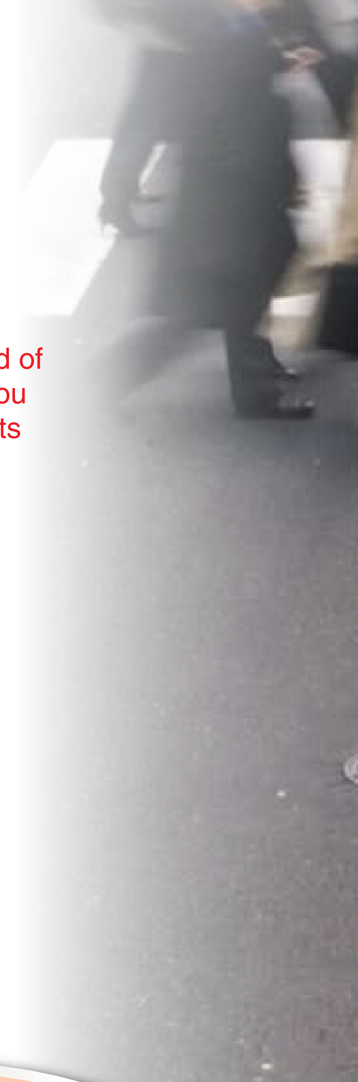
CHAPTER 3

Consumers in the Economy: An Overview



Reading for Meaning

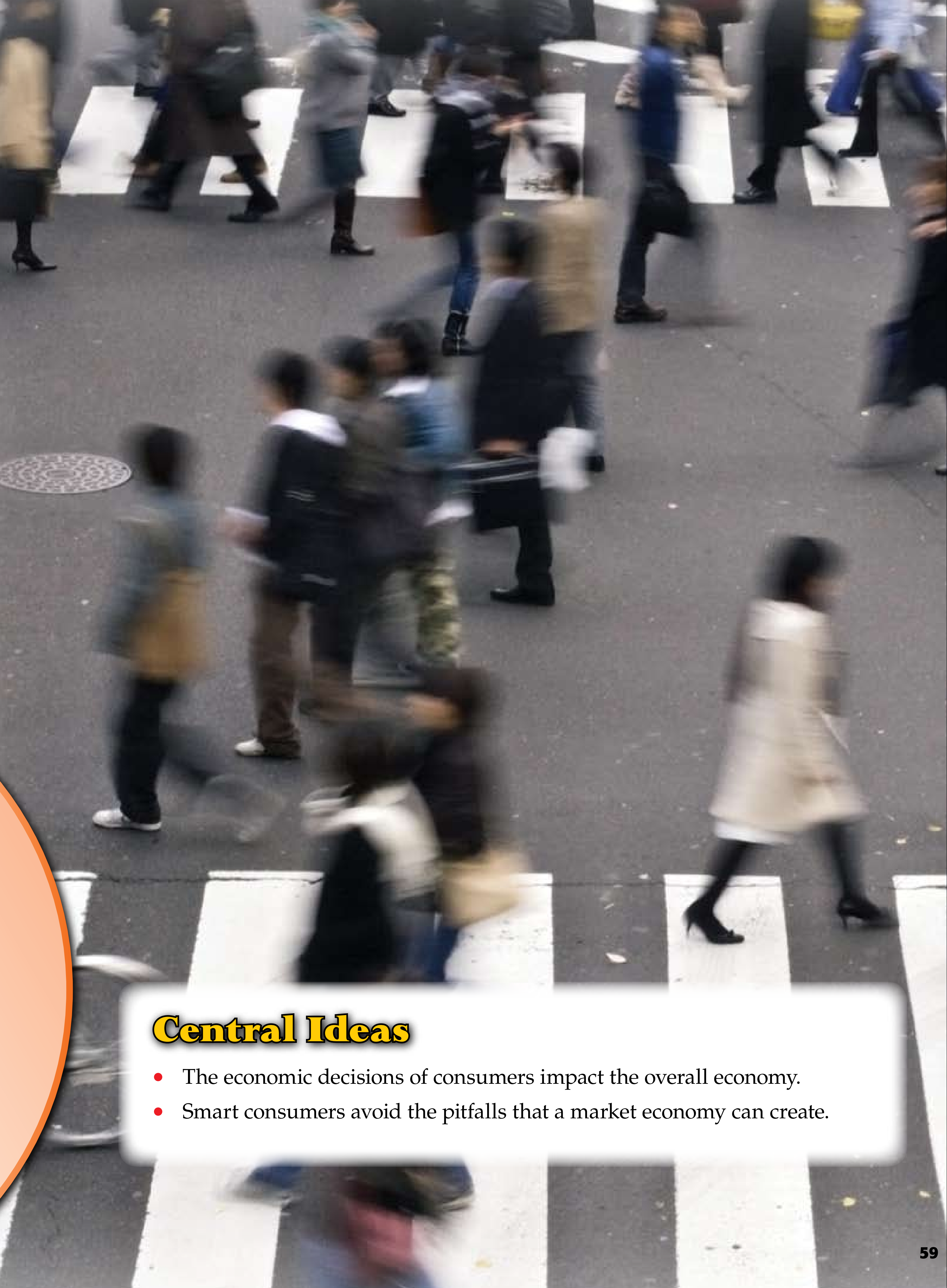
Skim the review questions at the end of the chapter first. Use them to help you focus on the most important concepts as you read the chapter.

standard of living
GDP per capita
labor productivity
prosperity
durable goods
investment
asset
income tax
sales tax
property tax

CHAPTER OBJECTIVES

After studying this chapter, you will be able to

- **relate** your consumer economic activities to your financial well-being and to the state of the overall economy.
- **explain** how economic conditions affect job opportunities and standard of living.
- **summarize** how consumer spending influences overall economic conditions in a market economy.
- **describe** the impact of consumer and government borrowing on the economy.
- **give examples** of ways consumer economic problems arise from market characteristics.
- **outline** consumer economic problems that result from consumer mistakes.



Central Ideas

- The economic decisions of consumers impact the overall economy.
- Smart consumers avoid the pitfalls that a market economy can create.

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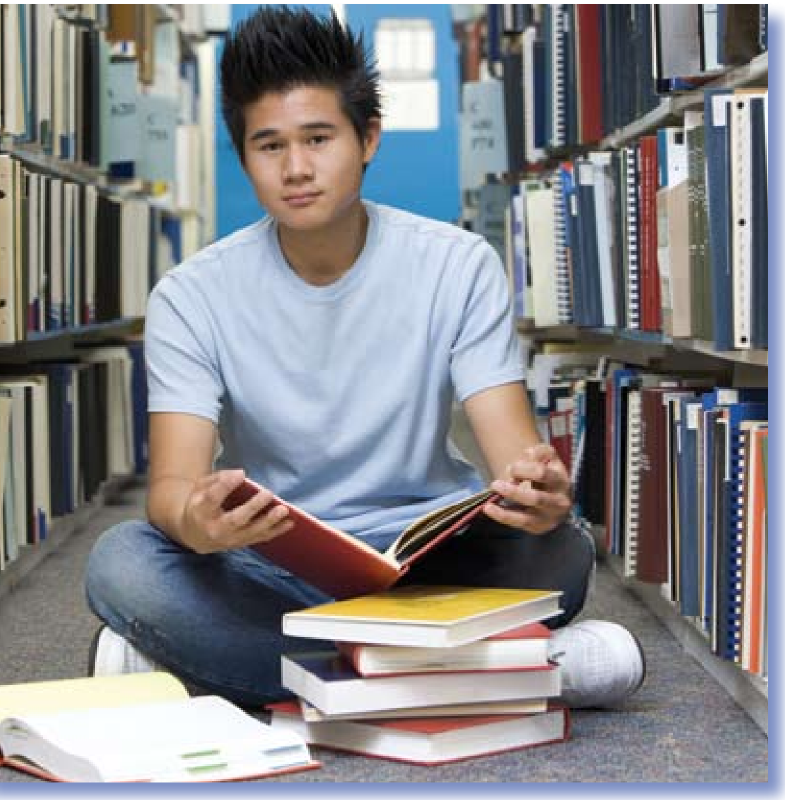
You live in a market economy. Your economic activities, such as spending and voting, all make a difference. You are fortunate to live in a market economy with its freedom and many advantages. However, living in a market economy can present problems and challenges. Making wise choices and managing money carefully are important skills for consumers in the marketplace.

This chapter provides a brief overview of consumer activities as they relate to the U.S. economic system. In Unit 2 of this text, individual topics and their connection to your personal finances will be covered in greater detail.

Economic Activities of Consumers

The economic activities of consumers play a vital role in a market economy. Consumers earn, spend, borrow, and save. They invest their dollars. They share financial risks through insurance. They pay taxes and vote for the candidates who support policies and programs that will affect the economy. The way consumers perform these activities determines how well they live and how well the economic system works.



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Certain career choices require many years of education and training. Advanced education often leads to greater earning potential.

Earning Your Way

A market economy permits you to choose the fields in which you work. You can also choose the level of education and training you want to attain, 3-1. Those choices largely determine your job opportunities and earning power.

The ability to find work depends on job skills, experience, and education. It also depends on your career choice and the demand for workers in your chosen field. Qualified people who want to work in high-demand fields are likely to find employment and earn a comfortable income.

Once hired, job performance helps determine how far and how fast a worker will advance. Hard work and the ability to work well with others are important qualities in almost every field. In today's fast-changing world, it also is important to continually update job-related skills.

As you advance on the job, your income and your personal *standard of living* should increase. **Standard of living** is the overall level of comfort of a person, household, or population as measured by the amount of goods and services consumed. If your income rises faster than prices, more goods and services will be available to you and your standard of living will rise. For most people, that translates into a higher quality of life. Your earning power and job performance are directly related to your standard of living.

Earnings and the Economy

Besides determining your personal wealth, your earning activities contribute to the nation's wealth. The *national standard of living* is the level of prosperity in the country. It is measured by income levels and the ability of citizens to acquire necessary goods and services. These include housing, food, health care, education, transportation, and communications. As a nation, the United States has one of the highest standards of living in the world.

GDP Per Capita. There are different ways to measure a nation's standard of living. Many economists use *GDP per capita*. As you will recall, GDP, or *gross domestic product*, is a measure of the market value of all final goods and services created in an economy during a given time period. *Per capita* simply means *per person*. **GDP per capita** is the market value of final goods and services produced per person. It is the national GDP divided by the number of people in the country. GDP is usually adjusted for inflation and stated in dollars.

When GDP per capita is high or rising, incomes are rising and more goods and services are available to each citizen. This indicates that people are consuming more and their standard of living is rising. On the other hand, when GDP per capita is falling, it indicates falling incomes. Fewer goods and services are available and being consumed. A lower GDP signals a lower standard of living for a nation's people.

There are some problems with using GDP per capita to measure standard of living. It assumes that everyone gets an equal share, although that is false in reality. Also, GDP as a measure of output does not account for unpaid work, such as housework, child care, and volunteer work. However, despite these problems and others, GDP per capita is the most common way to measure living standard.

Labor Productivity. Economists also use *labor productivity* as an indicator of a nation's economic health or *prosperity*. **Labor productivity** is the value of the goods and services a worker creates in a given time. High labor productivity indicates a healthy economy. To raise labor productivity, businesses and governments must invest in productive resources, such as technology, factories, and the education and training of workers. Top-performing workers using efficient tools and technology increase their own earnings. Their high productivity also boosts the nation's wealth by raising GDP.

It is clear that your earning activities plus those of all others in the job market make a huge impact on the economy. At the same time, the state of the economy affects your earning potential. Economic conditions influence the number of jobs that are available, the type of work in demand, and salary levels. Demand in job markets is ever changing.

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Human Services

Market Researchers

Market researchers help companies understand what types of products people want and at what price. They gather data on competing products, successful methods of marketing and distribution, and future sales potential. Their evaluations help companies decide whether to expand product lines or develop new ones.

Spending and the Economy

A market economy permits you to make your own spending choices. The way you make those choices determines what your money will buy. Getting the most satisfaction for the dollars you spend requires careful choices in the marketplace.

Your spending decisions help create a demand for the goods and services you buy. You contribute to the profit and success of the business from which you buy. Your individual spending may not be major in creating a demand for specific products or in supporting one business over another. However, as a group, you and other consumers determine the success or failure of specific goods, services, and businesses.

Consumer confidence is a key factor in determining the state of the economy. When consumers believe the economy is strong or improving, they tend to spend more. This creates a greater demand for goods and services. Businesses expand to meet the increased demand. As they expand, they create more jobs. This creates a sense of **prosperity**. Times of economic prosperity can be defined as periods of growth and financial well-being. They are marked by high employment, job security, and overall stability.

When consumers are doubtful about the economic future, they spend and borrow less. This lowers the demand for goods and services. Businesses slow down because sales decline. Jobs are harder to find. Workers are laid off. These conditions can lead to a recession, or a period of economic slowdown. As discussed in Chapter 2, a recession is marked by rising unemployment, falling demand, slowed production, and declining economic activity.

Saving Your Money

People think of savings as money that is put aside for the future. However, anything that improves a person's financial position is considered savings. This includes the cash value of a life insurance policy, home

ECONOMICS in ACTION

Consumer Confidence

Consumer confidence is a key indicator of the state of the economy. It is based on a survey that asks people in 5,000 U. S. households how they view their financial well-being, spending power, job opportunities, and confidence in the future. Researchers at the nonprofit Conference Board process their answers and reduce them to a number.

The Consumer Confidence Index is a value between 0 and 100. By following the index from month to month, researchers gauge whether consumers are more or less optimistic. A high number indicates optimistic public opinion. To see current Consumer Confidence Index values, check the Conference Board Web site at www.conference-board.org.

improvements, and the purchase of durable goods. Furniture, appliances, and cars are called **durable goods** because they have lasting value. Savings such as these increase your financial well-being as long as you do not spend beyond your ability to pay.

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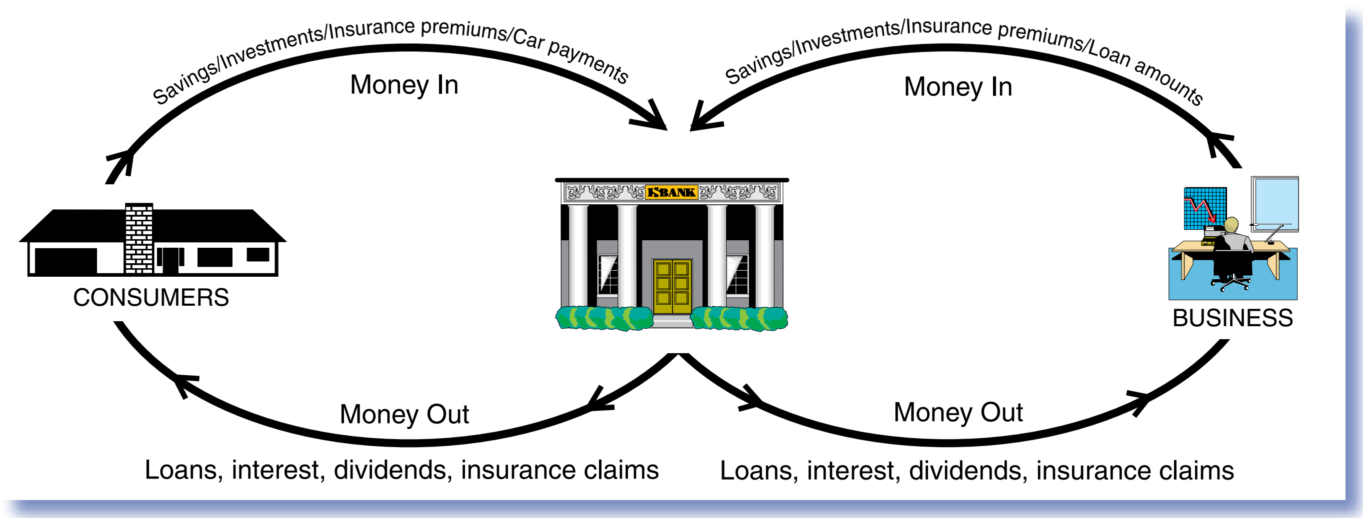
Saving and the Economy

In a market economy, the money you and other consumers transfer to financial institutions is pumped back into the economic system, 3-2. It is loaned to businesses and other consumers to pay for business growth, building construction, and the purchases of homes. Savings used this way help generate more jobs, greater productivity, and a growing economy. Therefore, the health of the economy is closely related to the *savings rate*, or the amount of money people save.

Borrowing to Spend

Each time you use a credit card or charge account or take out a cash loan, you are borrowing. These are forms of *consumer credit*. This is a tool that lets you buy now and pay later. There are good reasons to borrow. Borrowing is sometimes the only way consumers can pay for major purchases, such as a house, car, or college education. Saving enough money to pay for these large expenditures all at once is difficult. Credit can also help you pay for unexpected expenses, such as a large medical bill.

In most cases, you pay a fee for using credit. Credit is costly in another way, too. When you use credit, you spend future income. This means part of your future earnings must be used to pay what you owe. The use of credit reduces future income. People who do not monitor and control their borrowing can get into serious financial trouble. Chapter 9 discusses both the sound and risky uses of credit.



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This diagram shows the flow of money in and out of financial institutions—banks, credit unions, and insurance companies.

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Borrowing and the Economy

Consumer borrowing has two important effects on the economy. It increases the amount of money in circulation, and it increases the demand for consumer goods and services. For example, when you borrow, you have more money to spend. As you and other consumers use borrowed money, you increase consumer demand in the marketplace.

When the economy is in a recession, the use of credit can help increase consumer demand. Consumer spending, whether with cash or with credit, stimulates the production of goods and services. This is why the Federal Reserve System may lower interest rates and encourage the use of credit during a recession. It helps stimulate growth.

Consumer borrowing can have a negative impact on the economy when the supply of money increases faster than the supply of goods and services. This causes prices to rise, and inflation is the result.

Another reason for the cautious use of credit is its long-term effect. Unfortunately, the overuse of credit carries the seeds of an eventual economic downturn because the credit used today must be repaid with tomorrow's dollars. That means tomorrow's dollars will be paying today's debts rather than supporting future demand. Using credit increases immediate demand, but it decreases future demand. Economic prosperity is threatened if many people are deeply in debt.

Insuring Against Financial Risks

Insurance is a risk-management tool or a way to protect yourself against certain financial losses. When you buy insurance, you and other buyers pay a fee to own an insurance policy. A policy is a document that

Real Life Connections

Fear as an Economic Problem

Since it is often described with data and charts, the economic system appears to function according to logic, science, and cold hard facts. However, human emotions play a huge role in the economy.

The best example of this is the ups and downs of the stock market. It can be highly volatile, fluctuating with consumer confidence and anxiety. The feelings and behavior of consumers can cause economic upturns and downturns. When consumers are optimistic about the economy, they spend more money, which boosts the economy. When they are feeling anxious or pessimistic, they curtail their spending, which depresses the economy.

The U.S. economic system is built on faith and trust. For example, millions of people put their money into banks because they trust that it will be safe there. The banks make money by taking in deposits and lending to businesses and other consumers. If anything should happen to frighten large numbers of depositors, they can demand their money and a bank failure can result.

outlines the specific terms, the risks covered, and the payments that must be made.

You share financial risks related to life, health, and property. For example, suppose you and 5,000 others buy health insurance. If you must go to the hospital for an illness, the insurance premiums of those who do not need to be hospitalized will help pay your expenses, 3-3. Insurance companies invest the insurance payments of all policyholders. These payments and their earnings are used to pay the bills of policyholders who suffer financial losses. The number of people who suffer losses at any given time is much smaller than the number of policyholders in the insurance pool. Many types of insurance are available. They will be covered in detail in Chapter 10.

3-3

Health insurance will help pay this patient's medical bills.

Insurance and the Economy

Insurance strengthens the overall economic stability of the nation. It spreads financial risks and stabilizes income in the face of serious financial losses. Social insurance programs contribute to social stability. These government programs include Social Security, Medicare, Medicaid, unemployment insurance, and workers' compensation. They provide income, medical care, and other services to citizens who are retired, ill, disabled, or unemployed.

In addition, insurance companies invest billions of dollars of insurance payments in business enterprises each year. This investment contributes significantly to the strength of the economy. Personal insurance needs are covered in detail in Chapter 10.

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Investing for the Future

When you have saved enough money to provide for emergencies and some goals, you will want to think about investing your money. An **investment** is an asset you buy that increases your wealth over time, but carries the risk of loss. An **asset** is an item of value you own, such as cash, stocks, bonds, real estate, and personal possessions. Consumers invest money to improve their financial position and increase their future economic security. The purpose of investing is to make more money than you invest. Investments include financial instruments such as stocks, business ownership, valuable items, and real estate.

Investments usually give consumers a greater return on their money than savings. However, the risk of loss is greater for investments than for savings accounts. The desire for profit motivates people to invest. Investors hope to eventually sell their investments at a higher price than they paid for them. However, there is the chance that they will lose part or all of their investment. That is why it is important to do careful research before you invest. Greater detail on investing your money will be covered in Chapter 12.

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Investment and the Economy

Consumer investments pay for a large share of business growth and activity. Businesses use the money to help purchase new plants and equipment. Investments also help pay for the research and development of new technology and the marketing of new products and services. Economic development and growth are directly related to the investments and savings of individuals as described in the following example.

If an airline company wants to expand its service, it can issue new stock for sale to the public. When investors buy the stock, the company gets the money it needs to buy new planes. Companies building the planes create jobs. Operating the planes creates more jobs, better service for consumers, and a profit for the airline.

If the company continues to make a good profit, the price of its stock may rise. This encourages more investors to buy stock in the company with the hope of making a profit. Investors make money on the investment and workers receive more job opportunities. The company makes money on the new planes and consumers benefit from more flights and better service. Investment dollars start this type of chain reaction in businesses of all types, 3-4. The benefits of investment ripple through the economy.

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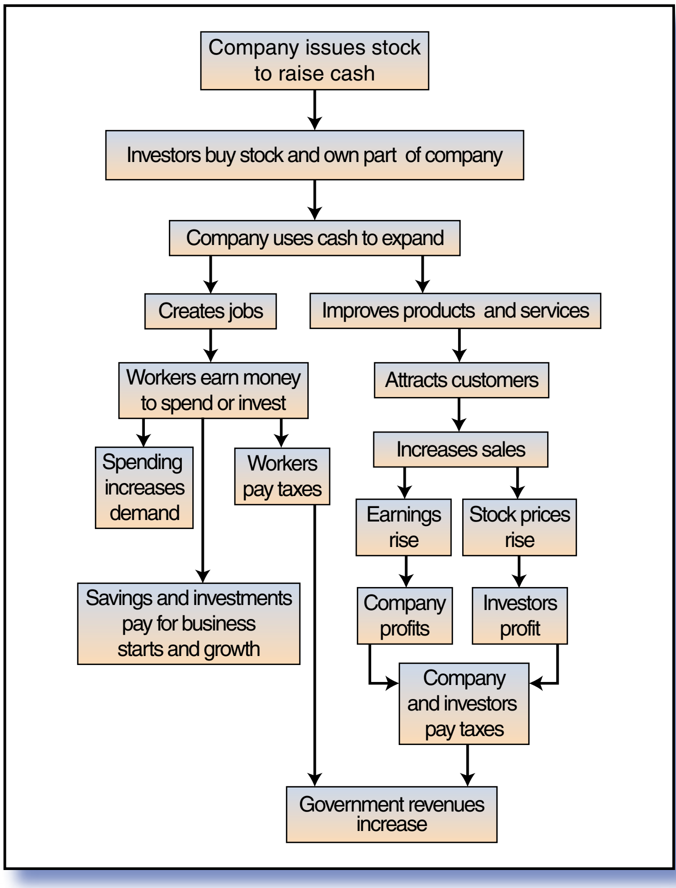
This diagram shows how consumers and business work together through consumer investments to keep the economy going.



Paying Taxes for Government Services

In the previous chapter, you learned that the government provides many of the goods and services that citizens want and need. These include the military, highways, the judicial system, schools, and parks. Tax revenues pay for the many government departments, agencies, and programs and the services they provide.

Local, state, and federal governments levy different types of taxes. They include

- **income tax**—a tax on the earnings of individuals and corporations. It is levied by the federal government and most state governments.
- **sales tax**—tax added to the price of goods and services you buy.
- **property tax**—a tax that is paid on real estate owned by individuals and corporations.

In the U.S., voters indirectly decide what they want to "buy" from government. They decide the level of taxes they will pay for their purchases. For example, citizens vote for more taxes every time they vote for a new school, more police protection, or a new highway. They vote for higher taxes every time they vote for a candidate who advocates new government programs without reductions in government spending.

Taxes, Government Spending, and the Economy

As you learned in the last chapter, government economic policies play an important role in the overall economy. The government's spending of tax dollars stimulates the economy. It creates demands for goods and services that are usually met by private businesses.

Government spending can also harm the economy. It can drive prices up and cause inflation. When the government spends more than it receives in tax revenues, it must borrow money. Year after year of deficit spending increases the national debt. U.S. citizens ultimately pay for government spending and the national debt through taxes.

When government increases taxes, it tends to depress the economy because it reduces the amount of money available for business activity. Taxes and government spending are discussed in more detail in Chapter 7.

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Economic Problems of Consumers in a Market Economy

A market economy offers you, the consumer, both the privilege and the challenge of making free economic choices. You are free to choose how to earn a living and what to do with your money. You can choose to pay cash or use credit. You can decide to spend or save. Free choice offers you the opportunity to decide for yourself how to get the most satisfaction from your money.

Free choice does not guarantee satisfaction. Certain characteristics of a market economy can complicate choices. Following are some of these characteristics.

Confusing Variety of Products

Businesses compete with one another in a market economy. As a result, the same or similar goods and services are sold by a wide variety of outlets. Choosing a reliable seller and finding the best product for the best price is a challenge. It is necessary to learn something about the sellers as well as the products and services you buy.

A market system also supports the development of countless new products and ideas. The system rewards producers who give consumers what they want. As a result, the variety of goods and services found in the marketplace is extensive. Consider all the fabrics, styles, and colors of clothing you can buy. Ponder the many sizes, models, and features of cars. Count the specialties in medical care and the number of choices in home furnishings. Think of the many forms of consumer credit, types of insurance, and ways to save and invest money. Even the many flavors, types, and brands of ice cream can make choosing difficult.

Marketing

Customer Support Specialist

Customer support specialists are employed by companies to serve as a direct point of contact for customers. They interact with customers and are responsible for ensuring that customers receive appropriate, courteous service and help with questions and concerns.

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The choices open to consumers make it possible to meet almost every need. However, these many options also make it a challenge to choose intelligently. Careful comparison shopping, particularly for costly purchases, is one way to reduce the confusion and make satisfying choices.

Questionable Selling Methods

In a system where the survival of a business depends largely on attracting consumer dollars, selling plays an important role. Businesses want to sell as much as possible at the highest price they can get. With this goal in mind, most businesses advertise and market their goods and services aggressively.

While most businesses are honest and fair, some may use questionable selling methods to increase their sales and profits. Techniques such as high-pressure selling, less-than-truthful advertising, contests, and "free" offers can encourage you to buy for the wrong reasons. Too often, factual information is not part of a sales pitch. You need to focus on what is important to you before making purchases.

Keep in mind that deliberately deceptive advertising and other dishonest business practices are illegal. If you question the ethics of a store or selling method, contact the local Better Business Bureau, the chamber of commerce, or the nearest office of the Federal Trade Commission. You have the power through these agencies to fight back.

Conflict of Interest

To a certain extent, buyers and sellers want different things. Suppose you are in the business of selling cell phones. You want to sell as many phones at the highest price you can get. You want to be able to pay your business expenses and make a good profit.

When you are buying a cell phone, you want the phone that best fits your needs at the lowest possible price. You want to have money left over to spend for other items. In other words, sellers want the highest price they can get, while consumers want the best quality at the lowest price.

The free-market system helps resolve the conflict of interest between sellers and buyers. Both wages earned by the seller and prices paid by the buyer are tied to the forces of supply and demand. Everyone depends on these forces to achieve the proper balance between wages and prices. The system strives to create a supply of goods and services to meet demand at prices that will keep the producer in business and the buyer able to buy.

Public Information Coordinators

Public information coordinators serve as advocates for businesses, associations, and other organizations. They build and maintain positive relationships with the public by working closely with print or broadcast media. They also handle tasks such as organizing special events and mediating conflicts.

Consumer Mistakes Leading to Problems

For a variety of reasons, consumers sometimes make poor choices when presented with the many options offered by a market economy. These choices can lead to economic problems. Following are some common consumer mistakes.

Lack of Planning

Some of the worst consumer economic problems are caused by lack of planning. When consumers fail to plan ahead, they lack direction for their spending. They do not set goals for the use of income or build savings for future needs. Lack of planning also makes it difficult to control the use of credit.

Consumers who do not plan ahead often have trouble paying routine monthly bills. They can even have difficulty buying groceries to make nutritious meals at reasonable prices. Clothing buys that can be incorporated into a person's wardrobe require planning. Buying a car to meet needs for transportation and fit the budget requires planning. Planning is also necessary to have money available for occasional expenses, such as birthday gifts, insurance payments, vacations, and taxes, 3-5.

Poor planners often find it difficult to save enough for big expenses, such as a car, a home, education, or retirement. They often end up making purchases that do not meet needs and wants. Careful planning is the only way you can take charge of your own financial well-being. It allows you to match the highs and lows of expenses with the highs and lows of income over a lifetime.

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Case Study: Consumer Mistakes

Poor Planning

Lamont has a pay-as-you-go cell phone. He figures the 1,000 minutes he purchased would last a month. However, he burns through the minutes in three weeks and does not have the money to buy more.

Sarah's friends are taking a trip together during spring break. She intends to go too, but blows her savings on a new jacket.

Ken gets a job and opens a savings account at a bank. He plans to deposit his paycheck and eventually buy a car with his savings. However, a few days after payday, he has nothing left to deposit.

Case Review

1. How does poor planning affect each person?
2. What would you have done differently in each case?
3. What did Ken do right? How did his good intentions go wrong?

3-5
With proper financial planning, you will be not only able to afford a vacation, but also to relax and enjoy the time away.

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Failure to Use Information

The failure to thoroughly investigate and to ask questions concerning a future purchase can lead to disappointment and even big mistakes. For instance, Mariko signs up for an $800 online course in communications. She does not finish the course because the assignments take more time and hard work than she expected. It also is difficult to get help from the school because she gets a different instructor every time she has a question. She drops the course and loses her $800.

These types of situations are avoidable when consumers seek and use available information. Reliable facts can be found for almost every product and service you want to buy. When reliable information is not available for a given product or service, you will be wise to make another choice. Sources of information abound, and the Internet can retrieve consumer information in seconds. Salespeople and other consumers who have used specific products and services can be helpful, too.

The fastest and easiest way to get information is to ask questions. Make it your rule to ask first and buy later. Getting the facts first is especially important where health, safety, or large amounts of money are involved. Making uninformed choices can be costly, disappointing, and even dangerous.

Impulse Buying and Overspending

Even informed consumers sometimes indulge in impulse or thoughtless spending. Others habitually overspend, which can lead to debts that are difficult to repay.

If you are like most consumers, you sometimes buy things without thinking about your needs and goals or the consequences of spending.

Case Study: Consumer Mistakes

Buying on the Spur of the Moment

Ginny buys a pair of shoes because they are on sale. They are the right size, the right price, comfortable, and attractive—but they are red. She has nothing to wear with red shoes.

Rafael goes to the grocery store for a loaf of bread. He ends up spending $18 for groceries he did not plan to buy.

Althea sees a TV commercial for an exercise machine and dials the toll-free number. When the machine is delivered, she has lost interest and sticks it in the closet.

Case Review

1. Have you ever made similar mistakes? How might you have avoided them?
2. What could each person have done to spend more wisely?
3. Who do you think made the most foolish purchase? Why?

When done regularly, this type of spending can consume a sizable amount of money. Thoughtful spending will leave more dollars for the needs and wants that are truly important to you.

Overspending happens most frequently with credit cards. When spending cash, you cannot spend more than you have. You think more carefully before making a purchase. A budget or spending plan can help you control spending and stay within your means. Details on planned spending and the use of credit will be covered in later chapters.

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Poor Communication

Most businesses want to know the likes, dislikes, wants, needs, and problems of their customers. Failure to speak up, ask questions, and complain when necessary can be costly. An open line of communication can lead to greater satisfaction with products, services, and sellers.

Consider this example. Charlene calls to request servicing for her furnace. She is told that a repairperson could come on Monday afternoon. Since Charlene works during the week, she takes Monday afternoon off to let the repairperson into her house. She is docked $80 from her paycheck. Later she learns that the repair could have been done on Saturday or in the evening. Better communication would have saved money. If Charlene had requested a different day or time, she would not have lost pay.

Chapter Summary

Consumers play an important role in the functioning of a market economy. In a free market economy, consumers influence outcomes directly. Consumer behavior also affects overall economic conditions and prosperity, or the lack of it.

While a market economy offers freedom and many advantages to consumers, it also presents problems and challenges. For example, the vast selection of goods and services available in the marketplace can make choosing difficult. Selling methods of merchants often pressure consumers to buy what they do not need. There is a natural tension between the seller who wants to make money and the buyer who wants to get the most for money spent.

In some cases, consumers create their own problems in the marketplace. Lack of planning, failure to seek needed information, impulse spending, and poor communication can result in faulty buying decisions and poor money management. You need to be aware and alert to avoid such common mistakes.

Review

1. How can a person's income affect his or her personal standard of living?
2. How does consumer spending affect the state of the economy?
3. How does the use of credit affect immediate consumer demand?
4. Why does the overuse of credit eventually lead to an economic downturn?
5. What role do consumer savings and investments play in the overall economy?
6. What type of tax is paid on real estate owned by individuals and corporations?
7. What questionable selling methods do some businesses use to increase their sales and profits?
8. Explain the conflict of interest between consumers and sellers in a market economy.
9. Name four common ways consumers create problems for themselves in a market economy.
10. Describe how poor communication can result in problems for consumers.

Critical Thinking

11. How do consumer savings and investments support business growth and expansion?
12. Explain how savings, investments, and insurance premiums serve as the source of credit for consumers and businesses. Illustrate your explanation with a chart or drawing showing the flow of money.

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13. What industries suffer most when consumer spending is down? For example, what happens to the housing and construction industry? What related industries are likely to suffer? What industries seem to suffer the least during a recession?
14. What consumer problems do you consider most serious? What do you think can be done about them? What consumer problems have you experienced? How might you have avoided them?
15. Describe the consequences of impulse buying and habitual overspending.

Academic Connections

16. **Social studies.** Using travel guides, almanacs, and the Internet, make a chart comparing the standard of living in the U.S. with that of another country. Include information on price comparisons for similar goods and services.
17. **Speech.** Create a short video of consumers in the marketplace, such as shopping at a sale or buying groceries. Focus on the economic problems they may encounter in a market economy.
18. **Research, writing.** Research and report on the economic impact of the attack on the World Trade Center in 2001. Discuss which industries were most affected. Describe the effects on jobs, consumer spending, government spending, and taxes.
19. **Social studies, research.** Research a period of economic prosperity in the United States. What events led to this period? What events caused an eventual downturn?

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Math Challenge

20. A country's standard of living, or level of prosperity, is measured by GDP per capita. Using the figures for GDP and population, calculate the GDP per capita for each of the following countries.
    A. India: GDP = $1.209 trillion; population = 1.17 billion
    B. Guatemala: GDP = $67 billion; population = 14 million
    C. France: GDP = $2.499 trillion; population = 64.3 million

Tech Smart

21. Use the Internet to find the most current GDP and total population for each of the following countries:
    - Ethiopia
    - China
    - United States

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