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.

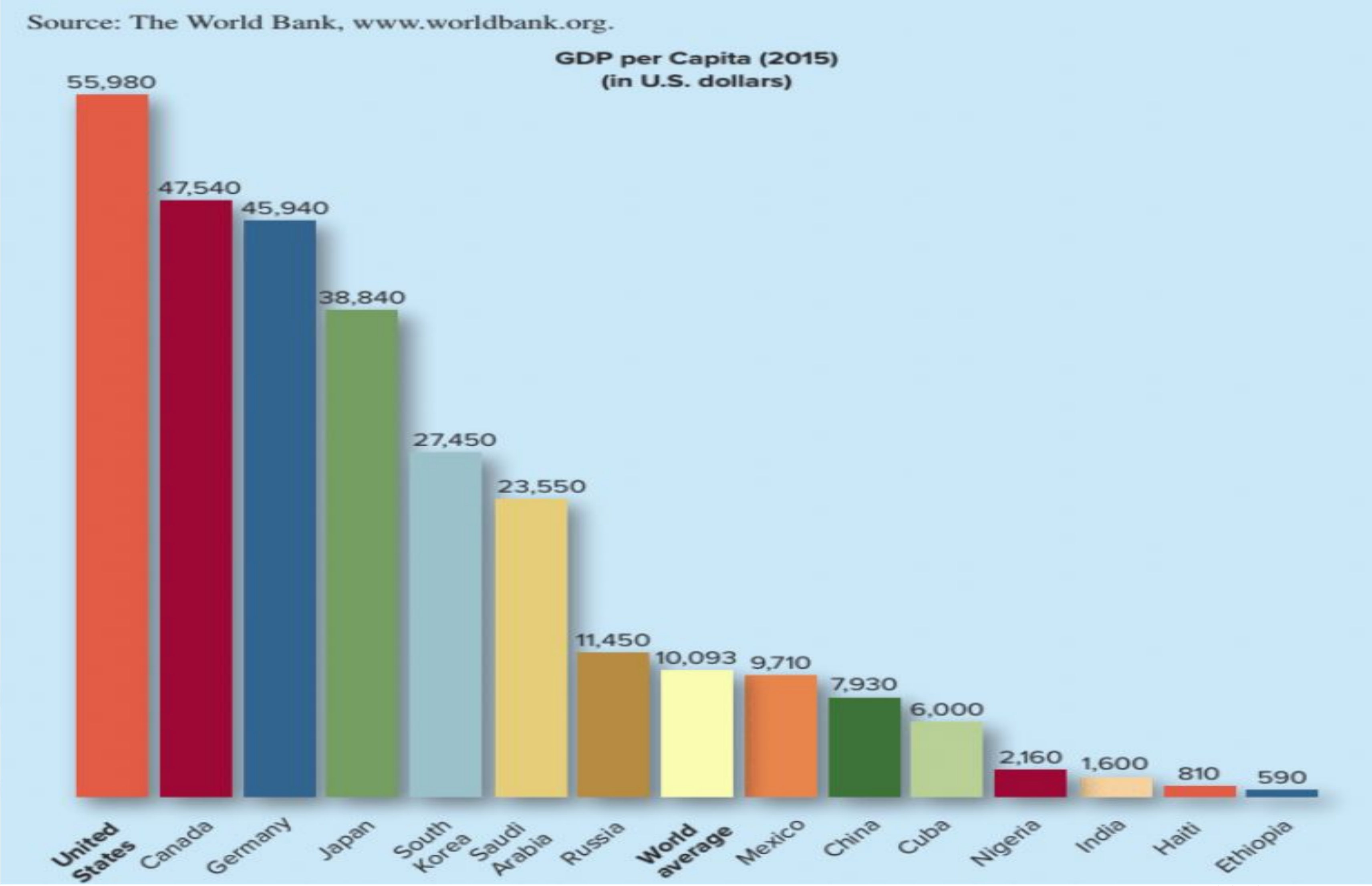
Living Standards

- **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.

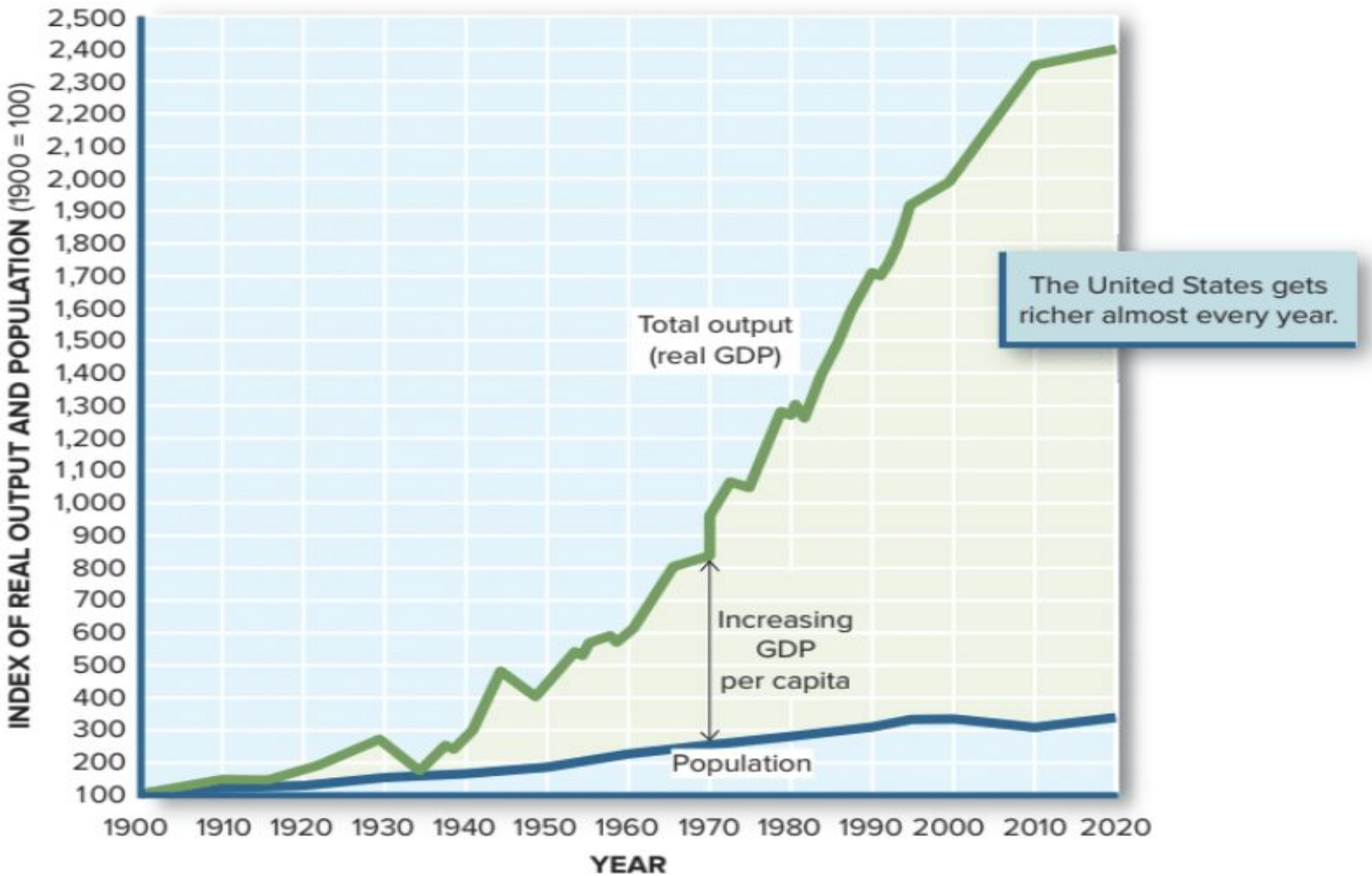
GDP Per Capita Around the World



GDP Growth

- **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



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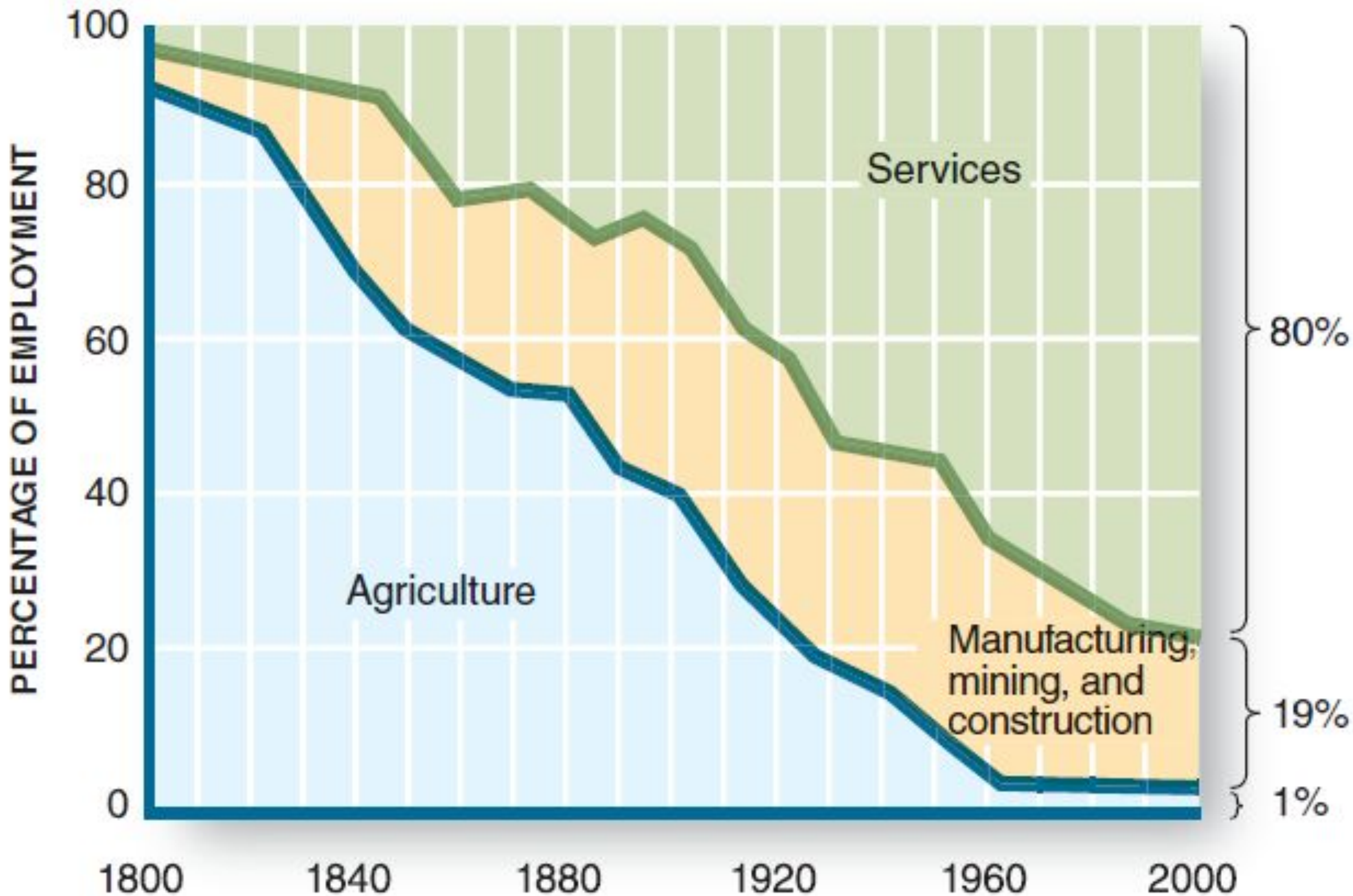
Rich Nations and Poor Nations

- 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.
  - **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.

The Changing Mix of Output

- In the past 100 years, the United States transformed from an agricultural society to an industry-based society, and **now** to a service-based society.
  – Eighty percent of U.S. output consists of services, not goods.
  – Even so, the United States remains one of the world's largest manufacturers of goods.

The Changing Mix of Output II



Exercise

- Write down the occupations of your parents and your grandparents.
- Add to the list the type of occupation you are aspiring to.
- **How do the differences relate to the changing output mix in the United States over the last century?**

The Changing Mix of Output III

- The transformation of the United States into a <u>service economy</u> reflects our increasing incomes and relative affluence.

- 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.
  - When technology advances, an economy can produce more output with existing resources.
  - Its production possibilities curve shifts outward.

Other Factors II

- **Factor mobility:**
  - Rapidly reallocating resources from declining industries to expanding industries.
- **Outsourcing and trade:**
  - Taking advantage of low opportunity cost around the world.
  - Exploiting technological advancements to use resources from 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
  - Rule of law (contracts, fraud)
- **Protecting the environment**
  - Negative externalities
  - Eliminate third-party harm

Roles of Government II

- **Protecting consumers**
  - Fostering competition
  - Product safety
- **Protecting labor**
  - Workplace safety
  - Child labor laws
  - Compulsory schooling
  - Minimum wage law
  - Overtime provisions

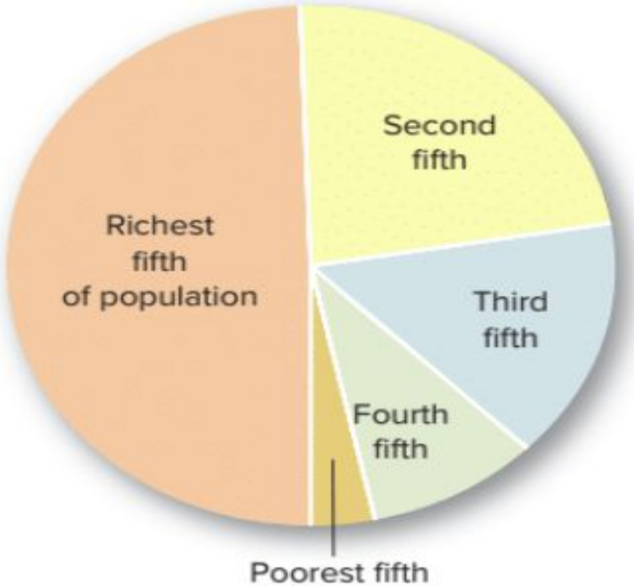
For Whom America Produces

- 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.
  - In market distribution those with the most income get the most goods.

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.

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? (cont.)

- **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? (cont. II)

- **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.

Application: The Economy Tomorrow

- There is poverty around the world.
  - 3 billion people live on incomes of less than $3 a day.
  - One-sixth are illiterate.
  - A fifth is chronically undernourished.
- The World Bank set goals to reduce extreme poverty, achieve universal primary education, reduce infant mortality, and increase access to potable water.

Application: The Economy Tomorrow II

- People aspire to higher living standards.
- Rich nations choose to meet their own needs first before helping the world's poor.
- Most poor nations have major problems:
  - Corruption.
  - No private property protection.
  - No contract enforcement.
  - This discourages investment in their nations from the world's richer nations.

Revisiting the Learning Objectives

- **LO2-1 Know the relative size of the United States economy.**
  - The United States produces about $18 trillion of output per year.
  - This is more than one-fifth of the world's total.
  - The U.S. GDP per capita is five times the world average.

Revisiting the Learning Objectives II

- **LO2-2 Know how the U.S. output mix has changed over time.**
  - The output mix has transitioned from agricultural, to industrial, to services over the past century.
  - Services now account for nearly 80 percent of U.S. output.
  - This is due to the relatively high incomes in the United States.

Revisiting the Learning Objectives III

- **LO2-3 Know how America is able to produce so much output.**
  - U.S. workers possess high productivity.
  - Abundant capital, education, technology, training, and management all contribute.
  - Also, the United States enjoys a relatively high degree of economic freedom (market reliance).

Revisiting the Learning Objectives IV

- **LO2-4 Know how incomes are distributed in the United States and elsewhere.**
  - Incomes are distributed unequally everywhere.
  - The worst inequity occurs in the poorer nations.
  - In the United States the highest quintile receives over 16 times more income than the lowest quintile.

Looking Ahead: Chapter 3

Supply and Demand

After learning about this chapter, you should know

- The nature and determinates of market demand.
- The nature and determinants of market supply.
- How market prices are established.
- What causes market prices to change.
- How government price controls affect market outcomes.