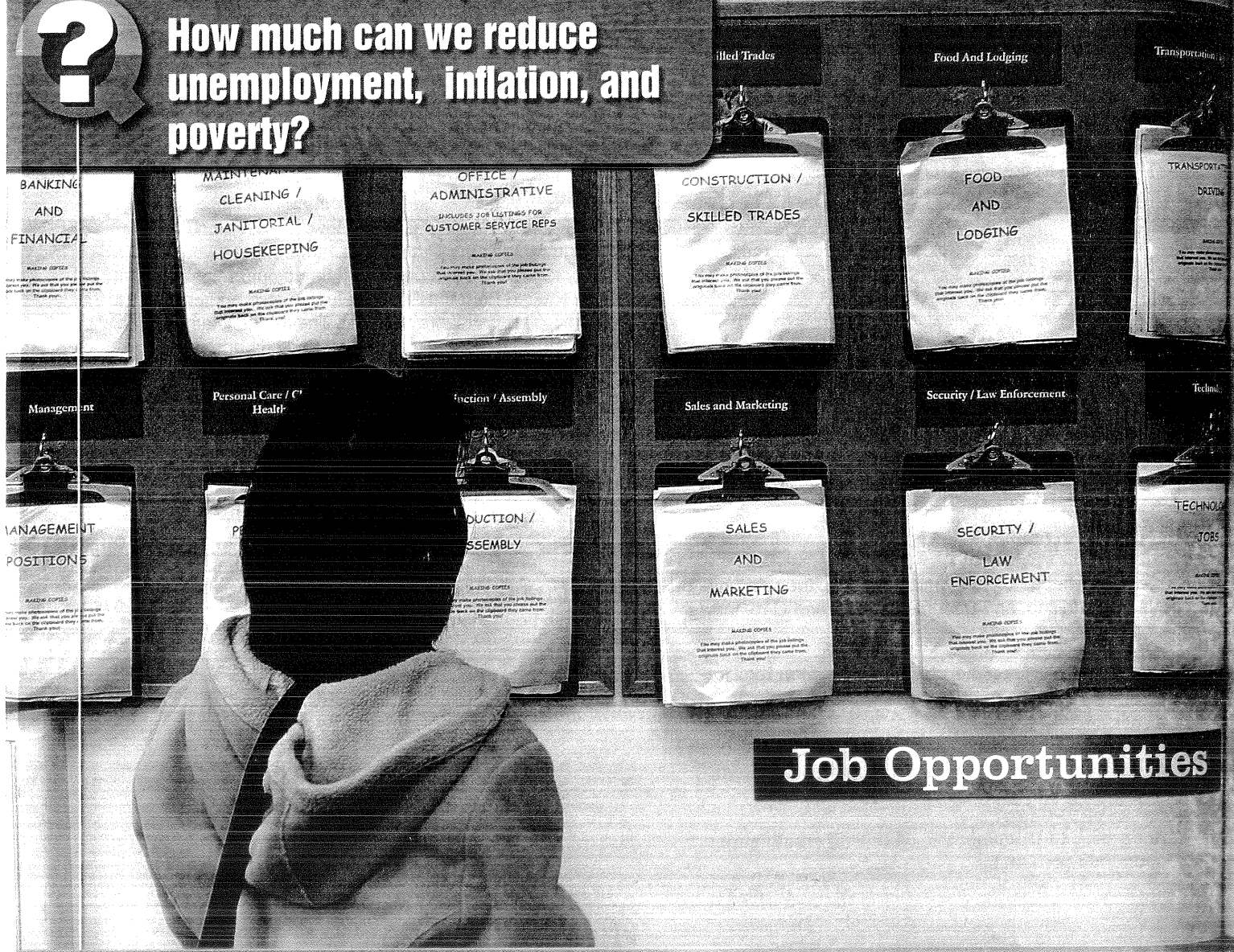


13 Economic Challenges

Essential Question, Chapter 13



How much can we reduce unemployment, inflation, and poverty?



- Section 1: Unemployment
- Section 2: Inflation
- Section 3: Poverty

Economics on the go

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SECTION 1 Unemployment

OBJECTIVES

1. **Differentiate** between frictional, seasonal, structural, and cyclical unemployment.
2. **Describe** how full employment is measured.
3. **Explain** why full employment does not mean that every worker is employed.

ECONOMIC DICTIONARY

As you read the section, look for the definitions of these **Key Terms**:

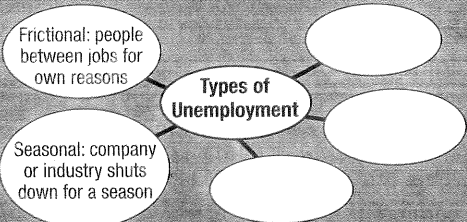
- frictional unemployment
- structural unemployment
- globalization
- seasonal unemployment
- cyclical unemployment
- unemployment rate
- full employment
- underemployed
- discouraged worker



Guiding Question

What are the causes of unemployment?

Copy this concept web and fill it in as you read to identify the causes of unemployment.



► **Economics and You** Many people face unemployment at some point in their lives. For the jobless worker it is a very personal issue. For the government, it is a national economic issue. Economists measure the health of the economy by tracking the number of people who are out of work. The government pays close attention to these statistics so that it can take actions that will spur economic recovery.

Principles in Action General economic conditions, lengthy job searches, and seasonal production schedules are some of the factors that cause unemployment. A woman who believes in “keeping the humanity in human resources” is profiled in this section’s Innovators.

Types of Unemployment

Economists look at four categories of unemployment: frictional, seasonal, structural, and cyclical. Sometimes, factors outside the economy can cause unemployment. The various kinds of unemployment have different effects on the economy as well as on the people who are unemployed.

Frictional Unemployment

Unemployment always exists, even in a booming economy. **Frictional unemployment** occurs when people take time to find a job. For example, people might change jobs, be laid off from their current jobs, or need some time to find the right position after they finish their schooling. They might be returning to the workforce after a long period of time. In the following examples, all three people are considered frictionally unemployed.

frictional unemployment type of unemployment that occurs when people take time to find a job

Visual Glossary online

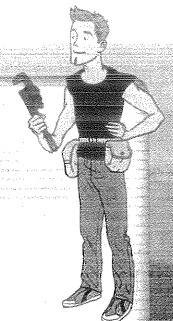
Go to the Visual Glossary Online for an interactive review of **inflation**.

Action Graph online

Go to Action Graph Online for animated versions of key charts and graphs.

How the Economy Works online

Go to How the Economy Works Online for an interactive lesson on **structural unemployment**.



How do workers deal with structural unemployment?

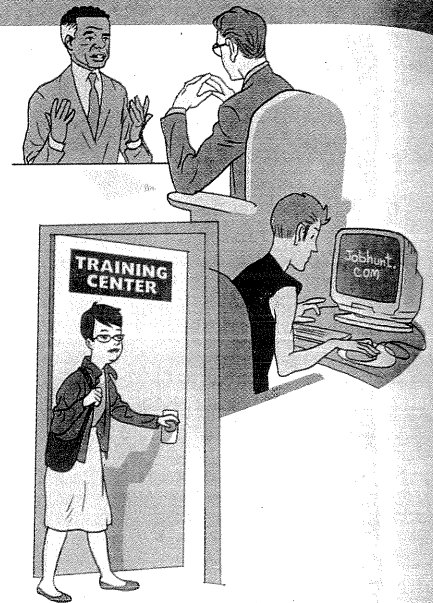
The United States has shifted from a manufacturing economy to a service economy. Many workers do not have the skills needed for jobs in the new technology-based industries. Structural unemployment occurs when workers' skills don't match the jobs that are available.

1

Reginald's position as an accounting manager was eliminated after the company upgraded to a new computer software program.

Jennifer's job was outsourced when the furniture manufacturer she worked for moved to another country.

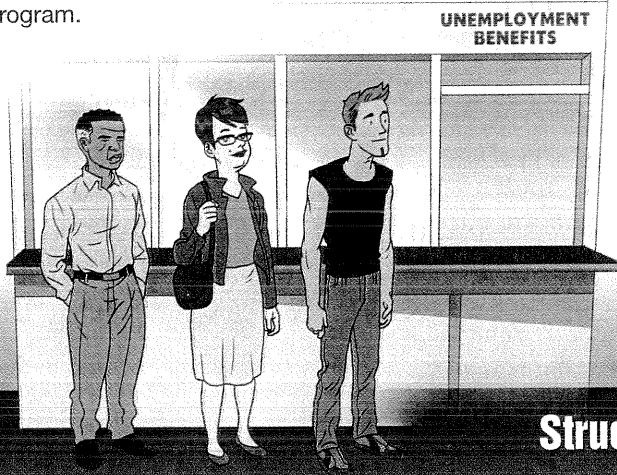
Matthew's job as a landscaper was eliminated when the Parks Department's budget was cut.



2 **Reginald** contacts former associates and gets a couple of interviews.

Jennifer realizes that she needs to get training in another field.

Matthew searches online for a new job, but discovers that his high school education leaves him unqualified for many positions.



Structural Unemployment

- Hannah was not satisfied working as a nurse in a large hospital. Last month she left her job to look for a position at a small health clinic.
- Since Jorge graduated from law school three months ago, he has interviewed with various law firms to find the one that best suits his needs and interests.
- Liz left her sales job two years ago to care for an aging parent. Now she is trying to return to the workforce.

None of these three people found work immediately. While they look for work, they are frictionally unemployed. In the large, diverse U.S. economy, economists expect to find many people in this category.

Unemployment insurance, which provides income to laid-off workers seeking new jobs, may contribute slightly to frictional unemployment. A worker receiving unemployment insurance faces

somewhat less financial pressure to find a new job immediately.

Structural Unemployment

As you read in Chapter 9, the structure of the American economy has changed over time. Two centuries ago, people needed basic farming skills to survive. As the country developed an industrial economy, farm workers moved to urban areas to work in factories. Today, service industries are rapidly replacing manufacturing industries, and information services are expanding at breakneck speed.

All these shifts lead to upheavals in the labor market. When the structure of the economy changes, the skills that workers need to succeed also change. Workers who lack the necessary skills lose their jobs. **Structural unemployment** occurs when workers' skills do not match those needed for the jobs that are now available.

structural unemployment type of unemployment that occurs when workers' skills do not match those needed for the jobs available

How the Economy Works online

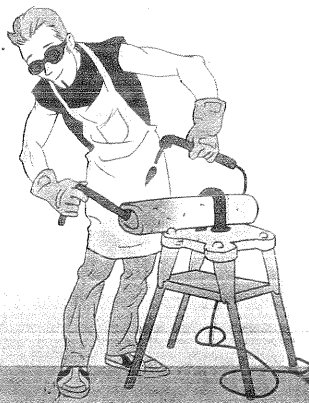
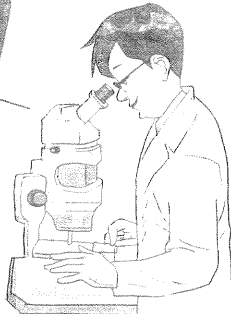
For an animated, interactive version of this feature, visit PearsonSchool.com/PHecon



3 Reginald's recent experience inspires him to earn a degree in business technology management.

Jennifer gets into a federal job training program for people who have lost their jobs due to globalization. She is studying to become a biomedical technician.

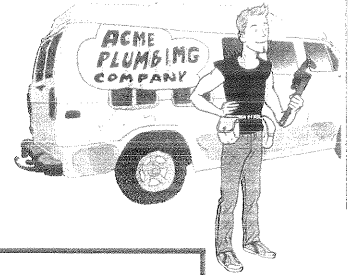
Matthew, who likes to work with his hands, takes a friend's advice and enrolls in a technical school. He is training to become a plumber.



4 **Reginald** continues his studies and his job search. Although he gets some temporary jobs, Reginald is underemployed.

Jennifer finds a good position as a technician at a pharmaceutical company.

Matthew will earn more money as a plumber than he did as a landscaper.



Check Your Understanding

1. Identify three causes of structural unemployment.
2. How can the education system help reduce structural unemployment?

Retraining

Employment

There are five major causes of structural unemployment.

- **The development of new technology** New inventions and ideas often push out older ways of doing things. For example, downloading music has hurt the sales of compact discs. Firms making CDs have let workers go, and those workers must find jobs in another field.
- **The discovery of new resources** New resources replace old resources. The discovery of petroleum in Pennsylvania in 1859 severely hurt the whale-oil industry. Whaling ship crews lost their jobs and did not have the skills needed for the petroleum industry.
- **Changes in consumer demand** Consumers often stop buying one product in favor of another. Many people now favor athletic shoes over

more traditional kinds of shoes. As a result, traditional shoemaking jobs have declined.

- **Globalization** The mobility of capital and labor has fueled a shift from local to international markets. Countries have become more open to foreign trade and investment in a trend called **globalization**. As a result, companies often relocate jobs or entire facilities to other countries where costs are lower. Celia, for example, spent many years working on an automobile assembly line in Michigan. When her company moved much of its auto assembly work to Mexico where labor is less expensive, Celia lost her job. Unfortunately, there were no local jobs that matched Celia's skills.
- **Lack of education** People who drop out of school or fail to acquire the minimum skills needed for today's

globalization the shift from local to global markets as countries seek foreign trade and investment

seasonal unemployment type of unemployment that occurs as a result of harvest schedules, vacations, or when industries make seasonal shifts in their production schedule

cyclical unemployment unemployment that rises during economic downturns and falls when the economy improves

FUTURE WATCH
Personal Finance
For more about how to find a job, see your Personal Finance Handbook in the back of the book or visit PearsonSchool.com/PHecon

Migrant farm workers face seasonal unemployment once the harvest season is over. ▼

job market may find themselves unemployed, employed part-time, or stuck in low-wage jobs. For example, Martin barely managed to graduate from high school. When he was hired as a clerk by a local clothing store, he had trouble using the computerized checkout register. The store manager fired Martin after just two months because he lacked the skills needed for the job.

Policymakers in the 1990s and 2000s recognized that computer technology, globalization, and other structural changes threatened the futures of many workers. As a result, they developed job-training programs to help workers gain new skills, especially computer skills.

Retraining takes time, however, and the new skills do not ensure that the trainees will obtain high-wage jobs. Some companies offer their own training programs. In this way, they can teach trainees the specialized skills they need to become valued employees.

Seasonal Unemployment

Gregory is a brick mason for a small construction company in the northeastern United States. Every winter Gregory's employer lays off all seven of his employees when cold weather forces an end to outdoor work. In the spring, he hires them back again for the new

construction season. Gregory and his co-workers are examples of people who experience seasonal unemployment.

In general, **seasonal unemployment** occurs when industries slow or shut down for a season or make seasonal shifts in their production schedules. Seasonal unemployment can also occur as a result of harvest schedules or vacations. When this school year ends, you or your friends may need some time to find the perfect summer job. Until you do so, economists will count you as seasonally unemployed.

As with frictional unemployment, economists expect to see seasonal unemployment throughout the year. Government policymakers do not take steps to prevent this kind of unemployment, because it is a normal part of a healthy economy.

Still, the lives of seasonally unemployed workers can be extremely difficult. Migrant agricultural workers, for example, travel throughout the country to pick fruits and vegetables as various crops come into season. They know that their work will likely end when winter arrives. Migrant workers can also have periods of unemployment even during harvest season, depending on the weather. Heat, cold, rain, and drought can ruin harvest schedules by causing fruits and vegetables to ripen sooner or later than expected. Instead of moving smoothly from crop to crop, migrant workers might lose work time waiting for a crop to be ready for picking.

Cyclical Unemployment

Unemployment that rises during economic downturns and falls when the economy improves is called **cyclical unemployment**. During recessions, or downturns in the business cycle, the demand for goods and services drops. The resulting slowdown in production causes the demand for labor to drop as well, and companies begin to lay off employees. Many of these laid-off employees will be rehired when the recession ends and the business cycle resumes an upward trend. Although economists expect cyclical unemployment, it can severely strain the economy and greatly distress the unemployed.

The most damaging example of cyclical unemployment in the twentieth century was



the Great Depression. During the Great Depression, one out of every four workers was unemployed. Many remained jobless for years. In 1935, President Franklin D. Roosevelt proposed, and Congress passed, the Social Security Act. In addition to providing monthly payments for retirees and people who could not support themselves, the Social Security Act established a program of unemployment insurance.

Today, unemployment insurance still provides weekly payments to workers who have lost their jobs. The payments usually provide about half of a worker's lost wages each week for a limited amount of time.

Factors Outside the Economy

Sometimes events outside the economy can cause unemployment. The September 11, 2001, terrorist attacks on the World Trade Center and the Pentagon cost the country an estimated 1.5 to 2 million jobs. Many of the lost jobs were in the travel and tourism industries. About 20 percent of the lost jobs were in the airline industry. In Manhattan, the area around the World Trade Center site was especially hard-hit, and New York City lost some 150,000 jobs.

Natural disasters also affect employment. In October 2005, Hurricane Katrina slammed into the Gulf Coast region. The powerful storm caused widespread destruction and thousands of people lost their jobs. Many families were relocated to other areas while their communities were being rebuilt. Months later, unemployment among people affected by Hurricane Katrina was still higher than the national average.

✓ CHECKPOINT *Why are policymakers less concerned about frictional and seasonal unemployment?*

Measuring Employment

The amount of unemployment in the nation is an important clue to the health of the economy. For this reason, the government keeps careful track of how many people are unemployed, and why.

To measure employment, the United States Bureau of the Census conducts a monthly household survey for the Bureau of Labor Statistics (BLS). For this survey, called the Current Population Survey, interviewers

Figure 13.1

Calculating the Unemployment Rate

To calculate the unemployment rate, use the following formula:

Number of people unemployed divided by number of people in the civilian labor force multiplied by 100

For example,

if the number of people unemployed = 7 million
and the number of people in the civilian labor force = 151.4 million

then,

$$7 \div 151.4 = .046$$

$$.046 \times 100 = 4.6$$

Therefore,

the unemployment rate is 4.6%

SOURCE: Bureau of Labor Statistics

CHART SKILLS

To calculate the unemployment rate, follow the steps in the chart.

1. In May 2008, the civilian labor force was 154.5 million and 8.5 million were unemployed. What was the unemployment rate?
2. Does the unemployment rate accurately reflect the number of people who are unemployed? Why or why not?

poll 60,000 families about employment during that month. This sample is designed to represent the entire population of the United States. The BLS, a branch of the U.S. Department of Labor, analyzes the data from the survey to identify how many people are employed and how many are unemployed. Using these numbers, the BLS computes the **unemployment rate**, or the percentage of the nation's labor force that is unemployed.

Determining the Unemployment Rate

As you read in Chapter 9, the labor force is composed of civilians age 16 and older who have a job or are actively looking for a job. To determine the unemployment rate, BLS officials add up the number of employed and unemployed people. That figure equals the total labor force. Then they divide the number of unemployed people by the total labor force and multiply by 100. As **Figure 13.1** shows, the result is the percentage of people who are unemployed.

For example, in September 2007, the Current Population Survey showed that 146.3 million people were employed, and 7.2 million were unemployed. The total labor force, therefore, was 153.5 million. Dividing 7.2 million by 153.5 million, and then multiplying the result by 100, yields

unemployment rate
the percentage of the nation's labor force that is unemployed

Janice Bryant Howroyd



“Never compromise who you are personally to become who you wish to be professionally.”

Careers are all about making a commitment. In 1978, Janice Bryant Howroyd rented a small office in Beverly Hills and launched ACT•1 Personnel Services, an employment services agency. From the outset, her focus was on providing employers with qualified employees and developing long-term business relationships.

Howroyd did not advertise. Instead, she relied on the WOMB method. WOMB means “Word of Mouth, Brother!” Her strategy was successful: today, the company is approaching \$1 billion in annual revenue.

Initially, Howroyd focused on the entertainment field. But soon her business expanded to include the technical, clerical, engineering, and accounting industries. Loyal clients include General Mills, DuPont, and Wachovia.

Howroyd’s once small company has grown. The ACT•1 Group of companies includes Agile•1, which uses talent procurement software and workforce planning to help businesses meet their staffing needs.

Equally important is her emphasis on skills. Howroyd owns a continuing-education school. She wants to supply clients with employees who have basic academic skills, as well as higher-order thinking skills such as problem solving and decision making.

It’s no surprise that ACT•1’s motto is “pride in performance.”

Critical Thinking: Employers want to hire lifelong learners. Why is there an emphasis on continuing education for employees?



Fast Facts

Janice Bryant Howroyd

Born: Sept. 1, 1952, in Tarboro, NC

Education: University of Maryland, North Carolina State University

Claim to Fame: Founder, CEO, of ACT•1 Personnel Services

an unemployment rate of 4.7 percent for that month.

Adjusting the Unemployment Rate

When you see the unemployment rate for a particular month, it has usually been “seasonally adjusted.” This means that the rate has been increased or decreased to take into account the level of seasonal unemployment. Taking this step allows economists to more accurately compare unemployment rates from month to month. This comparison helps them better detect changing economic conditions.

The unemployment rate is only an average for the nation. It does not reflect regional differences. Some areas, such as the coal-mining region of Appalachia in the southeastern United States, have long had a higher-than-average unemployment rate. The BLS and individual state agencies therefore establish unemployment rates for states and other geographic areas. These rates help pinpoint trouble areas on which policymakers can focus attention.

CHECKPOINT How is the unemployment rate calculated?

full employment the level of employment reached when there is no cyclical unemployment

underemployed working at a job for which one is over-qualified or working part-time when full-time work is desired

Full Employment

Look at **Figure 13.2**. Notice the low levels of unemployment in the late 1990s and early 2000s. As you read earlier, zero unemployment is not an achievable goal in a market economy, even under the best of circumstances. Economists generally agree that in an economy that is working properly, an unemployment rate of around 4 to 6 percent is normal. Such an economy would still experience frictional, seasonal, and structural unemployment. In other words, **full employment** is the level of employment reached when no cyclical unemployment exists.

Underemployment

Full employment means that nearly everyone who wants a job has a job. But are all those people satisfied with their jobs? Not necessarily. Some people working at low-skill, low-wage jobs may be highly skilled or educated in a field with few opportunities. They are **underemployed**, that is, working at a job for which they are over-qualified, or working part-time when they desire full-time work.

For example, Jim, a philosophy major, earned a graduate degree in philosophy. When he left school, Jim found that although the economy was booming, he could not find jobs in which he could apply his knowledge of philosophy. Jim found a part-time job that did not pay well and did not challenge his mind. He was underemployed.

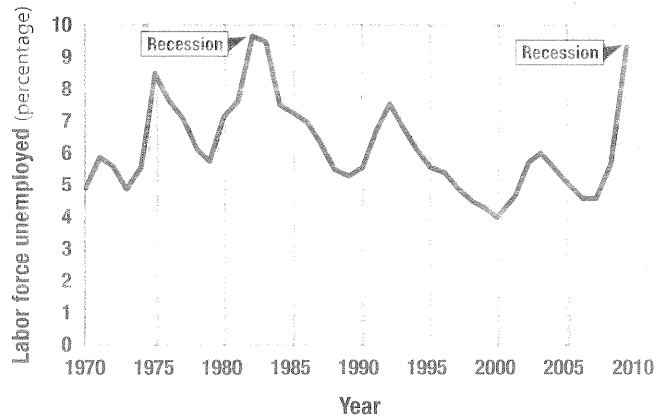
Underemployment also describes the situation of people who want a permanent, full-time job but have not been able to find one. Many part-time workers and seasonal workers fit into this category.

Discouraged Workers

Some people, especially during a long recession, give up hope of finding work. These **discouraged workers** have stopped searching for employment and may rely on other family members or savings to support them. Although they are without jobs, discouraged workers do not appear in the unemployment rate determined by the Bureau of Labor Statistics because they are not actively looking for work.

If underemployed and discouraged workers were included, the unemployment rate would be much higher than reported. Some

Figure 13.2 Unemployment Rate



SOURCE: Bureau of Labor Statistics

GRAPH SKILLS

The unemployment rate peaked in 1982 and 2009.

1. In what years was the unemployment rate between 4 and 6 percent, the rate considered normal for a healthy economy?
2. Why does a high unemployment rate correspond with a recession?

estimates are that the 2009 unemployment rate would have been above 17 percent.

CHECKPOINT What kinds of unemployment are present even in a healthy economy?

discouraged worker someone who wants a job but has given up looking

SECTION 1 ASSESSMENT

Essential Questions Journal

To continue to build a response to the Essential Question, go to your Essential Questions Journal.

Guiding Question

1. Use your completed concept web to answer this question: What are the causes of unemployment?
2. **Extension** Suppose that you are unemployed and looking for work. You are a good worker, but it is taking you longer than expected to find a job. What might be making your search so difficult?

Key Terms and Main Ideas

3. What are some factors that affect **seasonal unemployment**?
4. When does **cyclical unemployment** take place?
5. What is **globalization**?
6. How does the Bureau of Labor Statistics determine the **unemployment rate**?
7. Why isn't **full employment** the same as zero unemployment?

Critical Thinking

8. **Contrast (a)** What are frictional unemployment and structural unemployment? **(b)** Give an example of each. **(c)** In what ways are frictional unemployment and structural unemployment different?
9. **Apply** After a car accident, Santo needed six months to recover. Since his recovery, he has spent the last year trying to find work in his former occupation, medical technology. So far, he has not found a position, even though the economy is booming. Which of the four kinds of unemployment best describes Santo's situation? Explain.
10. **Calculate (a)** What is the formula for calculating the unemployment rate? **(b)** Determine the unemployment rate for a month in which 125.4 million people were employed and 7.3 million people were unemployed.

Quick Write

11. A recent magazine article listed the jobs of the future along with the jobs that won't exist in twenty years. One promising career is computer software engineer. However, there will be little need for film processors in the future. Write a paragraph on each occupation. Suggest reasons why there will be a greater need for computer software engineers and less need for film processors.

SECTION 2 Inflation

OBJECTIVES

1. Explain the effects of rising prices.
2. Understand the use of price indexes to compare changes in prices over time.
3. Identify the causes and effects of inflation.
4. Describe recent trends in the inflation rate.

ECONOMIC DICTIONARY

As you read the section, look for the definitions of these **Key Terms**:

- inflation
- purchasing power
- price index
- Consumer Price Index
- market basket
- inflation rate
- core inflation rate
- hyperinflation
- quantity theory
- wage-price spiral
- fixed income
- deflation



Guiding Question

What are the causes and effects of inflation?

Copy this chart and fill it in as you read to explain the causes and effects of inflation.

Inflation	
Causes	Effects
<ul style="list-style-type: none"> • Growth of the money supply • Changes in aggregate demand, as during wartime • 	<ul style="list-style-type: none"> • Decreases purchasing power • •

inflation a general increase in prices across an economy

purchasing power the ability to purchase goods and services

Economics and You At first, the changes are hardly noticeable. You pay more for lunch at your favorite eatery. Your personal grooming products are more expensive. Clothing prices are higher. A ticket for the movies costs two dollars more. You realize that as a result of these steady price increases, your money doesn't buy as much as it did just a few months ago.

Principles in Action As you will see, you cannot escape rising prices. Economists believe that the money supply, changes in demand, and increased production costs all contribute to a rise in prices throughout the economy. This section's Economics & You shows how higher prices can affect your life.

The Effects of Rising Prices

Josephine and Jack Barrow have owned the same house for 50 years. Recently, they had a real estate agent estimate their home's present market value. The Barrows were astounded. The house that they had bought for \$12,000 was now worth nearly \$150,000—a rise in value of more than 1,100 percent.

How could the value of a house, or anything else, increase so much? The main reason is inflation. **Inflation** is a general increase in prices across an economy. Over the years, prices generally go up. Since World War II, real estate prices have risen greatly.

The Barrows were pleased that they could get so much money for their house. Then they realized that inflation had raised the prices of all houses, just as it had also raised wages and the prices of most other goods and services. As a result, they could not buy a similar house in their area for \$12,000 or even \$120,000.

Another way to look at the Barrows' situation is that inflation had shrunk the value, or purchasing power, of the Barrows' money. **Purchasing power** is the ability to purchase goods and services. As prices rise, the purchasing power of money declines. That is why \$12,000 buys much less now than it did 50 years ago.

CHECKPOINT Why does purchasing power decrease over time?

	March 1996	March 2008
Bread, white (per lb.)	0.85	1.35
Eggs, large (per dozen)	1.14	2.20
Milk, whole (per gallon)	2.54	3.78

* U.S. City average
Source: Bureau of Labor Statistics

▲ The effects of inflation over the years can be seen in this comparison of prices for basic food items.

Price Indexes

Housing costs are just one element that economists consider when they study inflation. The economy has thousands of goods and services, with millions of individual prices. How do economists compare the changes in all these prices in order to measure inflation? The answer is that they do not compare individual prices; instead, they compare price levels. As you read in Chapter 12, price level is the cost of goods and services in the entire economy at a given point in time.

To help them calculate price level, economists use a price index. A **price index** is a measurement that shows how the average price of a standard group of goods changes over time. A price index produces an average that economists compare to earlier averages to see how much prices have changed over time.

Using Price Indexes

Price indexes help consumers and businesspeople make economic decisions. For example, after Marina read in the newspaper that prices for consumer goods had been rising, she increased the amount of money she was saving for a new car. She wanted to be sure that when the time came to buy the car, she had saved enough money to pay for it.

The government also uses indexes in making policy decisions. A member of Congress, for example, might push for an increase in the minimum wage if she thinks inflation has reduced purchasing power.

The Consumer Price Index

Although there are several price indexes, the best-known index focuses on consumers. The **Consumer Price Index** (CPI) is computed each month by the Bureau of Labor Statistics (BLS). The CPI is determined by measuring the price of a standard group of goods meant to represent the “market basket” of a typical urban consumer. This **market basket** is a representative collection of goods and services. By looking at the CPI, consumers, businesses, and the government can compare the cost of a group of goods this month with what the same or a similar group cost months or even years ago.

Figure 13.3 CPI Market Basket Items

Category	Examples
Food and Drinks	cereals, coffee, chicken, milk, restaurant meals
Housing	rent, homeowners' costs, fuel oil
Apparel and upkeep	men's shirts, women's dresses, jewelry
Transportation	airfares, new and used cars, gasoline, auto insurance
Medical care	prescription medicines, eye care, physicians' services
Entertainment	newspapers, toys, musical instruments
Education and communication	tuition, postage, telephone services, computers
Other goods and services	haircuts, cosmetics, bank fees

SOURCE: Bureau of Labor Statistics

As you can see from **Figure 13.3**, the CPI market basket is divided into eight categories of goods and services. These categories and a few examples of the many items in each group are shown above.

About every 10 years, the items in the market basket are updated to account for shifting consumer buying habits. The BLS determines how the market basket should change by conducting a Consumer Expenditure Survey. The BLS conducted one such survey from 2000 to 2001, collecting spending information from 10,000 families. Another 7,500 families kept diaries, noting everything they purchased during a two-week period for both years. This process resulted in the list of market basket items used today.

Price Indexes and the Inflation Rate
Economists also find it useful to calculate the **inflation rate**—the percentage rate of change in price level over time. (To learn how to calculate the inflation rate, go to page 358.) Since the CPI is the most familiar price index, we will focus on it. How does the BLS determine the CPI and use it to calculate the inflation rate?

CHART SKILLS

The CPI market basket helps economists calculate the average inflation rate for the country.

1. Why might an individual family experience an inflation rate that is higher or lower than the national average?
2. Which categories of market basket items are currently experiencing sharp price increases?

price index a measurement that shows how the average price of a standard group of goods changes over time

Consumer Price Index a price index determined by measuring the price of a standard group of goods meant to represent the “market basket” of a typical urban consumer

market basket a representative collection of goods and services

inflation rate the percentage rate of change in price level over time

VISUAL GLOSSARY

Reviewing Key Terms

To understand *inflation*, review these terms:

business cycle, p. 57

inflation, p. 342

purchasing power, p. 342

price index, p. 343

inflation rate, p. 343

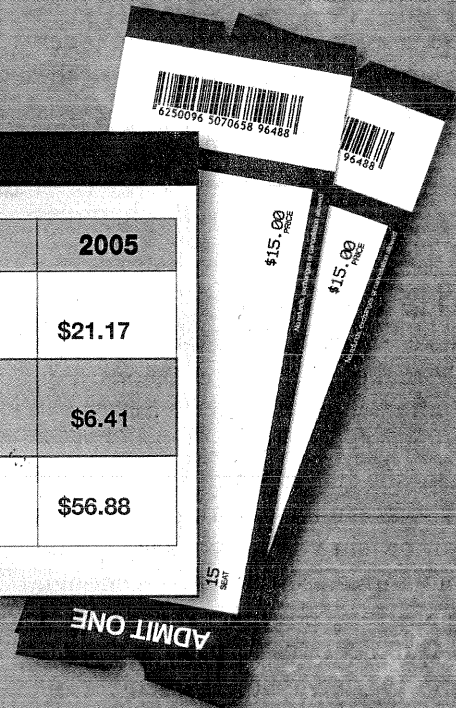
What is Inflation?

◀ **inflation** a general rise in prices across an economy

The Effects of Inflation on Entertainment

	1985	1995	2005
Average Price of a Ticket for a Major League Baseball Game	\$10.14	\$10.65	\$21.17
Average Price of a Movie Theater Ticket	\$3.55	\$4.35	\$6.41
Average Price for a Top 25 Concert Ticket	\$15.31	\$25.40	\$56.88

SOURCE: EH, Net Encyclopedia; www.teammarketing.com; National Association of Theatre Owners; www.msnbc.msn.com



Inflation has driven up the price you pay for admission to different kinds of entertainment. **What inputs may have contributed to higher ticket prices for these events?**



◀ In this cartoon, inflation has caused the cost of living to skyrocket while wages remain the same. **How will consumers react to an increase in the cost of goods and services? How might an increase in wages affect prices?**

Visual Glossary
online

To expand your understanding of this and other key economic terms, visit PearsonSchool.com/PHecon

Determining the CPI

To determine the CPI, the BLS establishes a base period to which it can compare current prices. Currently, the base period is 1982–1984. The cost of the market basket for that period is assigned the index number 100. Every month, BLS representatives update the cost of the same market basket of goods and services by rechecking all the prices. Each updated cost is compared with the base-period cost to determine the index for that month. As costs rise, the index rises.

The BLS determines the CPI for a given year using the following formula.

$$\text{CPI} = \frac{\text{updated cost}}{\text{base period cost}} \times 100$$

For example, suppose the market basket cost \$200 during the base period and costs \$360 today. The CPI for today would be:

$$\frac{\$360}{\$200} \times 100 = 180$$

In this example, the CPI rose from 100 in the base period to 180 today.

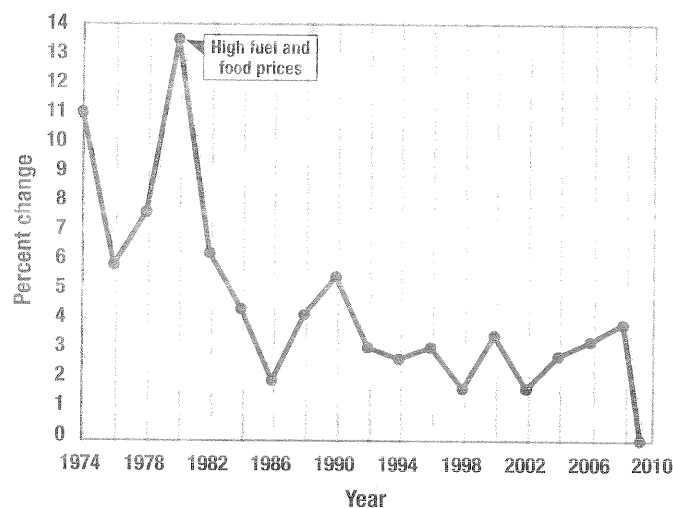
Types of Inflation

Inflation rates in the United States have changed greatly over time. When the inflation rate stays low—between 1 and 3 percent—it does not typically cause problems for the economy. In this environment, businesses and governments can make plans. When the inflation rate exceeds 5 percent, however, the inflation rate itself becomes unstable and unpredictable. This makes planning very difficult.

As you can see in **Figure 13.4**, the inflation rate sometimes spikes sharply, as in 1974 and 1980. These sharp increases in the inflation rate were due in part to increases in prices in world food and oil markets. In order to study long-term trends in the inflation rate, analysts need to set aside temporary spikes in food and fuel prices. To do this, economists have developed the concept of a core inflation rate. The **core inflation rate** is the rate of inflation excluding the effects of food and energy prices.

By far the worst kind of inflation is **hyperinflation**, or inflation that is out of control. During periods of hyperinflation, inflation rates can go as high as 100 or

Figure 13.4 Inflation Rate



SOURCE: Bureau of Labor Statistics

GRAPH SKILLS

Sharp inflation rate increases in 1974 and 1980 were due in part to increases in food and oil prices. An inflation rate of 1 to 3 percent does not typically cause economic problems.

1. In what two years was the inflation rate highest?
2. Why was the period from 1974 to 1982 a difficult time for people on fixed incomes?

even 500 percent per month, and money loses much of its value. This level of inflation is rare, but when it occurs it often leads to a total economic collapse.

CHECKPOINT How do economists calculate the CPI?

Causes of Inflation

Where does inflation come from? Price levels can rise steeply when demand for goods and services exceeds the supply available at current prices, such as during wartime. They can also rise steeply when productivity is restricted, for example, when a long drought leads to poor harvests.

Nobody can explain every instance of rising price levels. However, economists have several theories about the causes of inflation. These include the growth of the money supply, changes in aggregate demand, and changes in aggregate supply. Economists look at all these elements when they try to understand the inflation process.

Simulation Activity

Creating a Teenage Consumer Price Index

You may be asked to create a Teenage Consumer Price Index as part of a role-playing game.

core inflation rate the rate of inflation excluding the effects of food and energy prices

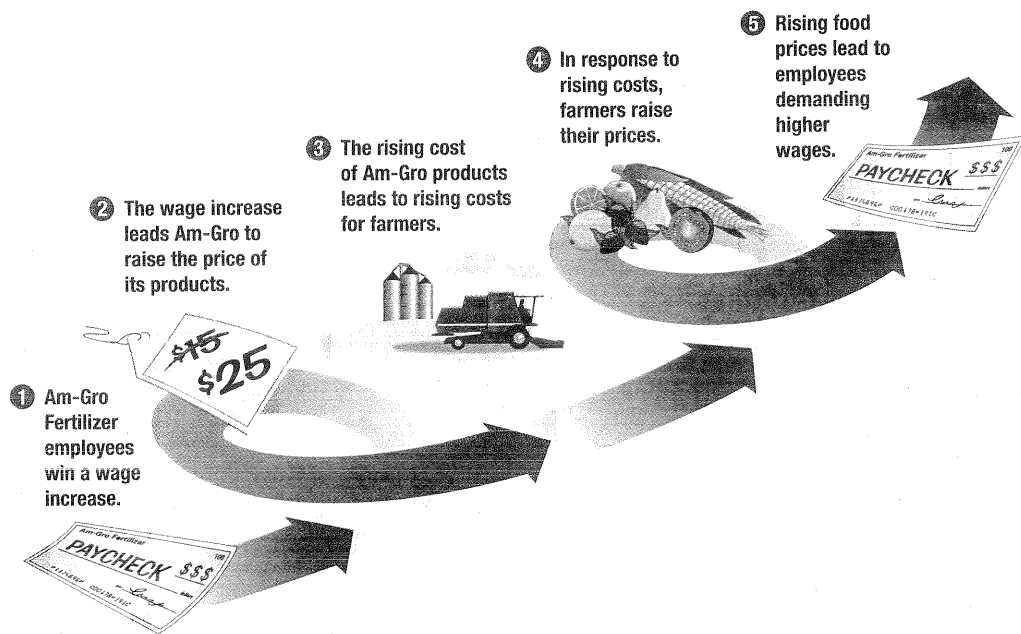
hyperinflation inflation that is out of control

Figure 13.5 The Wage-Price Spiral

CHART SKILLS

Inflation caused by the push of higher costs can lead to a wage-price spiral of increasing prices.

1. Why do rising food prices fuel a wage-price spiral?
2. How might globalization and outsourcing affect the wage-price spiral?



Growth of the Money Supply

The **quantity theory** of inflation states that too much money in the economy causes inflation. Therefore, the money supply should be carefully monitored to keep it in line with the nation's productivity as measured by real GDP.

Economists at the University of Chicago developed a popular version of this theory in the 1950s and 1960s. They maintained that the money supply could be used to control price levels in the long term. The key to stable prices, they said, was to increase the supply of money at the same rate as the economy was growing.

Changes in Aggregate Demand

As you learned in Chapter 12, aggregate demand is the amount of goods and services in the economy that will be purchased at all possible price levels. Inflation can occur when demand for goods and services exceeds existing supplies. During wartime, for example, the government's need for military supplies puts pressure on producers. The heavy demand for new equipment, supplies, and services increases the value of those items, pushing prices up. Wages

also rise as the demand for labor increases along with the demand for goods.

Changes in Aggregate Supply

Finally, inflation occurs when producers raise prices in order to meet increased costs. Higher prices for raw materials can cause costs to increase. Wage increases, however, are most often the biggest reason, because wages are the largest single production cost for most companies.

One cause of wage increases is low unemployment. Employers must then offer higher wages to attract workers. Wage increases can also occur as a result of collective bargaining.

For example, Jen is a union laborer at Am-Gro Fertilizer. The union she belongs to recently won a large wage increase from the company. The increased cost for labor led Am-Gro to raise its prices in order to maintain its profits.

Such a situation can lead to a spiral of ever-higher prices, because one increase in costs leads to an increase in prices, which leads to another increase in costs, and on and on. The process by which rising wages cause higher prices, and higher prices cause

quantity theory the theory that too much money in the economy causes inflation

higher wages, is known as the **wage-price spiral**. The effect of a wage-price spiral on Am-Gro Fertilizer is shown in Figure 13.5.

✓ **CHECKPOINT** What are the three causes of inflation?

Effects of Inflation

High inflation is a major economic problem, especially when inflation rates change greatly from year to year. Buyers and sellers find planning for the future difficult, if not impossible. The effects of inflation can be seen mainly in purchasing power, income, and interest rates.

Effects on Purchasing Power

You have seen, in the example of Jack and Josephine Barrow's house, how inflation can erode purchasing power. In an inflationary economy, a dollar will not buy the same number of goods that it did in years past. When there is no inflation, \$1.00 buys the same amount of goods it did in the previous year. If the inflation rate is 10 percent this year, however, \$1.00 will buy the equivalent of only \$.90 worth of goods today. In this case, the purchasing power of a dollar has fallen.

Effects on Income

Inflation sometimes, but not always, erodes income. If wage increases match the inflation rate, a worker's real income stays the same. People who do not receive their income as wages, such as doctors, lawyers, and businesspeople, can often increase their incomes by raising the prices they charge in order to keep up with inflation.

Not all people are so fortunate. If workers' wages do not increase as much as inflation does, they are in a worse economic position than before. Since prices are higher, their income has less purchasing power.

People living on a fixed income are especially hard hit by inflation. A **fixed income** is income that does not increase even when prices go up. The Barrows, for example, who are retired, are hurt by high inflation. The portion of their income from Social Security payments rises with the price level, because the government raises Social Security benefits to keep up

with inflation. Much of their income, however, comes from a pension fund that pays them a fixed amount of money each month. Inflation steadily eats away at the real value of that pension check.

Effects on Interest Rates

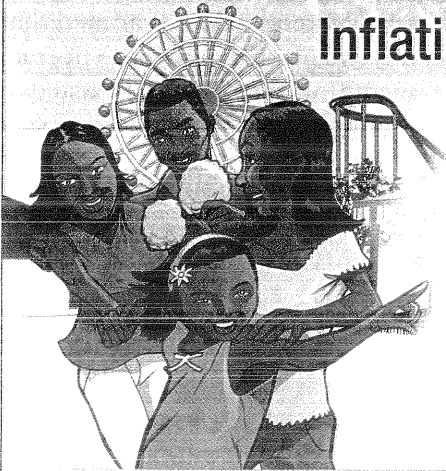
People receive a given amount of interest on money in their savings accounts, but their true return depends on the rate of inflation. For example, Sonia had her savings in an account that paid 7 percent interest. At the same time, the annual inflation rate was 5 percent. As a result, the purchasing power of Sonia's savings increased that year by only 2 percent, because 5 percent of her interest was needed to keep up with inflation.

wage-price spiral the process by which rising wages cause higher prices, and higher prices cause higher wages

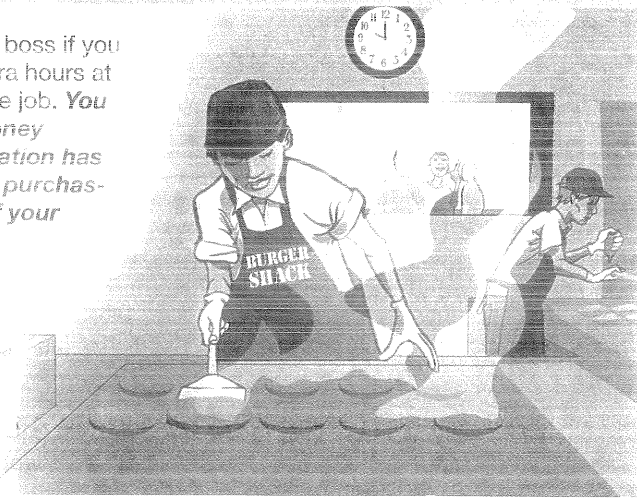
fixed income income that does not increase even when prices go up

Economics & YOU

Inflation



Instead of a cross-country vacation to see the Grand Canyon, your family takes some day trips. **Due to higher prices caused by inflation, your family cannot afford to travel across the country.**



You ask your boss if you can work extra hours at your part-time job. **You need the money because inflation has reduced the purchasing power of your paycheck.**

▲ As a consumer, you can feel the pinch of higher prices. **How has inflation changed your spending habits?**

deflation a sustained drop in the price level

When a bank's interest rate matches the inflation rate, savers break even. The amount they gain from interest is taken away by inflation. However, if the inflation rate is higher than the bank's interest rate, savers lose money.

✓ **CHECKPOINT** *What happens when income doesn't keep pace with inflation?*

Recent Trends in Inflation

Americans over age 30 have experienced fairly low inflation rates for most of their lifetimes. In the late 1990s, unemployment levels were low. Typically, low unemployment leads to higher inflation because companies compete for scarce workers by offering higher wages. Rising wages can push the inflation rate up, as you know from the discussion of the wage-price spiral. However, inflation crept along at less than 3 percent. Some economists suggested that the economy was going through a lucky streak. Others argued that the economy was returning to the normal levels of unemployment that had existed in the 1950s and 1960s.

As the economy entered a period of recession and slow growth in the 2000s, inflation fell to less than 2 percent. Rising

unemployment and falling capital investment removed two factors that might have led to inflation due to increases in aggregate supply. Prices at times seemed to be falling. Some experts even predicted a period of **deflation**, or a sustained drop in the price level. However, the economy recovered.

Although inflation remained relatively low through 2007, by mid-2008, soaring energy costs had pushed the inflation rate past 4 percent. The CPI recorded its biggest monthly gain since 1982. Consumers, pressured by sharp price increases for food and gasoline, had less demand for big-ticket items such as household appliances and automobiles.

By the end of 2008, the economy was in crisis. A severe recession led to a slowdown in economic activity. Global demand for oil dropped and the price of gasoline plunged by 30 percent in one month. The CPI was 3 percent lower than it had been just three months earlier. The record decline in retail prices and sales put added pressure on the federal government to solve the economic crisis and avoid a deflationary spiral in prices.

✓ **CHECKPOINT** *How does low unemployment lead to higher inflation?*

SECTION 2 ASSESSMENT

Essential Questions Journal

To continue to build a response to the Essential Question, go to your Essential Questions Journal.

Guiding Question

1. Use your completed chart to answer this question: What are the causes and effects of inflation?
2. **Extension** Ten years ago you could buy a soda for \$0.75. Today the same soda costs \$1.25. What factors might have caused the price of the soda to rise?

Key Terms and Main Ideas

3. How does **inflation** influence **purchasing power**?
4. Why is the **Consumer Price Index** important?
5. What is **hyperinflation**?
6. What causes a **wage-price spiral**, and how does it affect the economy?
7. What are three possible effects of inflation? Explain or give an example of each.

Critical Thinking

8. **Explain (a)** What categories of goods and services are included in the CPI market basket? **(b)** What is the purpose of including these categories? **(c)** Why might an individual family experience an inflation rate that is higher or lower than the national average?
9. **Contrast (a)** How is the core inflation rate different from the inflation rate? **(b)** What is the purpose of calculating these two separate rates? **(c)** In what situation might the core inflation rate *not* be useful?
10. **Apply (a)** According to the quantity theory, what causes inflation? **(b)** Based on this theory, how can inflation be prevented? **(c)** What tools can the government use to achieve this goal? Give at least two examples.

Math Skills

11. Suppose the market basket cost \$800 during the base period and \$1,800 today. What is the CPI for today? (Remember, to calculate CPI, divide today's cost by the base period cost and multiply by 100.)
Visit PearsonSchool.com/PHecon for additional math help.

SECTION 3 Poverty

OBJECTIVES

1. **Define** who is poor, according to government standards.
2. **Describe** the causes of poverty.
3. **Analyze** the distribution of income in the United States.
4. **Summarize** government policies intended to combat poverty.

ECONOMIC DICTIONARY

As you read the section, look for the definitions of these **Key Terms**:

- poverty threshold
- poverty rate
- income distribution
- food stamp program
- Lorenz Curve
- enterprise zone
- block grant
- workfare



Guiding Question

What factors affect the poverty rate?

Copy this table and fill it in as you read to explain the causes of poverty.

Causes of Poverty	
Lack of education	Less education equals lower wages
Location	

Economics and You The United States has millions of people living in poverty. It also has one of the highest per capita GDPs in the world. How can that be? Looking at poverty rates among different groups of Americans reveals some important reasons.

Principles in Action Statistically, you are at greater risk for living in poverty if you come from a single-parent home, live in the inner city, or do not have at least a high school education. Other factors, including the way that income is distributed, also affect the poverty rate.

poverty threshold

the income level below which income is insufficient to support a family or household

Limited job opportunities and lower levels of education are some of the factors that contribute to rural poverty. ▼

The Poor

As you have read, the United States Bureau of the Census conducts extensive surveys to gather data about the American people. Its economists then analyze the data and organize it to reveal important characteristics. One key feature they look at is how many families and households live in poverty. The Census Bureau defines a *family* as a group of two or more people related by birth, marriage, or adoption who live in the same housing unit. A *household* is all people who live in the same housing unit, regardless of how they are related.

The Poverty Threshold

According to the government, a poor family is one whose total income is less than the amount required to satisfy the family's minimum needs. The Census Bureau determines the income level, known as the poverty threshold, required to meet those minimum needs. The **poverty threshold** is the income level below which income is insufficient to support a family or household.

The poverty threshold, or poverty line, varies with the size of the family. For example, in 2006, the poverty threshold for a single parent under age 65 with one child was \$13,896. For a family of four with two children, it was \$20,444. If a family's total income is below the poverty threshold, everyone in the family is counted as poor.

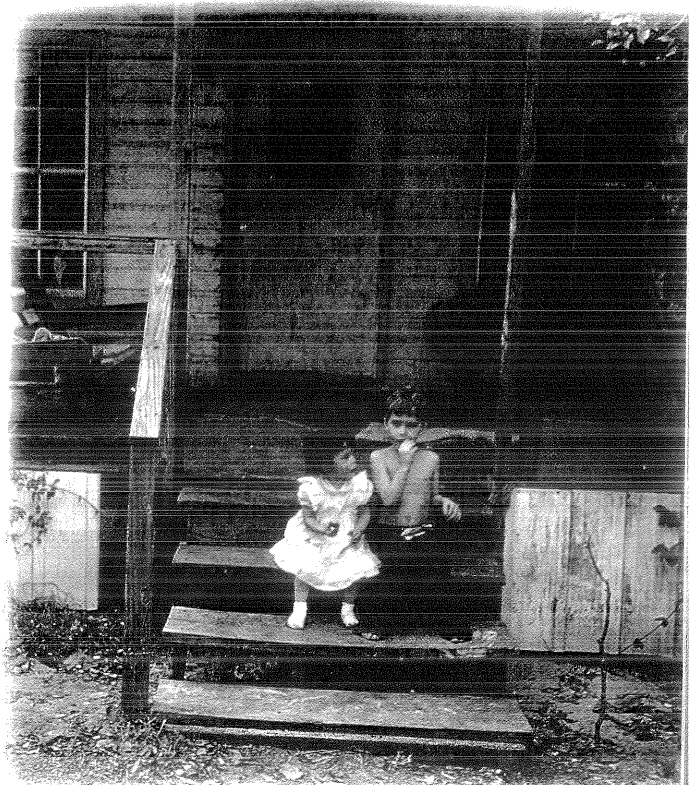


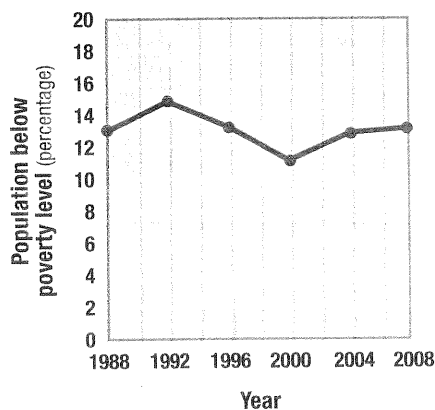
Figure 13.6

Poverty Rate

GRAPH SKILLS

In 2008, 13.2 percent of the population equals 39.8 million people.

1. What happened to the poverty rate from 1994 to 2000?
2. Why do you think the government tracks the poverty rate?



SOURCE: U.S. Census Bureau

The Poverty Rate

Trends in the national poverty rate are shown in **Figure 13.6**. The **poverty rate** is the percentage of people who live in households with income below the official poverty threshold.

Poverty rates for various groups are shown in **Figure 13.7**. We can use poverty rates to discover whom the government considers to be poor and what factors seem to contribute to poverty. Poverty rates differ sharply by groups, according to several different indicators:

- **Race and ethnic origin** The poverty rate among African Americans, Hispanics, and Native Americans is more than twice the rate for white Americans.
- **Type of Family** Families with a single mother have a poverty rate more than four times greater than that of two-parent families.
- **Age** The percentage of children living in poverty is significantly larger than that for any other age group. Adults over 65 are the next largest group.
- **Residence** Inner city residents have double the poverty rate of those who live outside the inner city. People who live in rural areas also have a higher poverty rate, especially in regions where job prospects are limited.

CHECKPOINT What is one reason for the higher poverty rate in rural areas?

poverty rate the percentage of people who live in households with income below the official poverty threshold

Causes of Poverty

Put simply, a family is poor when the adults in the family fail to earn enough income to provide for its members' basic needs. This failure to earn adequate income is often the result of unemployment.

As you read in Section 1, millions of Americans are unemployed for a variety of reasons. While they are out of a job, their families might well fall below the poverty threshold. Many other poor adults are not even considered a part of the labor force. Some suffer from chronic health problems or disabilities that prevent them from working. Others are discouraged workers who are no longer looking for work.

Many poor adults do have jobs, however. In fact, more than half of poor households have someone who works at least part-time, and one in five have a full-time, year-round worker. For these "working poor," the problem is usually low wages or a limited work schedule, rather than the lack of a job. For example, Ray makes \$9.00 an hour as a full-time clerk in a clothing store. While he is at work, his wife stays at home with their two young children. Although Ray works 40 hours per week, and his salary is well above the minimum wage, his annual earnings amount to just \$18,720, which is below the poverty threshold for a family of four.

Economists agree that poverty and lack of income go hand in hand, but they have different ideas about the causes of poverty. Here are some of the most important explanations for why some people are poor.

Shifts in Family Structure

Single-parent families are more likely to live in poverty than two-parent families. That is especially the case when the lone parent is a single mother. The divorce rate has risen significantly since the 1960s, as has the number of children born to unmarried parents. These demographic shifts tend to result in more single-parent families and more children living in poverty.

Location

In most American cities, racial minorities are concentrated in the inner cities, far from the higher-wage jobs in suburban areas. Many of these inner-city residents do not own cars, and mass-transit systems are often not an efficient means of commuting from the inner city to the suburbs. As a result, people who live in the inner city earn less than people living outside the inner city. Similar obstacles exist for many people living in rural areas, where there is little business or industry.

Racial and Gender Discrimination

White workers generally earn higher salaries than minority workers, and men generally earn more than women. Much of this income inequality can be explained by differences in hours worked, education, and work experience. Part of the inequality, however, results from racial and gender discrimination. Even when all the workers in a group are equally productive, whites are often paid more than African Americans, and men are often paid more than women. Economists agree, however, that discrimination based on race or gender has been diminishing.

Growth of Low-Skill Service Jobs

In the past, less-educated people could earn good wages working in manufacturing jobs. Globalization, the decline in manufacturing, and the rise of the service economy has led to a decline in the number of higher-paying manufacturing jobs. More workers with less education now work in low-skill service jobs, where wages are often not as high as they are for factory jobs.

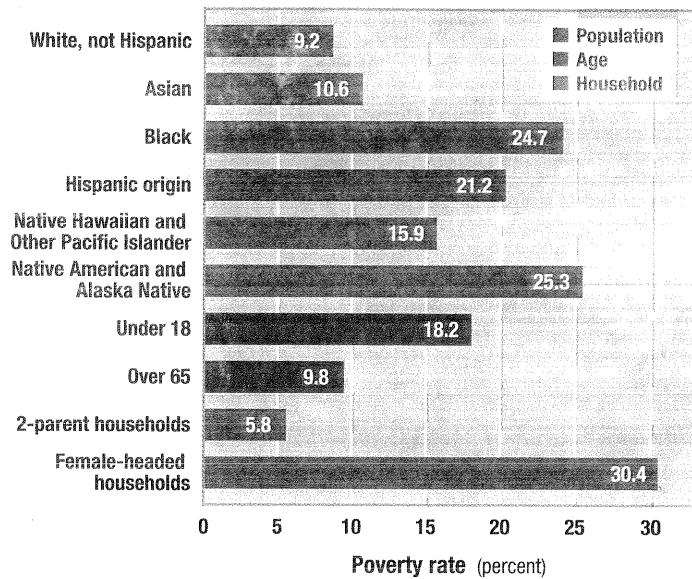
Lack of Education

The median income of high school dropouts in 2006 was \$25,912, which was above the poverty threshold for a family of four in that year. High-school graduates earned about two-thirds more than the dropouts and college graduates earned more than three times as much.

CHECKPOINT What are three causes of poverty?

Figure 13.7

Poverty Rates by Group, 2008



SOURCE: U.S. Census Bureau

GRAPH SKILLS

Households headed by women, African Americans, Hispanics, and Native Americans are more likely than other groups to have incomes below the poverty threshold, as this recent data shows.

1. Which population group has the highest poverty rate?
2. Why do you think differences exist in poverty rates among groups?

Income Distribution

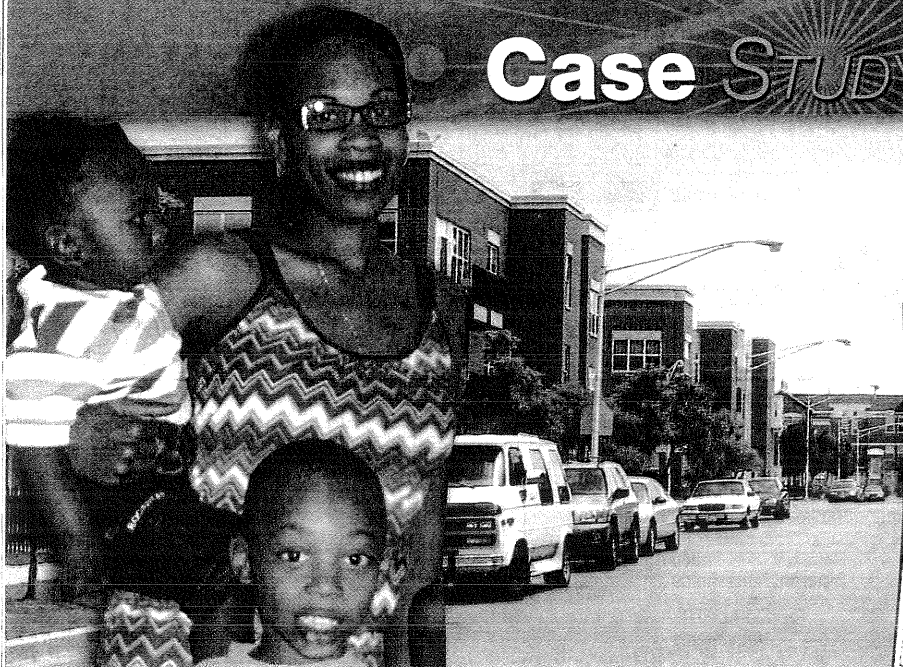
In 2006, the estimated median household income in the United States was \$48,023, which means that half the households earned more than this amount and half earned less. This figure tells only part of the income story. To fully understand poverty in this country, you also need to understand **income distribution**, or how the nation's total income is distributed among its population.

Income Inequality

Income distribution in the United States is shown in Figure 13.8 on page 353. These figures do not reflect the effects of taxes or non-cash government aid such as housing subsidies, healthcare, or food stamps. The **food stamp program** helps low-income people buy food. Benefits are provided on an electronic card that is accepted at most food stores.

income distribution
the way in which a nation's total income is distributed among its population

food stamp program
government program that helps low-income recipients to buy food.



Extra Credit

ANTIPOVERTY PROGRAMS

Incentive programs for the poor offer an alternative to traditional welfare.

By Jonathan Eig
The Wall Street Journal

Consumers earn rewards for flying, for using credit cards and for staying at hotels. In one low-income Chicago neighborhood, residents are earning rewards for paying their rent, getting their children to school every day and seeking work.

The “Pathways to Rewards” program has awarded about \$19,000 in prizes to about 130 people since its inception. It is one of several small, local programs around the country attempting to use incentives to help the poor improve their lives.

At a recent rewards banquet, more than 150 people gathered in a church basement to celebrate and cash in points for prizes. Devant-e and Ireonna Brown, 10 and 7, rode off on new bicycles with points earned for school attendance and volunteer work. Their

mother, Marilyn, walked away with a DVD player, thanks to points earned mostly for attending PTA meetings.

In the Pathways program, participants tell a counselor what they want to buy and how much it costs. Then the required number of points is set. Each point is worth one dollar. When the participant accumulates enough points, the counselor arranges either a gift certificate or a check made out to the store. Cash is never exchanged.

Incentive-based programs have sprung up in recent years because they are more politically palatable than traditional welfare benefits, and because advocates say such programs offer a better chance of changing the behaviors tied up with poverty. But incentives aren’t safety nets. And it’s not clear whether they are enough to

prompt meaningful long-term changes for those entrenched in poverty.

No one is saying this small experiment will be enough to transform a poor neighborhood. “It’s a piece of the puzzle,” says Crystal Palmer, a social worker with the nonprofit Near West Side Community Development Corp., a partner in the Pathways to Rewards program.

“The clients who are doing well [in Pathways] are the clients who are already motivated,” says Vorrucia Harvey, program director for the Near West Side CDC. “It’s an incentive to say, ‘You’re doing well, keep it up.’”

Some social workers and area residents complain that Pathways is paying people to do things they ought to be doing anyway. Even some of the program’s participants say there’s truth to that. “But why not use it to my advantage?” asks Willie Wright. She used her points to help buy a computer.

Applying Economic Principles

Rewards programs are one approach to changing behaviors linked to poverty. But rewards programs do not provide basic necessities as traditional welfare programs do. Use the information in this section to give examples of other ways that people might be able to pull themselves out of poverty.

Video News Update Online
Powered by
The Wall Street Journal
Classroom Edition

Use videos at PearsonSchool.com/PHecon as a springboard for a discussion on a current topic.

Look at the table on the left side of **Figure 13.8**. To compute the numbers in the table, economists take four steps.

1. First, they rank the nation's households according to income.
2. Then, they divide the list into fifths, or quintiles, with equal numbers of households in each fifth. The lowest fifth, which appears at the top of the list, includes the poorest 20 percent of households. The highest fifth, shown at the bottom of the list, includes the richest 20 percent of households. The first column in **Figure 13.8** shows this division into quintiles.
3. Next, they compute each group's average income by adding up the incomes of all the households in the group, and then dividing by the number of households.
4. Finally, they compute each group's share, or percentage, of total income by dividing the group's total income by the total income of all the groups. The second column shows each group's share. The third column shows the cumulative total. (For example, the

lowest two fifths of households earned 12 percent of total income.)

Compare the share of the poorest fifth with that of the richest fifth. If you divide richest by poorest, you will see that the richest fifth receives nearly 15 times the income of the poorest fifth.

Now look at the graph on the right side of **Figure 13.8**. It shows that the numbers for shares of total income, when they are plotted on a graph, form a curve. This graph, called the **Lorenz Curve**, illustrates the distribution of income in the economy.

Let's see what this Lorenz Curve tells you. First, read the label on each axis. Then look at the straight line running diagonally across the graph. This reference line represents complete equality. Under conditions of complete equality, each quintile would receive one fifth of total income. That means the lowest 20 percent of households would receive 20 percent of total income, as shown by the point (lowest, 20). Similarly, the lowest 40 percent (the first two quintiles) would receive 40 percent of total income, as shown by the point (second, 40), and so on.

Lorenz Curve the curve that illustrates income distribution

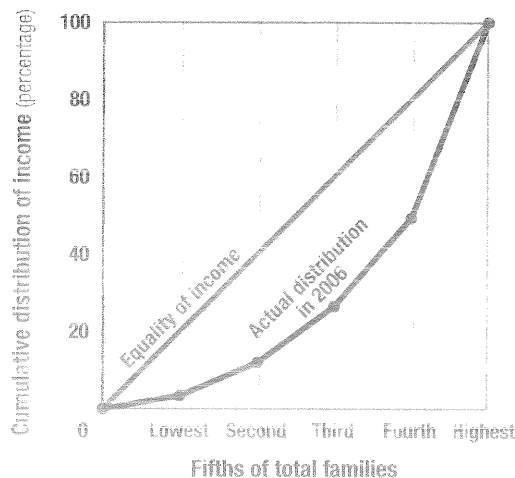
Figure 13.8 Income Distribution

Percent of Total Income, 2006

Quintile	Percent of income for quintile	Cumulative: Percent of income for this and lower quintiles
Lowest fifth	3.4%	3.4%
Second fifth	8.6%	12.0%
Third fifth	14.5%	26.5%
Fourth fifth	22.9%	49.4%
Highest fifth	50.5%	100.0%

Note: Because of rounding, totals may be greater than or less than 100 percent.
SOURCE: U.S. Census Bureau

Lorenz Curve



GRAPH SKILLS

The table (left) shows family income ranked by category. When plotted on a Lorenz Curve (right), these data show the distribution of income in the United States.

1. What percent of total income did the lowest three fifths of households make in 2006?
2. How would taxes and government programs affect the Lorenz Curve?

Action Graph
online

For an animated version of this graph, visit PearsonSchool.com/PHecon

In 2006, the distribution of income was not equal, as the Lorenz Curve indicates. For example, the point (lowest, 3.4) shows that the lowest 20 percent, or one fifth, of households received just 3.4 percent of the nation's total income. The point (second, 12) shows that the lowest 40 percent, or two fifths, of households received only 12 percent of the income. The area on the graph between the line of equality and the Lorenz Curve represents the amount of inequality in income distribution. The larger the area between the curves, the greater the income inequality.

Income Gap

As you can see from **Figure 13.8**, the wealthiest fifth of American households earned more income (50.5 percent) than the bottom four fifths combined. A study published in 1999 showed that after taxes are deducted, the richest 2.7 million Americans receive as much income as the poorest 100 million Americans. Why are there such differences in income among Americans? Here are some factors.

- **Differences in skills and education**
Some people are more highly skilled than others, so they earn higher wages. Labor skills are determined by education, training, and by a worker's natural ability.

- **Inheritances** Some people inherit large sums of money and earn income by investing it. Others inherit businesses that produce income from profits.
- **Field of work** Wages are determined by the demand for labor. As you read in Chapter 9, labor demand is a "derived demand" because it is set by demand for what people produce. People who produce goods with a low market value usually earn lower wages.

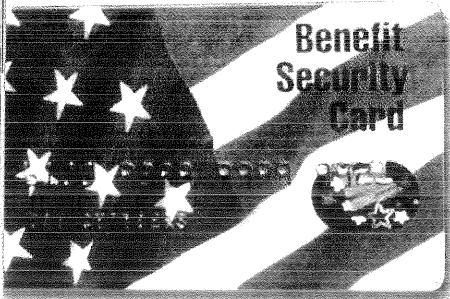
James Webb, a former Secretary of the Navy who won election to the United States Senate in 2006, commented on the growing income gap:

“America's top tier has grown infinitely richer and more removed over the past 25 years.... The top 1 percent now takes in an astounding 16 percent of national income, up from 8 percent in 1980.”

—James Webb, Democratic Senator-elect from Virginia,
The Wall Street Journal, Nov. 15, 2006

In fact, in the last two decades, the distribution of income has become less equal. Since 1977, the share of income earned by the lowest three fifths has decreased by 12 percent, while the share earned by the top 1 percent has more than doubled.

✔ **CHECKPOINT** What does income distribution tell economists?



The electronic benefits transfer card authorizes the transfer of government benefits, such as food stamps, for payment to retailers. Private charities run soup kitchens and food pantries to help the poor. ▶



CAREER CENTER

CIVIL SERVICE

Possible Careers

- Firefighter
- Police officer
- Tax examiner
- Magistrate
- **Social worker**
- License clerk
- Correctional officer

Profile: Social Worker

Duties:

- provide social services and assistance to improve the well-being of children and their families
- provide needed support to those coping with disease or chronic illness
- counsel individuals with mental illness or substance abuse problems

Education:

- bachelor's degree in social work, master's degree usually required for positions in health settings

Skills:

- sensitivity to people and their problems
- ability to maintain good relationships

Median Annual Salary:

- \$45,800 (2007)

Future prospects:

- The aging baby boom generation will create greater demand for social services, resulting in rapid job growth for gerontology social workers.
- Strong demand is expected for substance abuse social workers.



Career Link Activity

Choose another career in civil service from the list of possible careers. Create a profile for that career similar to the one for Social Worker.

Antipoverty Policies

As you read in Chapter 3, the government spends billions of dollars on programs designed to reduce poverty. This money is spent mainly on cash assistance, education, medical benefits, and non-cash benefits such as food stamps and subsidized housing.

Critics of antipoverty programs say that much of the money is wasted. Many argue that the programs themselves harm the very people they are intended to help. The criticisms have led to new policies. These include the Earned Income Tax Credit, the establishment of enterprise zones, job training and other employment assistance, housing assistance, and welfare reform.

The Earned Income Tax Credit

One of the government's most successful antipoverty programs is the Earned Income Tax Credit (EITC). The EITC is a refundable tax credit that low-income families with children receive when they file their federal income tax return. Eligibility is based on the taxpayer's earned income and the number of qualifying children. In 2010 for example, a married couple with

an earned income of \$40,363 and two children would receive a maximum credit of \$5,036.

Established in 1975 to offset the impact of the Social Security payroll tax on low-income families, the EITC has been expanded over the years. A report by the Center on Budget and Policy Priorities said that in 2005, the EITC lifted more than four million people above the official poverty line and was "the nation's most effective antipoverty program for working families."

Enterprise Zones

Enterprise zones, which became popular in the 1980s, are areas where companies can locate and be free of certain state, local, and federal taxes and restrictions on business operations. Zones benefit businesses by lowering their costs. They help local people by making it easier for them to find work. By providing jobs, these zones can help revitalize rundown areas such as inner cities.

Employment Assistance

In recent decades, federal and state governments have designed job-training programs to help workers who lack the skills to

enterprise zone area where businesses can locate free of certain state, local, and federal taxes and restrictions

block grants federal funds given to the states in lump sums

workfare a program requiring work in exchange for temporary government assistance

earn an adequate income. In addition, the federal government has made a minimum wage mandatory since 1938. The minimum wage ensures that workers' hourly pay will not fall below a certain point.

Housing Assistance

The government also has programs to help poor people obtain affordable housing. In one approach, the government makes payments to landlords who then lower the rent they would otherwise charge. In another program, poor people receive vouchers that cover part of the rent they pay. The third approach is government-owned housing, which charges low rental fees.

Welfare Reform

Poor people often cannot afford basic needs, such as food and medical care. The United States has long had a welfare system that provides for those basic needs, especially for children and the elderly. That system underwent major reform when President Clinton signed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996.

This welfare-reform plan responded to criticisms that welfare encouraged poor people to remain unemployed in order to keep receiving aid. It replaced the traditional antipoverty program for poor families (Aid to Families with Dependent Children, or AFDC) with a new program called Temporary Assistance for Needy Families (TANF). TANF eliminated cash assistance for poor families. Instead, the federal government provides **block grants**, or lump sums of money, to the states. The states are now responsible for designing and implementing programs to move most poor adults from welfare dependence to employment. TANF also set a 5-year limit on receipt of benefits.

The plan calls for a shift from welfare to **workfare**—a program requiring work in exchange for temporary assistance from the government. It was hoped that this reform would reduce poverty by providing poor Americans with labor skills and access to a steady, adequate income.

✓ **CHECKPOINT** *What was the goal of TANF?*

SECTION 3 ASSESSMENT

Essential Questions
Journal

To continue to build a response to the Essential Question, go to your Essential Questions Journal.

Guiding Question

1. Use your completed table to answer this question: What factors affect the poverty rate?
2. **Extension** Two candidates for your state legislature have outlined their plans to reduce poverty in the state. The candidates will debate next week, and the public is invited to submit suggestions. What one suggestion would you offer to reduce poverty?

Key Terms and Main Ideas

3. How is the **poverty threshold** related to the **poverty rate**?
4. Explain how a family can include working adults but still have an income below the poverty threshold.
5. How does lack of education contribute to poverty?
6. What is the **Lorenz Curve** and what does a current Lorenz Curve show about the distribution of income in the United States?

7. Describe at least three ways in which the government combats poverty.

Critical Thinking

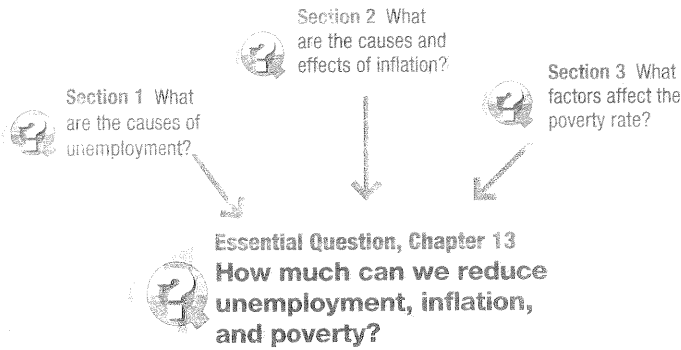
8. **Extend (a)** What kinds of families are more likely to live in poverty? **(b)** Why do you think these families have a greater risk of being poor?
9. **Predict (a)** What are three reasons for differences in income among Americans? **(b)** Do you think these differences are a problem? Why or why not? **(c)** In what ways might the government help make these differences smaller?
10. **Explain (a)** How did the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 change the assistance the government provides to poor families? **(b)** What are some benefits of these new programs? **(c)** What are some drawbacks? Explain your answers.

Quick Write

11. Reread the text under the Income Gap heading in this section. Then write two paragraphs on the income gap. In the first paragraph, describe how the income gap affects society, including economic growth and standard of living. In the second paragraph, predict what the long-term effects would be if the income gap increased, or what the long-term effects would be if the income gap decreased.

QUICK STUDY GUIDE

Chapter 13: Economic Challenges



Economic Indicators

Unemployment rate	The percentage of the nation's labor force that is unemployed	To find the unemployment rate, divide the number of unemployed people by the total labor force and multiply by 100.
Inflation rate	The percentage rate of change in price level over time as measured by the Consumer Price Index	To calculate the inflation rate, subtract the base year CPI from the current CPI. Then divide the result by the base year CPI and multiply that result by 100.
Poverty rate	The percentage of people who live in households with income below the official poverty threshold	The government establishes a poverty threshold, an income level below which total income is insufficient to support a family or household.

Economic Dictionary

frictional unemployment, p. 335
 structural unemployment, p. 336
 globalization, p. 337
 seasonal unemployment, p. 338
 cyclical unemployment, p. 338
 unemployment rate, p. 339
 full employment, p. 340
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Key Terms and Main Ideas

To make sure you understand the key terms and main ideas of this chapter, review the Checkpoint and Section Assessment questions and look at the Quick Study Guide on the preceding page.

Critical Thinking

- Predict (a)** What does the unemployment rate tell about a country's economy? **(b)** How is full employment related to the unemployment rate? **(c)** What issues might arise if the economy reached full employment?
- Apply (a)** What might cause inflation in food prices? **(b)** How would you react to higher food prices? **(c)** How could this type of inflation contribute to unemployment and poverty? Explain your answers.
- Draw Conclusions (a)** According to the quantity theory, how can the government limit inflation? **(b)** What other tools can the government use to control inflation? **(c)** Why would the government want to reduce inflation?
- Extend (a)** What are the most recognized causes of poverty? **(b)** What kinds of assistance might a poor family be able to get from the government? **(c)** What combination of personal action and good fortune could help a person rise out of poverty?
- Make Judgments (a)** On May 25, 2007, President George W. Bush signed a bill to increase the federal minimum wage in three steps: to \$5.85 per hour starting in July 2007; to \$6.55 per hour starting in July 2008; and to \$7.25 per hour starting in July 2009. What are some possible results of raising the minimum wage? **(b)** Why



do you think the government chose to raise the minimum wage in stages, rather than all at once? **(c)** Do you think this is a good strategy? Why or why not?

Applying Your Math Skills

Calculate the Inflation Rate

Use your math skills and the formula below to answer the following questions. Suppose that the CPI for last year was 164 and that for this year it is 168.

Visit PearsonSchool.com/PHecon for additional math help.

Calculating the Inflation Rate

To calculate the inflation rate, use the following formula:

CPI for Year A minus CPI for Year B divided by CPI for Year B multiplied by 100

For example,

If the CPI for 2004 (Year A) = 188.9
and the CPI for 2003 (Year B) = 184.0

then,

$$188.9 - 184.0 = 4.9$$

$$4.9 \div 184.0 = .027$$

$$.027 \times 100 = 2.7$$

Therefore,

the inflation rate for 2004 was 2.7%.

- Calculate the inflation rate from last year to this year.
- Suppose the CPI for the year before last year was 160. What was the inflation rate from the previous year to last year?
- If the inflation rate were 0%, what would the CPI be for next year?
- If the inflation rate were 10%, what would the CPI be for next year?



Essential Question Activity

Essential Questions Journal

To respond to the chapter Essential Question, go to your **Essential Questions Journal**.

- Complete this activity to answer the Essential Question **How much can we reduce unemployment, inflation, and poverty?** Your class should be divided into three groups. Each group is advising the President of the United States on ways that the federal government can help reduce unemployment, inflation, and poverty. Using the worksheet in your Essential Questions Journal or the electronic worksheet available at PearsonSchool.com/PHecon, gather the following information:
 - With globalization accelerating, and the loss of America's manufacturing base, what can we do to reduce unemployment? What is one benefit and one drawback of your plan?
 - What strategy or strategies would you recommend to reduce inflation? What is one benefit and one drawback of your plan?
 - What strategy or strategies would you recommend to reduce poverty? What is one benefit and one drawback of your plan?
- Modify** Present your group's ideas to the class. As a class, discuss the suggestions from all the groups.
 - What are the best ideas for reducing unemployment? What are the best ideas for controlling inflation? What are the best ideas for reducing poverty?
 - Do any of these ideas and goals conflict with each other? (For example, cutting taxes without reducing government spending could trigger inflation. Cutting taxes and cutting spending on entitlement programs could put more children below the poverty level.) How?
 - How can these conflicts best be resolved?
 - At the conclusion of your discussion, identify which steps you think would be most effective and most acceptable to the majority of the population.

DOCUMENT-BASED ASSESSMENT

Should the government help the poor?

In the United States, the federal government and local governments provide many kinds of welfare assistance to the poor. Some people argue that this aid is necessary to help reduce poverty. Others believe that providing welfare is not an appropriate role for government, and that private organizations can do a better job of helping the poor. Some also feel that government aid makes people less able and willing to earn a living independently.

Document A

"Voluntary charities and organizations, such as friendly societies that devoted themselves to helping those in need, flourished in the days before the welfare state turned charity into a government function.... Today, government welfare programs have supplemented the old-style private programs.... Releasing the charitable impulses of the American people by freeing them from the excessive tax burden so they can devote more of their resources to charity, is a moral and constitutional means of helping the needy."

—Representative Ron Paul (R-TX) in the U.S. House of Representatives, February 13, 2003

Document B

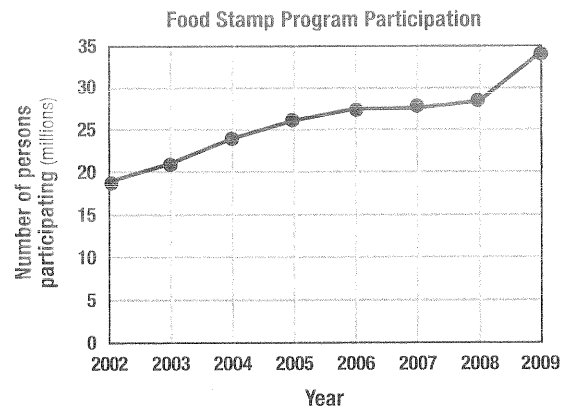
"What's most overwhelming about urban poverty is that it's so difficult to escape—it's isolating and it's everywhere....When you're in these neighborhoods, you can see what a difference it makes to have a government that

cares. You can see what a free lunch program does for a hungry child. You can see what a little extra money from an earned income tax credit does for a family that's struggling. You can see what prenatal care does for the health of a mother and a newborn. So don't tell me there's no role for government in lifting up our cities."

—Senator Barack Obama (D-IL) speech in Washington, DC, July 18, 2007

www.barackobama.com

Document C



SOURCE: United States Department of Agriculture, Food and Nutrition Service

ANALYZING DOCUMENTS

Use your knowledge of government aid to the poor and Documents A, B, and C to answer questions 1–3.

- 1. According to Document A, what does Representative Ron Paul believe would be a better alternative to federal welfare payments to the poor?**
 - A. local government welfare programs
 - B. private charities
 - C. state government welfare programs
 - D. ignoring poverty
- 2. The author of Document B believes**
 - A. that ending poverty is too costly.
 - B. that Americans hear too much about poverty.
 - C. that fighting poverty is a job for government.
 - D. that government is not accountable for poverty
- 3. What does Document C suggest?**
 - A. Food stamps are preventing poverty.
 - B. The food stamp program is unsuccessful.
 - C. Poverty is increasing, so more people need food stamps.
 - D. The food stamp program should be privatized.

WRITING ABOUT ECONOMICS

Whether government aid is the best way to reduce poverty is an ongoing question. Use the documents on this page and resources on the Web site below to answer the question:
Should the government help the poor?

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