," and "good driver." Consider buying several types of insurance—car and rental, for example—from the same company to qualify for a multiple-policy discount.

✓ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** Why do we purchase insurance?
2. **PREDICTING** When might you choose to pay a higher monthly medical premium?
3. **CITING TEXT EVIDENCE** How does a credit rating relate to shopping for insurance?

CHARITABLE GIVING

GUIDING QUESTION *What are some benefits of giving to charitable organizations?*

Remember the budget you created at the beginning of *Personal Financial Literacy*? There was a line in it allotted for charitable giving. A charity is an organization that has been created for the purpose of helping others, usually a specific group of people who share a common circumstance. Charitable giving is also called philanthropy. Some of the most popular charitable organizations are the Red Cross, Susan G. Komen®, and the American Cancer Society®.

People give to charity for a number of reasons. For many, they have a personal connection to the organization's mission—a family member has a condition that is supported by a charity, for example. Others want to make a difference in the world. Still others give because contributions are tax deductible, or can be claimed on an income tax return.

Research shows that those who regularly contribute to a charitable organization have higher self-esteem and developed social skills. You may

ANALYZING KEY IDEAS AND DETAILS

1. **EVALUATING EVIDENCE** Review the information in this section. If you had a small income and debt to repay, has the author convinced you to contribute to a charity? Explain.
2. **CITING TEXT EVIDENCE** What is philanthropic giving?

Research shows that people who give to charity or who participate in volunteer activities show consistent high levels of self-esteem and generally feel good about themselves. Also, charitable giving can be deducted from taxes.

Blend Images/Ariel Skelley/Getty Images

think that you don't have much to give, but you can always start with acts that don't require money. Volunteer your time. Contact Habitat for Humanity to see if you can help in your area, for example. Donating toys and clothing is also a good way to give back to the community. Find a nonprofit organization that interests you, and phone or email its headquarters for ideas to help.

☑ CHECKING FOR UNDERSTANDING

1. **ANALYZING ISSUES** What are some benefits of giving to charitable organizations?
2. **ANALYZING ISSUES** What can you do if you do not have money to donate to a charitable organization?
3. **CITING TEXT EVIDENCE** What should you do if you want to volunteer?

LESSON 3 REVIEW

Economic Reasoning

1. **ANALYZING ISSUES** Recall from Lessons 1 and 2 the importance of budgeting and saving. How does the information in this lesson reinforce this point?

Building History–Social Science Analysis Skills

2. **PREDICTING** What are the potential effects of defaulting on a loan?
3. **ANALYZING ISSUES** Compare and contrast the differences between a Federal Work-Study program and a non-Federal Work-Study program.
4. **IDENTIFYING CONNECTIONS** Explain the relationship between insurance premiums and deductibles.

Writing About Economics

5. **INFORMATIVE WRITING** Write a one-page essay describing the role of charitable organizations in a capitalist economy. Also, what financial and non-financial benefits can an individual receive through charitable giving?

Collaborating

6. **INTEGRATING INFORMATION** Working with a partner, examine the bulleted text, paragraphs, and the captions next to the photographs in the section on housing. Create a detailed and illustrated pro and con poster with columns to help other students consider the decisions they might make about housing.

STUDY GUIDE

FINANCIAL INSTITUTIONS AND YOUR MONEY
LESSON 1

- Open an account in a bank or credit union → Build a relationship with a financial institution
- Apply for a secured credit card → It is linked to the bank or credit union → Make small purchases and pay off the balance each month
- Apply for a retail credit card → These are easier to get than a regular card → Pay off the balance each month to begin rebuilding credit score
- Get a job and keep it → Steady employment improves your creditworthiness
- Pay service provider on time → a history of late payments for phone, electric, and other regular bills lowers credit scores

BUSINESS ORGANIZATIONS AND YOUR MONEY
LESSON 2

General Partnership
- management of the business, liability, and profits are equally split between partners

Joint Venture
- similar to a general partnership
- set up as a single project or for a limited time span

Limited Partnership
- allows certain partners to have less input

PERSONAL MONEY DECISIONS
LESSON 3

Non Traditional Methods of Paying for College
- Take an Advanced Placement (AP) course
- Sign up for the College-Level Examination Program (CLEP)
- Apply for employer reimbursement
- Join the military
- Attend tuition-free school
- Enroll in a Public Service Loan-Forgiveness Program after graduation

CHAPTER 19 Assessment

Write your answers on a separate piece of paper.

Short Answer

1. **SUMMARIZING** How does one begin a savings program?
2. **EXPLAINING CAUSES** Why is it important for you to reconcile your checking account each month?
3. **SUMMARIZING** What are your responsibilities as a borrower?
4. **ANALYZING ISSUES** How do financial institutions protect the money you deposit?
5. **EXPLAINING CAUSE AND EFFECT** How do savings form the basis of capital formation?
6. **CITING TEXT EVIDENCE** What are four ways for corporations to raise capital?
7. **IDENTIFYING CAUSES** What do you need to do to start investing in stocks?
8. **IDENTIFYING CONNECTIONS** Why are munis attractive to many investors?
9. **SUMMARIZING** As a renter, what are your rights and responsibilities?
10. **COMPARING** Explain the advantages and disadvantages of both fixed rate and adjustable rate mortgages.
11. **COMPARING** What are the advantages and disadvantages of buying a home?
12. **SUMMARIZING** Describe how insurance works.

History-Social Science Analysis

13. **ANALYZING ISSUES** What are money market mutual funds and how do they compare to a passbook account?
14. **INFERRING** Why would an investor choose to add Treasury instruments to diversify a portfolio?
15. **INFERRING** Why is it in the federal government's interest to help people pay for higher education?

Research and Presentation

16. **RESEARCHING FOR INQUIRY** Search the Internet for information on car insurance in your area. Write a summary about the companies that sell insurance and analyze the factors they use in determining what to charge for drivers in your age group.
17. **GATHERING EVIDENCE** Obtain various credit card applications from several retail stores and gas stations. Analyze the applications and prepare a database that organizes the answers to the following questions:
    - What questions asked on each application are virtually the same?
    - What questions asked on the gas station applications are different from those asked on the retail store applications?
    - What are the differences in finance charges and APR? Show your conclusions to your class.
18. **INTEGRATING INFORMATION** You have been practicing photography for a few years now, and you have taken senior pictures for some of your friends. You think you're ready to take your work to the next level and start a photography business, taking portraits for seniors, families, and whomever else requests your services. Research the loans and grants the Small Business Administration offers to small businesses. Would you qualify for any of the loans or grants? If so, how could you use the loan or grant? Discuss and compare your findings with a partner.

Need Extra Help?

If You've Missed Question	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
Review Lesson	1	1	1	1	2	2	2	2	3	3	3	3	1	2	3	3	1	2

Reading and Analyzing Primary Sources

Are you ready to try investing as little as $5 a week and skip that fast food? Joel Greenblatt, Partner at Gotham Capital and business professor at Columbia University, champions something called "value investing" which is finding companies on the verge of bigger success with shares that are affordable now. Below he discusses why investment clubs help you do that.

> "There's a clarity that comes with great ideas: You can explain why something's a great business, how and why it's cheap, why it's cheap for temporary reasons and how, on a normal basis, it should be trading at a much higher level. . . . There's a virtuous cycle—in the club or in any investment setting—in people having to defend challenges to their ideas. Any gaps in thinking or analysis become clear pretty quickly when smart people ask good, logical questions. You can't be a good value investor without being an independent thinker—you're seeing valuations that the market is not appreciating. But it's critical that you understand why the market isn't seeing the value you do. The back and forth that goes on in the investment process helps you get at that."
>
> —Joel Greenblatt, "Investor Insight: Value Investors Club," *Value Investor Insight*, October 2006

19 **DETERMINING MEANING** What does Greenblatt mean by the "virtuous cycle"?

- **A.** You find a cheap stock and buy it, then share the idea and others buy it so it goes up in price.
- **B.** The process of defending your ideas with facts and valid reasoning is helpful in finding valuable stocks.
- **C.** The companies' value investors find are good for society, so their investments help improve other people's lives.
- **D.** Stock prices fluctuate with the market, which is good for investors.

20 **ANALYZING IDEAS** According to Greenblatt, what must one be able to explain about a value investing idea?

- **A.** how the business is managed
- **B.** the amount of money an investor can make
- **C.** why the stock is temporarily cheap
- **D.** who is likely to buy the stock

21 **ANALYZING IDEAS** Why is it good to be an independent thinker?

- **A.** You don't want anyone else to figure out what you know and buy first.
- **B.** You must look for things others don't see or the stock would not be cheap.
- **C.** Being the best investor you can be is a lonely process.
- **D.** You need clarity and for that you must stay focused.

22 **INFERRING** Why is it crucial to understand why the market isn't seeing the value you see in a stock?

- **A.** You might be missing something important.
- **B.** You will have to fool them into buying more stock.
- **C.** They have gaps in thinking or analysis.
- **D.** The free market never makes a mistake and prices indicate value.

Writing About Economics

23 **USING TECHNOLOGY** Research at least three financial planning, tax, and/or record-keeping applications. Write a publishable article summarizing how each tool works and explaining how these tools can help a young person begin financial planning. Remember to cite your sources.

Speaking and Listening About Economics

24 **USING MULTIMEDIA** With a partner, find out the interest currently being paid for new savings accounts at two local financial institutions or national banks with a local presence. If your area has a bank for young people, start there. Find out if they give simple or compound interest and if they will open accounts for teens. Create a brief video or radio commercial for the best institution. Include an explanation (or a chart for video) using their interest rate and based on both simple interest and compound interest if you deposited $100, $200, or $500 and kept it for five years in each institution.

25 **MAKING DECISIONS** List your short-term savings goals, such as saving to buy a new cell phone. Explain the typical ways in which you can save for such a purchase. Then list your long-term savings goals, such as saving for a house or retirement. Explain how you can achieve these goals. What is the major difference between the two ways of saving?

Need Extra Help?

If You've Missed Question	19	20	21	22	23	24	25
Review Lesson	2	2	2	2	1	1	3

Heins, John, and Whitney Tilson, eds. "Investor Insight: Value Investors Club." Value Investor Insight, October 31, 2006, 2-3.