

## OGT REVIEW

### Market Economy

- **Market economies** base production decisions **on supply and demand**.
- In a **market economy**, businesses produce goods and services that consumers demand because the **businesses want to make a profit** and are **free to make production decisions**.
  - Businesses determine what to produce **based on consumer choice**.
- Under a market economy, **private industry/individuals** determines how much to produce in the event of high demand.
- In determining what to produce, how do market economies **typically respond to high consumer demand for a product**?
  - Private companies increase production of the product

### Reducing personal income tax rates and decreasing unemployment



- **By reducing personal income tax rates**, the U.S. government can promote economic growth because **lowered** income tax rates generally mean that **consumers have more money to spend on goods and services**.
- This increased spending **would cause companies to produce more goods and services to meet increased demand**. This could **lead to hiring more workers** and expanding businesses, which would stimulate the economy.



**Increasing** Income tax is related to unemployment



- What would be the expected effect on consumer spending and on the unemployment rate if the United States government were to **increase** personal income tax rates?

#### Explanation of Correct Answer

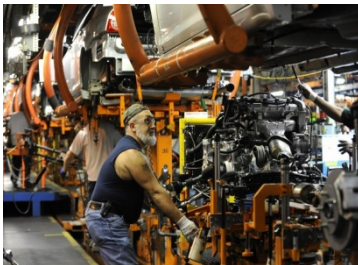
- If the U.S. government increased personal income tax rates, **individuals would receive less money in each of their paychecks and therefore have less money to spend**, which would **decrease consumer spending**.
- At the same time, an increase to the personal income tax and the **resulting decrease in consumer spending would cause the unemployment rate to increase because companies would be receiving less revenues and investments (people spending less on consumer products)**, so they **would not need** as many workers.

## Income Tax Rate Changes: Pros/Cons

<b>INCOME TAX RATE REDUCTION: PROS</b> 	<b>INCOME TAX RATE REDUCTION: CONS</b> 
<ul style="list-style-type: none"> <li>➤ More money available for consumer spending—can help to stimulate healthy economy</li> <li>➤ Business profits may increase—can help to stimulate healthy economy</li> </ul>	<ul style="list-style-type: none"> <li>➤ Government more likely to engage in <u>deficit spending</u></li> <li>➤ Less money available to manage government-run services; example services to the poor; military</li> </ul>
<b>INCOME TAX RATE INCREASE: PROS</b> 	<b>INCOME TAX RATE INCREASE: CONS</b> 
<ul style="list-style-type: none"> <li>➤ More money available to manage government-run public services</li> <li>➤ National debt could be reduced because of increased tax revenue.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Less money available for consumer spending—may contribute to unhealthy economy—shrinks the economy</li> <li>➤ Business profits may decrease spending—may contribute to unhealthy economy; example companies may have to lay-off workers</li> </ul>

### Effects (results) in **lowering corporate** income taxes

- **Reducing corporate income taxes would require businesses to pay less money to the government**, which would increase their profit margin and allow them to have more money to spend. With more money, businesses can invest in new equipment and research and even increase wages.
  - would improve the ability of businesses to raise wages, buy new equipment, and conduct product research



If the U.S. government wanted to **encourage businesses to hire more employees**, would the government raise taxes or lower taxes on businesses? Explain your answer.

**Answer:** The U.S. government would **lower tax rates** for businesses which would increase their profit margin and allow them to have more money to spend in order to encourage businesses to hire more people



## Increase Corporate Income Taxes

- would require businesses to pay more money to the government, which would decrease their profit margin and would cause them to have less money to spend.
- With less money, businesses would have less to invest in new equipment and research and would may have to decrease wages or layoff workers.

## The Federal Reserve System



### Federal Reserve Bank/System

- **Purpose:** to regulate the economy
- **The banks, bank!**
- **Regulates interest rates**—increases or decreases interest rates
- **Tightens money it gives to banks**—results in making it harder for businesses and individuals to get loans
- **Loosens money it gives to banks**—results in making it easier for businesses and individuals to get loans

- **The Federal Reserve System helps to promote economic stability by regulating the amount of money in circulation. The Federal Reserve can increase or decrease the amount of money in circulation through several measures. By increasing or decreasing the amount of money in circulation, the Federal Reserve influences whether there is more spending or saving in general, and therefore can help to avoid recessions and high inflation**
- **The Federal Reserve System has the ability to decrease the discount rate (interest rate), which can reduce consumer and business spending for two reasons. One reason is that there would be less money in circulation (which is a responsibility of the Federal Reserve. Another reason is that loans would be more difficult to obtain**
- **A key reason for the creation of the Federal Reserve System is to promote economic stability**
- **The Federal Reserve System helps to promote economic stability by regulating the amount of money in circulation.**
- **The Federal Reserve can increase or decrease the amount of money in circulation through several measures.**
  - **By increasing or decreasing the amount of money in circulation, the Federal Reserve influences whether there is more spending or saving in general, and therefore can help to avoid recessions and high inflation.**

Example:

- A newspaper headline states, “Federal Reserve Decides to **Reduce the Money Supply**; Slowing of the Economy Likely Impact.”
- According to the headline, what does the Federal Reserve wants banks to do?

**Answer:** reduce lending

Explanation

- There would be less money in circulation.
- Loans would be more difficult to obtain.

## Environmental regulations

- **Environmental regulations promote healthier environments.**
- This can **decrease environment-related illness** in the general population, and **may in turn reduce health care costs.**
- **Environmental regulations make businesses spend more money on pollution-reducing technologies.** These costs can eventually be passed on to consumers.

## Tariffs

Definition: tax on imports

By increasing the prices of foreign manufactured automobiles and limiting their availability through tariffs, the U.S. would make U.S. manufactured automobiles more appealing to U.S. consumers.