

THE U.S. ECONOMY

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Measuring the Economy

In order to plan for the needs of its people, a nation must be able to tell how its economy is doing. Economists use a number of ways to measure a national economy.

The **gross national product**, or **GNP**, measures a country's total production. GNP is the market value of all the goods and services a country produces in a given year. To avoid double counting, only the final goods and services are included. The values of the bricks, glass, mortar, and wood used to build a house, for instance, are not counted. Only the worth of the final good, the house itself, is included in the GNP.

Many economists think that in order to measure the true value of a country's GNP, they must look at the per capita GNP. The per capita GNP is the dollar amount they get when they divide the GNP by the number of people in the country. A country with a very large GNP may still be a poor country if its GNP must be distributed among a huge population. A country with a comparatively small GNP may be a rich country if its population is small.

Another important economic indicator is the **consumer price index**, or **CPI**. Increases in the CPI are used to measure **inflation**. Inflation occurs when prices keep rising. The CPI is calculated by keeping track of price changes in a "basket," or a particular group of goods and services that consumers normally buy in all parts of the country. Inflation in the United States is actually moderate compared with that of most other parts of the world.

Unemployment in a nation is measured by means of the unemployment rate. Unemployment occurs when there is not enough work for all the people who are looking for work. The unemployment rate is found by dividing the number of unemployed persons by the number of workers in the labor force, and then multiplying the result by 100. This gives a percentage figure. If 5 million people are unemployed, for example, and the labor force is 50 million, the unemployment rate will be 10 percent.

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Economic Growth

If a country's gross national product is increasing each year, economists say that its economy is growing. The percent of change in the GNP or per capita GNP from one year to the next measures the rate of a country's economic growth. If a country's GNP stays the same or goes down, it has experienced no economic growth for that year.

Most countries believe that economic growth is a good thing. If more and more goods and services are

produced, there will be more and more jobs for workers. There will also be more products for consumers, and life in general should keep getting better for the people of the country.

Economic growth can benefit more than one nation at a time. If the economy of the United States is growing, its producers will need to buy more materials from other countries. U.S. businesses will also have more money to invest in foreign businesses. The United States in turn can benefit from growing economies in other countries. The United States needs markets in other countries to sell its products. Countries with growing economies will have more money to buy U.S. goods. And the sale of U.S. goods abroad helps both business owners and workers at home.

Some people argue that economic growth does not always mean that a country is doing a good job of meeting its people's needs. In many countries, economic growth may help mainly those people who already have money—while the poor remain poor. And even though economic growth may bring more material goods, the people may not always be enjoying life more. Growth may go together with pollution of the environment and a hectic pace of life that increases everyday tensions.

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Economic Instability

Economic stability is a difficult goal for most countries to achieve. In a perfectly stable economy, economic growth would be combined with little or no inflation and low unemployment. No country, however, is free from inflation or unemployment.

Inflation is a constant rise in prices. It does not affect all people in the same way. Most salaried people and wage earners will feel some ill effects from inflation. People drawing Social Security or public welfare checks will suffer the most. Their incomes increase too slightly or much too slowly to keep up with the rate of price increases. The rich suffer least from inflation. They usually cut back on their savings rather than their spending. In addition, they are apt to own many stocks and bonds. During times of inflation, the interest earned by stocks and bonds may also go up; the income of rich shareholders may keep pace with inflation.

Another form of economic instability is **recession**. When a country is suffering from a recession, the production of goods and services declines. Some capital equipment, such as factories and machines, will be idle, and some workers will be unemployed. As a recession becomes more severe, unemployment increases.

A recession exists when a nation's GNP declines or fails to grow for a period of at least six months. When a recession lasts a long time and is very severe, it is called a **depression**. The worst depression in the history of the United States, the "Great Depression," occurred during the 1930s.

Inflation and recession occur under opposite circumstances. When the amount of money circulating—or being spent—in the economy greatly exceeds the value of available goods and services, prices go up. Inflation occurs. When there is too little money to pay for the available goods and services, production goes down and unemployment goes up. A recession occurs. At times, the United States and other countries have experienced yet a third form of instability, called **stagflation**. Stagflation means that the economy suffers from both high inflation and high unemployment.

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Policies for Economic Stability

The U.S. government fights economic instability on two main fronts: **fiscal** (budget) policy and **monetary** (money) policy. The government's fiscal policies decide how it will tax the people and how it will spend the money it collects. Its monetary policies dictate how much money will flow through the economy.

Inflation occurs when total demand and spending are greater than total production. To control inflation, the government may adopt a fiscal policy to cut down on its spending. Reducing the government's demand for goods and services reduces total demand. The decrease in demand tends to reduce inflation. The government can achieve the same result by increasing taxes without increasing government spending. Higher taxes will mean that individuals and businesses will have less income to spend. This will lower total demand and will tend to reduce inflation.

To fight recession, the government will reverse its fiscal policy. Instead of trying to reduce spending, the government will try to encourage it. The government probably will increase its own spending with the aim of boosting production, increasing jobs, and raising incomes. Or the government might reduce taxes. This would leave individuals and businesses with more money to spend and to invest.

Monetary policy in the United States lies with the Federal Reserve System, a government agency that is basically independent of Congress and the president. The Federal Reserve is basically a bank for banks. It holds a certain percentage of the banks' deposits, and it provides loans to banks.

The Federal Reserve controls the size of the money supply on a daily basis. During periods of *inflation*, the Federal Reserve *reduces* the amount of money flowing through the economy. Money then becomes scarcer, so it increases in value. The rise in prices slows down. During a *recession*, the Federal Reserve *expands* the money supply. This encourages producers to make more goods, and it gives the economy a needed boost.

Controlling the money supply has little to do with *printing* money. The Federal Reserve controls the money supply mainly through its dealings with banks. For instance, to fight inflation, the Federal Reserve can raise the **discount rate**. The discount rate is the rate of interest the Federal Reserve charges when it makes loans to private banks. Because banks must pay higher interest rates, they will raise the interest rates for their loans to customers. Individuals and businesses will borrow less money. Consequently, there will be less money in use and less pressure to increase prices. In times of recession, the Federal Reserve will take the opposite tack. It will lower the discount rate to increase the amount of money available for spending.

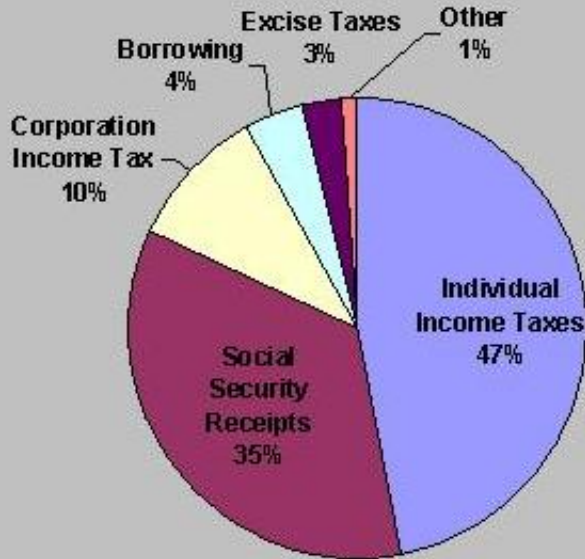
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Government Spending and Regulation

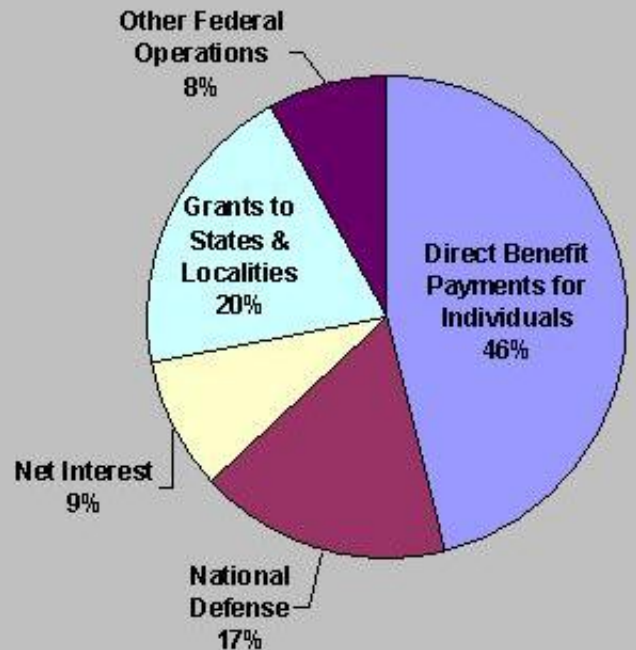
The government provides many services that are vital to all Americans. National defense, food and drug safety, highways, and Social Security's health and retirement benefits are just a few examples. The first graph below shows that the federal government gets most of the money to run its programs from taxes. It also borrows sizable sums from banks or from individuals who buy government bonds. The second graph shows that the government spends more than two-thirds of its money on national defense and benefit programs for individuals.

The Federal Government Dollar

Revenues: \$2.0 Trillion



Outlays: \$2.128 Trillion



If the government spends more than it takes in, the federal budget will show a **deficit**. Each year that the budget shows a deficit, the government's debt grows larger. The amount of interest the government owes on money it has borrowed also grows. The federal deficit for 2003 is expected to exceed \$200 billion. Many economists believe that large deficits will lead to higher interest rates. They also predict that other economic problems may result. Federal budget deficits have attracted the concern of thoughtful government leaders, citizens, and economists.

Private business is well aware of the government's presence in the economy. Government **antitrust laws** stand to prevent any one company from becoming so large that it eliminates all competitors. The government also plays public watchdog on private business practices. Factories that pollute the environment, for instance, must pay higher taxes.

Some people charge that the government's involvement in the economy does more harm than good. Some believe that government taxes discourage people in business. Other critics think that many of the government's safety standards are so high and so expensive that producers are forced to raise prices of goods. And then there is the enormous paperwork that government requires of business.

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