CHAPTER 2

The U.S. Economy:

A Global View

LEARNING OBJECTIVES

After learning about this chapter, you should know

LO2-1 The relative size of the U.S. economy.

LO2-2 How the U.S. output mix has changed over time.

LO2-3 How America is able to produce so much output.

LO2-4 How incomes are distributed in the United States and elsewhere.

Nations Have Different Economic Outcomes

- Every country must answer the three basic questions:
  - **WHAT** to produce?
  - **HOW** to produce?
  - **FOR WHOM** to produce it?
- Since each country has vastly different production possibilities, each must confront very different output choices.
- Some use central (government) planning, while others rely on the market mechanism.

What Is Produced?

The United States;

- is the largest producer of goods and services in the world.
- is the largest consumer of goods in the world.
- specializes in producing what it can produce at a lower opportunity cost than other countries can.
- purchases from other countries goods and services they can produce at a lower opportunity cost than the United States.

What America Produces

Gross domestic product (GDP): the total market value of all final goods and services produced within a nation's borders in a given time period; a measure of an economy's size.

- *U.S. GDP accounts for about* ***one-fifth*** *of the world's GDP.*
- *U.S. GDP is one and a half times that of China's, the second-largest GDP.*

Living Standards and GDP Growth

Per capita GDP: GDP divided by the population; an indication of a country's standard of living.

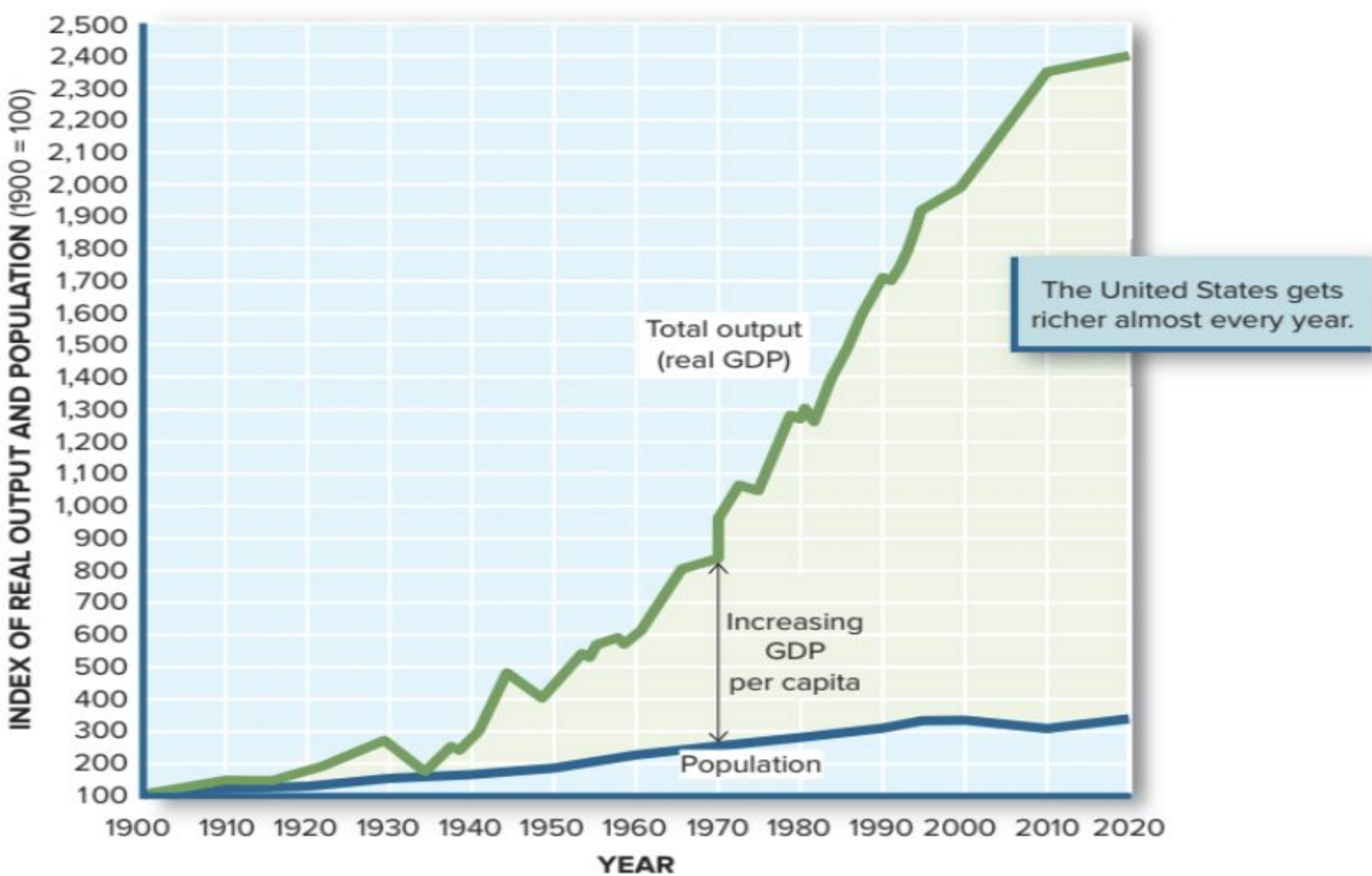
-If GDP grows faster than population grows, standard of living rises.

-If GDP grows slower than population grows, standard of living falls.

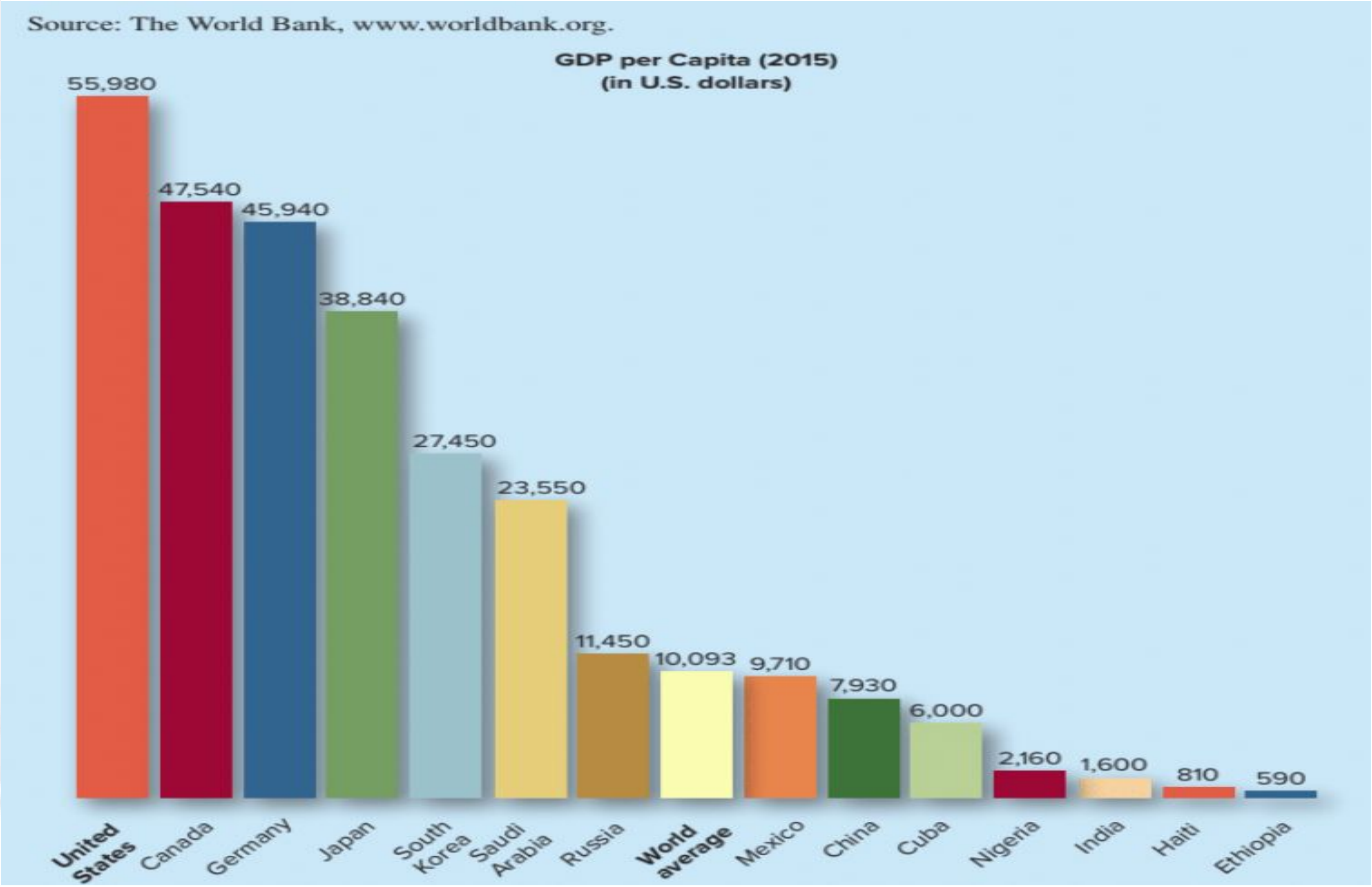
Economic growth: an increase in output; an expansion of production possibilities.

-U.S. output has grown roughly 3 percent per year, while population has grown about 1 percent per year, raising per capita GDP.

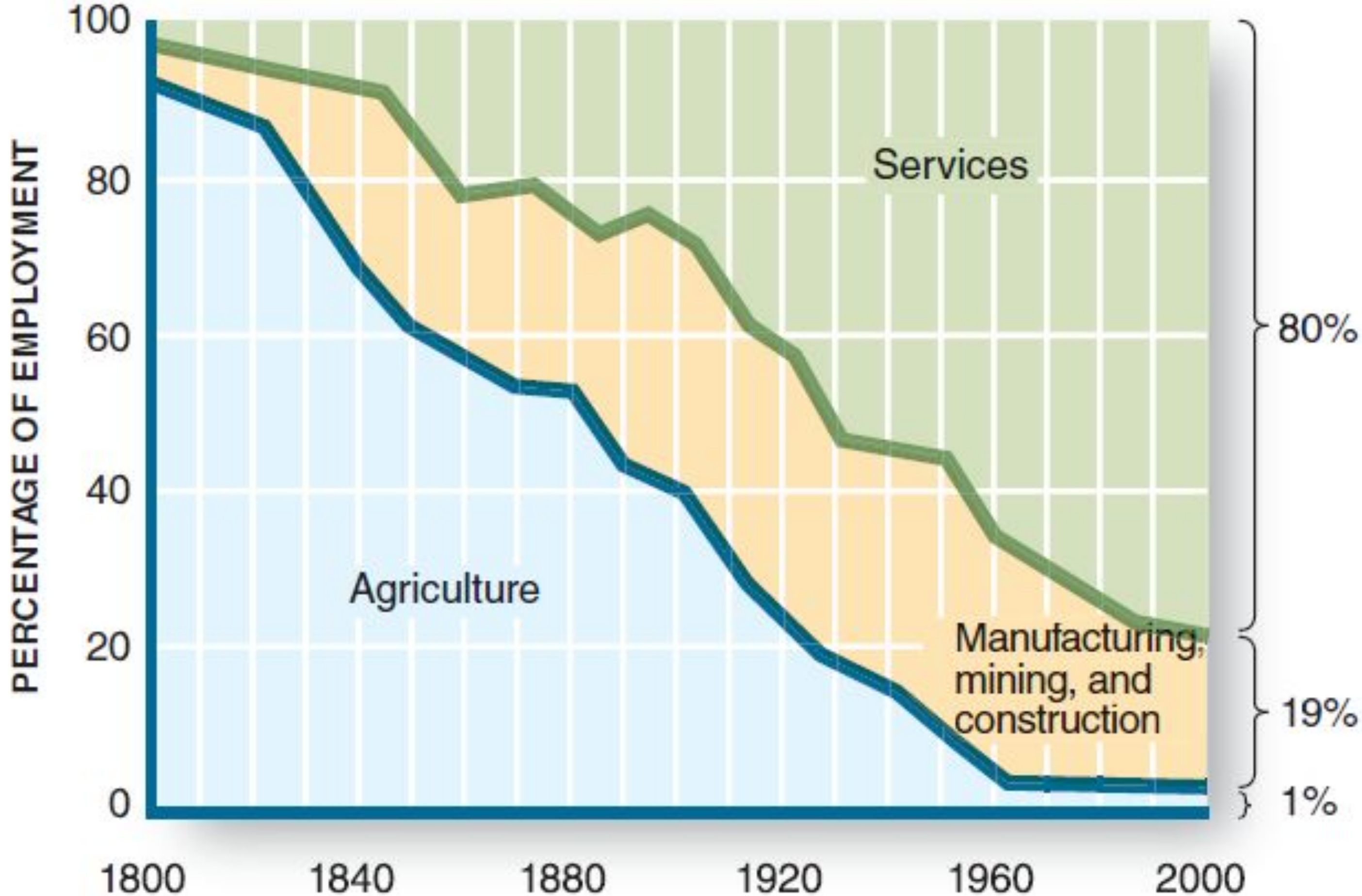
U.S. Output and Population Growth



GDP Per Capita Around the World



The Changing Mix of Output



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Rich Nations and Poor Nations

GDP per capita figures are very different in rich and poor nations.

- **Rich nations:** populations grow slowly, so GDP per capita increases, improving the standard of living.
  - ✔ *The transformation of the United States into a service economy reflects our increasing incomes and relative affluence.*
- **Poor nations:** population increases rapidly and GDP may be declining, so GDP per capita is stagnant or decreases, making it difficult to raise living standards.
  - ✔ *In poorer countries, resources must be devoted to producing food and goods, not services.*

How to Produce?

- How a country produces depends on what resource inputs are available.
- Key among the resource inputs is capital.
  - **Human capital:** the knowledge and skills possessed by the workforce.
  - **Physical capital:** the facilities, tools, equipment, and infrastructure available to the workforce.

Investment in Capital

The United States;

- invests heavily in **human capital.**
- has accumulated a massive amount of **physical capital.**
- has **high productivity** resulting from using highly educated workers with high-tech equipment in **capital-intensive** production processes.
- households are able to consume so much because American workers produce so much.

Capital? Or Labor?

Richer countries tend to be capital-intensive, while poorer countries tend to be labor-intensive.

- **Capital-intensive:**
  - Capital is abundant and relatively low-cost.
  - Labor is costly.
- **Labor-intensive:**
  - Capital is unavailable or very expensive.
  - Labor is cheap.

Other Factors

- **Technological advancement:**
  - Finding new and better ways to produce products.
- **Factor mobility:**
  - Rapidly reallocating resources from declining industries to expanding industries.
- **Outsourcing and trade:**
  - Taking advantage of low opportunity cost around the world.

Outsourcing

- U.S. workers have a comparative advantage in high-skill, capital-intensive jobs.
- Workers in other countries have a comparative advantage in lower-skill, labor-intensive jobs.
- Outsourcing flows both ways – low-skill jobs leaving the United States and high-skill jobs coming to the United States.

Role of Government in Market Reliant Economy

Market-reliant economies **grow faster** than government-dominated economies.

- Entrepreneurs can freely pursue opportunities in the market. They will innovate and create new products. This leads to faster economic growth.
- When government owns the factors of production, imposes high taxes, or tightly regulates output, there is little incentive to design new products or pursue new technology.

Roles of Government

- **Providing a legal framework**
  - Property rights and the Rule of law (contracts, fraud)
- **Protecting the environment**
  - Negative externalities and Eliminate third-party harm
- **Protecting consumers**
  - Fostering competition and Product safety
- **Protecting labor**
  - Workplace safety, Child labor laws and Compulsory schooling
  - Minimum wage law and Overtime provisions

Externalities

Externalities

- Costs (or benefits) borne by a third party when a two-party (buyer and seller) transaction occurs.
- The difference between the social and private costs (benefits) of a market activity.

When externalities are present, market prices are not a valid measure of a good's value to society.

What Is the U.S. Economy Like?

WHAT goods and services does the United States produce?

– It produces goods desired by its consumers.

– If it has lower opportunity costs, it produces goods in the country; if not, it buys goods from other countries.

– The United States has become a heavily service-based economy.

What Is the U.S. Economy Like?
(continued II)

HOW is that output produced?

– United States firms are in business to be profitable.

– To succeed, they must satisfy their customers and comply with government regulations.

– Each firm will select the low-cost mixture of inputs necessary to produce a good acceptable to its customers.

What Is the U.S. Economy Like? (continued III)

FOR WHOM is the output produced?

- *For those who are both willing and able to pay for it.*
- *In the market economy, those with larger incomes satisfy more of their wants than those with less.*

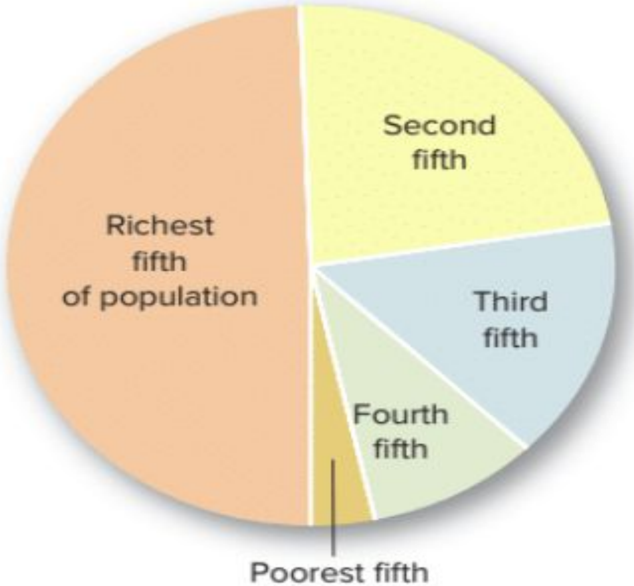
Allocating the products to the users can be done by government or by the market mechanism.

- *or by a mixture of the two.*
- *In the United States, the majority of GDP is distributed via the market mechanism.*

U.S. Income Distribution

- Income has an unequal distribution in the United States (and in every other country).
- The higher the income, the greater the ability to buy goods and services.
- We sort U.S. income earners by **quintile** (one-fifth of the population) rank-ordered by income.
- The top quintile gets more than half of all U.S. income. The bottom quintile gets only 3.1percent.

U.S. Distribution of Income



Income Quintile	2015 Income	Average Income	Share of Total Income (%)
Highest fifth	Above $117,000	$202,000	51.1
Second fifth	$72,000–117,000	$ 92,000	23.2
Third fifth	$44,000–72,000	$ 57,000	14.3
Fourth fifth	$23,000–44,000	$ 33,000	8.2
Lowest fifth	$0–23,000	$ 12,500	3.1

Source: U.S. Department of Commerce, Bureau of the Census (averages rounded to thousands of dollars; 2015 data).

World View: Distribution of Income

- ✔ Income disparities are greater in other countries, especially in the poorer countries.
- ✔ Poor people (bottom quintile) in the United States receive far more goods and services than the average household (middle quintile) in most low-income countries.

- If you put the federal government in charge of the Sahara Desert, in 5 years there'd be a shortage of sand.

- The government solution to a problem is usually as bad as the problem.

Milton Friedman

- Capitalism is the astounding belief that the most wickedest of men will do the most wickedest of things for the greatest good of everyone.

-Long run is a misleading guide to current affairs. In the long run we are all dead.

John Maynard Keynes