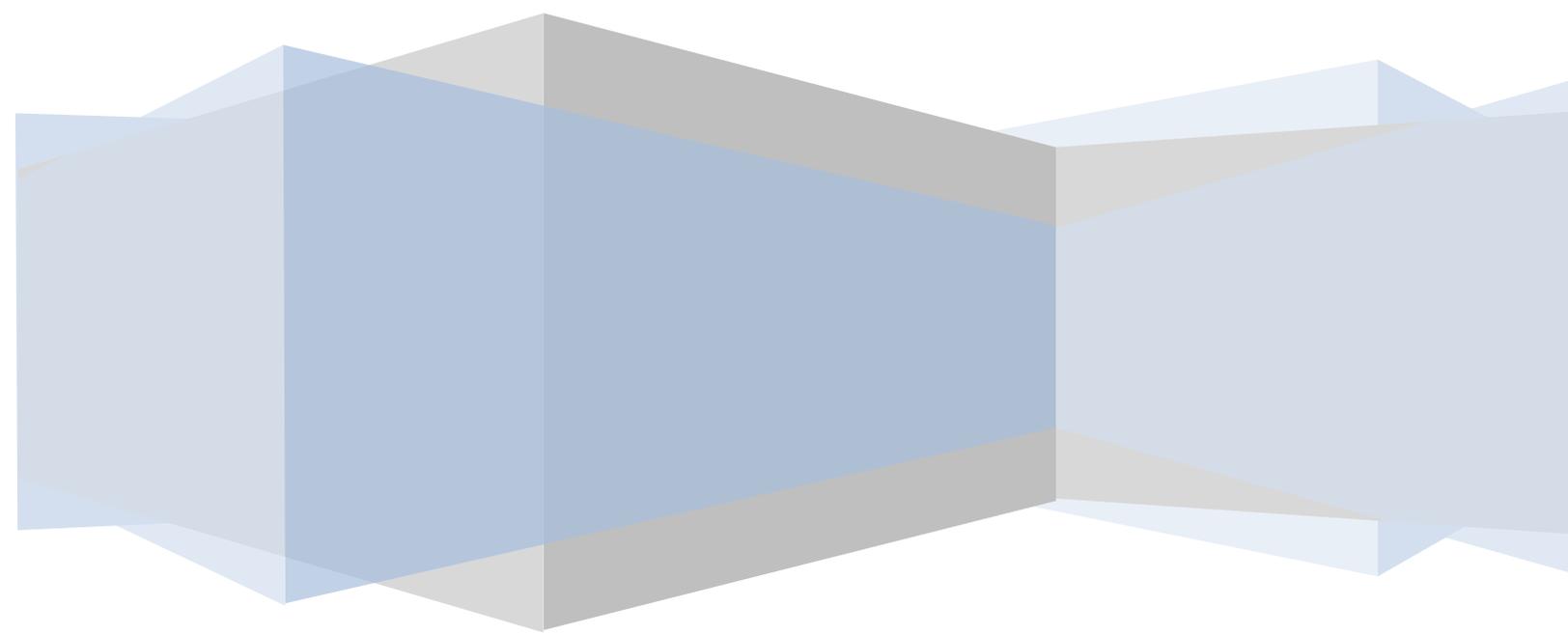

GEORGIA PERFORMANCE STANDARDS

Fundamental Domain



**Georgia Council on
Economic Education**



GEORGIA PERFORMANCE STANDARDS

Fundamental Economic Concepts

SSEF1 The student will explain why limited productive resources and unlimited wants result in scarcity, opportunity costs and trade offs for individuals, businesses and governments.

Individuals have wants that are, for practical purposes, unlimited. But the total resources of society, including natural resources, human resources, capital goods and entrepreneurship, are limited, so that scarcity exists. As a result, it isn't possible for everyone to have everything he or she wants. No society has ever had enough resources to produce the full amount and variety of goods and services its members wanted. In a world of scarcity, producing any one good or service means that other goods and services cannot be produced, and trade-offs are inevitable.

a. define scarcity as a basic condition which exists when unlimited wants exceed limited productive resources

Scarcity is the condition that exists because human wants exceed the capacity of available resources to satisfy those wants; also a situation in which a resource has more than one valuable use. The problem of scarcity faces all individuals and organizations, including firms and government agencies.

b. define and give examples of productive resources as land (natural), labor (human), capital (capital goods), entrepreneurship

Productive resources are used to produce goods and services. Productive resources are classified into four categories. Land stands for natural resources or gifts of nature such as oil, iron ore, forests and water. Labor refers to human resources. Labor is more than the number of people willing and able to work. Labor also reflects the abilities of people and includes people's health, strength, education, motivation and skills. Capital refers to goods and services such as buildings, equipment, roads, dams and machinery. The level of technology also influences capital. Finally, entrepreneurship is a special kind of labor that represents the characteristics of people who assume the risk of organizing land, labor and capital resources to produce goods and services.

c. list a variety of strategies for allocating scarce resources

For a list of allocation strategies, see the table on back page of this document.

d. define opportunity cost as the next best alternative given up when individuals, businesses and governments confront scarcity by making choices.

Opportunity cost is what you must give up to obtain something else, the second-best alternative. However, what you must give up to obtain, say, a bicycle is not really money--it is whatever other good or service you would have spent the money on as your next-favorite choice. Similarly, what a government gives up to obtain, say, more educational services is not really money either--it is whatever alternative goods or services the government could have

purchased instead, or the goods and services that individuals might have purchased if their taxes had been lower.

Opportunity cost includes all costs, including those of time or alternative activities. For example, one part of the opportunity cost of attending college is the money that could have been spent on something else, but another part is the cost in terms of time or alternative activities, when a student could have been working and earning income. As a different example, the opportunity cost for a business of holding a three-hour meeting with 30 employees attending isn't an additional monetary cost, since they are paying the employees already; instead, the opportunity cost of the meeting is the work that could have been accomplished if people hadn't had to attend the meeting. The opportunity cost of the meeting is the next-best alternative use of the time spent at the meeting.

A trade-off is the giving up of one benefit or advantage in order to gain another regarded as more favorable.

SSEF2 The student will give examples of how rational decision making entails comparing the marginal benefits and the marginal costs of an action.

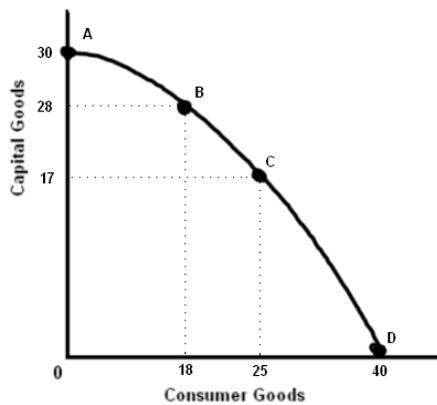
Decision making refers to the process by which rational consumers seeking their own happiness or utility will make choices. The process begins by defining the range of options that are possible. The next steps are to evaluate the costs, benefits and trade-offs involved in each choice and to reach a decision. Since people have different preferences and face different life situations, there is no expectation that all people will make the same ultimate decision. Not even economists believe that people always follow this decision-making process carefully since decision making is costly. But economists do believe that, at least implicitly, people do consider their options and trade-offs and try to make the choice that brings them the greatest satisfaction.

Cost-benefit analysis is a technique for deciding whether an action should be taken by comparing its benefits and costs. It can be applied by individuals, firms or governments. However, difficulties often arise when cost-benefit analysis is used by government; for example, it can be difficult for a government agency to compare anticipated costs and benefits. If a cost of \$100 million means that the view over the Grand Canyon is improved by 20 percent, how can an unbiased analyst decide if the benefit exceeds the cost? Thus, cost-benefit analysis often ends up using somewhat controversial assumptions to put monetary values on lives saved, days of sickness avoided, wildlife habitat protected and so on. Nevertheless, cost-benefit analysis provides a useful way of summarizing a great deal of information and organizing decision making.

a. illustrate by means of a production possibilities curve the trade offs between two options

Production Possibilities Curve

A table or graph that shows the full employment capacity of an economy in the form of possible combinations of two goods, or two bundles of goods, that could be produced with a given amount of productive resources and level of technology.



In the graph above, a movement from Point B to Point C indicates that this society now prefers to build more consumer goods and less capital goods. This movement from Point B to Point C shows the tradeoff involved in choosing a different combination of goods. In order to gain more consumer goods this society is unable to consume as many capital goods.

b. explain that rational decisions occur when the marginal benefits of an action equal or exceed the marginal costs.

Economic decisions are always made on the basis of marginal costs and marginal benefits. For example, the marginal cost of producing a good is the additional cost of producing one more unit of the good. Similarly, the marginal benefit of consuming a good is the additional value of consuming one more unit of it. Marginalism is critically important in understanding decision making because almost all of the decisions we make are marginal, as opposed to all-or-none decisions. For example, we don't make decisions between spending the entire day watching TV or the entire day studying. Instead, we choose between spending a little more time studying and a little less time watching TV, or vice versa. So a decision between studying and watching TV involves comparing the marginal benefit of studying with the marginal benefit of watching TV, not comparing their total benefit. The total benefit of studying could be far greater than the total benefit of watching TV, but after several hours of studying, the marginal benefit of studying could be less than the marginal benefit of watching TV.

SSEF3. The student will explain how specialization and voluntary exchange between buyers and sellers increase the satisfaction of both parties.

a. give examples of how individuals and businesses specialize

The division of labor refers to the practice that the tasks of producing a good or service are divided up into separate tasks. When workers focus on performing separate tasks, specialization occurs. Within a company, for example, there are typically workers who specialize in buying supplies, different aspects of production, future planning, paying bills and taxes, collecting sales revenue, hiring and managing workers, and many other categories. Within the economy as a whole, the division of labor explains why even if you bake your own bread, you typically don't grow your own wheat, grind it into flour, build your own oven, make your own bread-pans and so on. Instead, people specialize in a few skills and then take the wages that they earn from those skills to purchase the other goods and services that they desire from other specialists. In this way, the division of labor and specialization is the basis for an economy to exist.

Adam Smith started his classic book *The Wealth of Nations* with a discussion of the division of labor as the basis for understanding how an economy works. He identified three reasons why the division of labor increases output: workers who specialize on one job become much better at doing it; with specialization, the time that it would take to switch between jobs is eliminated; and workers who specialize on one job often invent more effective ways or new machines for doing the job. But as Adam Smith makes clear, specialization is possible only when people are able to coordinate their production and consumption decisions with each other. The study of economics is largely concerned with explaining how this coordination takes place.

b. explain that both parties gain as a result of voluntary, non-fraudulent exchange.

People do not make everything that they and their family use: that is, they do not grow all their own food, sew their own clothes, build their own house and provide themselves personally with health care and education. Instead, people focus on a particular job and then use the wages that they earn from that job to purchase the goods and services they desire. In this way, an economy forms an interlinked network of trade, exchange and interdependence.

Specialization is the basis of trade and interdependence among individuals, cities, regions and countries. Most countries do not produce all of what they consume. Instead, they focus more heavily on producing certain products and trading with other countries. Thus, the global economy is a network of trade and interdependence. When trade is voluntary and non-fraudulent, both parties in the trade gain.

SSEF4 The student will compare and contrast different economic systems, and explain how they answer the three basic economic questions of what to produce, how to produce and for whom to produce.

Every society must contend with the problem of scarcity. Every society, regardless of its political structure, must develop an economic system to determine how to use its limited productive resources to answer the three basic economic questions.

What goods and services will be produced?

How will goods and services be produced?

Who will consume the goods and services?

The way a society answers these questions determines its economic system.

Three types of economic systems exist to answer these questions.

Traditional – In a traditional economy, economic decisions are based on custom and historical precedent.

Command – In a *centralized* command economy, government planning groups make the basic economic decisions. They determine such things as which goods and services to produce, their prices, and wage rates.

Market – In a *decentralized* market economy, economic decisions are guided by the changes in prices that occur as individual buyers and sellers interact in the market place (which it is also referred to as a price system). Other names for market systems are free enterprise, capitalism, and laissez-faire.

There are no pure command or market economies. To some degree, all modern economies exhibit characteristics of both systems and are often referred to as **mixed** economies. However, most economies are closer to one type of economic system than another.

Market economies rely primarily on the price system to answer these questions. For example, suppose a new craze for tennis results in consumers purchasing more tennis rackets. If this is the only change in the market, the increase in demand for tennis rackets will cause their **price** (the amount people pay when they buy a good or service or the amount they receive when they sell a good or service) to rise, resulting in more **profits** for producers of tennis rackets. The rise in profits will encourage existing producers to make and sell more rackets. It will also encourage new racket producers to enter the market, encouraging **competition** from new **businesses** (an organization that produces or exchanges goods or services for a profit). Eventually, the supply of tennis rackets will increase and the price will fall.

a. compare command, market, and mixed economic systems with regard to private ownership, profit motive, consumer sovereignty, competition, government regulation

Economic systems are those institutional frameworks of formal and informal rules that a society uses to determine what to produce, how to produce and for whom. Economic systems can be categorized according to who makes most of the decisions in an economy. In a market economy, most of the decisions in the economy about what to produce, how to produce it and who receives it are made by individuals and firms. At the other end of the spectrum, in a command economy, government officials make most of the decisions in the economy about what to produce, how to produce it and who receives it. Most economic systems also contain elements of tradition or repeating decisions in ways made at an earlier time or by an earlier generation. Most economies are mixed in that some economic decisions are made by individuals and private firms, but some are also made by government officials, either through rules and regulations or through government-owned firms. The U.S. economy leans toward the market-oriented side of the spectrum. An economy like Cuba or North Korea is near the command economy side of the spectrum. But the dividing line between market and command economies in most nations is blurry rather than bright.

Command (centralized) Economy

An economy in which most economic issues of production and distribution are resolved through central planning and control.

Market (decentralized) Economy

An economy that relies on a system of interdependent market prices to allocate goods, services, and productive resources and to coordinate the diverse plans of consumers and producers, all of them pursuing their own self-interest.

Mixed Economy

There are no pure command or market economies. To some degree, all modern economies exhibit characteristics of both systems and are, there, referred to as “mixed”.

Profit Motive

The desire to make money which motivates or causes people to work hard to produce goods and services.

Consumer Sovereignty

The extent to which people are free to choose in the marketplace without government regulation

Competition

Attempts by two or more individuals or organizations to acquire the same goods, services, or productive and financial resources. Consumers compete with other consumers for goods and services. Producers compete with other producers for sales to consumers.

Governmental Regulation

The extent to which government intervenes in the decisions of buyers and sellers in a market

b. evaluate how well each type of system answers the three economic questions and meets the broad social and economic goals of freedom, security, equity, growth, efficiency and stability

Economic Freedom

The freedoms of the marketplace--the freedom of consumers to decide how they wish to allocate their spending among various goods and services; the freedom of workers to choose to change jobs; the freedom of individuals to establish businesses and to decide what to produce and when to change their pattern of production; and the freedom of savers to decide when and where to invest their savings.

Economic Security

Protection against economic risks, such as unemployment, accidents on the job, business failures or natural disasters, over which people have little or no control. Economic security refers to protecting consumers, producers, and resource owners from risks that exist in society. Each society must decide from which uncertainties individuals can and should be protected, and whether individuals, employers, or the government should provide or pay for this protection.

Economic Equity

The application of our concepts of what is "fair" or "unfair" and what is "right" or "wrong" to an economic policy. Ultimately deals with the distribution of income and wealth. Some people judge equity based on providing equal opportunity. Others judge based on equality of outcomes.

Economic Growth

Increasing the production of goods and services over time. Economic growth is measured by changes in the level of real gross domestic product (GDP). A target annual growth rate of 3 to 4 percent in real GDP is generally considered to be reasonable and sustainable.

Economic Efficiency

A situation in which no one in a society can be made better off without making someone else worse off. The gains for society must be more than the costs to that society. Economic efficiency refers to how well scarce productive resources are allocated to produce the goods and services people want and how well inputs are used in the production process to keep production costs as low as possible.

Economic Stability

This is the process of maintaining stable prices and full employment and keeping economic growth reasonably smooth and steady. Price stability means avoiding inflation or deflation. Full employment occurs when an economy's scarce resource, especially labor, are fully utilized.

SSEF5 The student will describe the roles of government in a market economy.

Government has an active role in establishing a framework or rules of the game in economic life. In the United States, this activity involves preserving and fostering competition, regulating natural monopolies, providing information and services to enable the market to work better, regulating externalities, providing certain public goods, offering some economic security and income redistribution to individuals, assuring a sound monetary system and promoting overall economic stability and growth.

Markets perform well in providing most goods and services of everyday life: groceries, restaurant meals, clothing, movies and cars. Nevertheless, there is a role for government in areas where markets fail or are inefficient. Some roles of government include protecting the environment, helping the poor and providing national defense. In these cases, there is a role for government to provide economic security and foster competition. Governments also provide public goods. Public goods are those that cannot easily be restricted to those who pay for them. For most public goods, consumption by one person does not reduce the amount of the good available to others. Political opinions differ about how extensive the role of government should be in managing the economy. But even those who favor a primarily market-oriented economy usually concede that markets also need a backdrop of a rule of law to function well, in which the government enforces contracts and protects property rights. The paradox of good government is that it must be strong enough to perform its appropriate roles, but weak enough that it does not intervene excessively in people's lives. Although there is a role for government, we cannot assume that it will perform that role well. There are and have been policies that hurt the poor, harm the environment and protect monopolies.

a. explain why government provides public goods and services, redistributes income, protects property rights and resolves market failures.

Public Goods and Services

Most goods and services produced in the marketplace are private goods and services. This kind of good or service is purchased by a consumer who desires it and can afford it, and then consumed only by that individual or anyone he or she gives it to. But some goods and services must be produced by the public sector or government. Public goods and services are paid for through tax dollars and are available to everyone, even those who do not pay taxes. That means taxpayers have an incentive to use public goods, and try to get more of them produced, while shirking tax burdens to others. This is known as “free riding.”

Public goods are characterized by shared consumption and nonexclusion. Nonexclusion means that it is difficult to exclude nonpayers from receiving the benefit of a good or service once it is produced. Shared consumption means that the consumption of a good or service by one individual does not reduce the amount available for others to consume. Although many goods and services are produced by the government, only those that exhibit these two characteristics, shared consumption and nonexclusion, are considered pure public goods.

Income Redistribution

Income distribution refers to how the total income earned ends up divided over members of the economy. One common method of describing the income distribution is to divide the population into equal-sized groups, and then to say what share of income is received by each group. For example, in the United States in recent years, the bottom fifth of all households ranked by income have received about 4 percent of all income earned in a given year; the

second fifth, 10 percent; the third fifth, 16 percent; the fourth fifth, 23 percent; and the top fifth, 47 percent.

A perfectly equal income distribution would mean that everyone receives exactly the same income. However, there is no reason to expect a perfectly equal income distribution. After all, some people are in their 20s, some in their 50s, and some in their 80s--so incomes are different in a given year because of where people are in their life cycle. Some people pursue careers that require higher levels of skills; others do not. Some people choose to work extra jobs to earn additional income; others do not. Also, the income distribution in any given year does not reveal how many people are moving higher or lower in the income distribution over time. Given these complications, whether the level of income inequality in the current income distribution should be viewed as fair, unfair or somewhere in between is a controversial issue. In fact, even people's definition of "fair" can differ dramatically.

The functional distribution of income refers to how income is divided among wages, interest, rents and profits. In the U.S. market economy, the bulk of total income goes to wages. About three-fourths of our national income is wages. When demagogues claim that most income goes to business profits or rents to large landowners, this is factually wrong.

Property Rights

Property rights refer to the legal ownership of resources, which include the right to own, use and sell them. Property rights are essential to the transactions in a market economy, and one of the essential roles of government in a market-oriented economy is to protect property rights. When goods, including everything from cars to groceries, are bought and sold, a property right is transferred from one party to the other. Your ownership of your own labor, that is, your property rights in your own labor, is what gives you the right to be paid for your work. Without property rights and ownership, firms would lack any reason to build factories, produce and innovate, because they wouldn't be able to keep what they made or earned. Similarly, people and firms would have a greatly reduced incentive to save or invest, because they wouldn't be confident of receiving the future value from doing so.

Market Failures

A market succeeds when it brings together a willing buyer and willing seller to make a mutually beneficial transaction in a way that satisfies the parties involved. However, there are certain well-recognized conditions under which market failure occurs; this means either that a market transaction affects third parties not involved in the transaction or that a market has difficulty in providing certain kinds of products.

Here are some examples of market failure. First, externalities are situations in which a market transaction affects a third party who is not part of the transaction. A classic example is pollution, where people who do not purchase the good whose production created the pollution must nevertheless face polluted air or water. A second market failure is one in which the private market is unable to provide the good or service. Two examples of this are national defense and police protection. It is very difficult for the private market to charge individuals for these services. This means that this role falls to the Government. Although not a market failure, it is interesting to note that the Federal Government is also unable exclude individuals from these services for failure to pay their taxes. The difference is that the Federal Government is not expected to make a profit from their services. Third, a monopoly firm that operates without competition, and thus has the power

to increase the prices it charges to consumers, is an example of market failure. Imperfect information is often cited as a market failure. Ideally all market participants would have perfect information, and it is often argued that markets fail when buyers and sellers have imperfect information. But buyers and sellers always have less than perfect information. Indeed, any attempt to acquire perfect information would be inefficient because it would soon begin costing more than it was worth. Also, it should be emphasized that the prices that emerge from market exchanges provide buyers and sellers with far more information relevant to their decisions than would otherwise be available.

b. give examples of government regulation and deregulation and their effects on consumers and producers.

Is there too much government regulation or too little? Who answers that question, and on what basis? Many critics have cited the total cost of government regulation and claimed that there is too much regulation. The U.S. Office of Management and Budget recently provided a report to Congress on the overall costs and benefits of federal regulations suggesting that the critics have failed to accurately consider all of the benefits resulting from regulation. The report goes on to emphasize the importance of applying cost-benefit analysis when making changes in regulatory policy – in other words comparing the expected costs of a new policy or a change in an existing policy to the expected benefits.

SSEF6 The student will explain how productivity, economic growth and future standards of living are influenced by investment in factories, machinery, new technology and the health, education and training of people.

a. define productivity as the relationship of inputs to outputs

Productivity is measured as the quantity of output per unit of input. For example, labor productivity is measured as the quantity of output produced by an economy divided by the number of hours of labor input. A more complex measure of productivity is the quantity of output produced by all inputs. An increase in productivity means producing more goods and services with the same amount of resources, producing the same amount of goods and services with fewer resources or a combination of the two possibilities. Over time, productivity growth means that the average worker is producing more per hour, which means that the average standard of living in the economy will be higher. This assumes that the additional output is of goods and services that people value. Producing more output that is of no value is not a real increase in productivity.

b. give illustrations of investment in equipment and technology and explain their relationship to economic growth

Economic growth refers to the ability of the economy to increase its total real output or real GDP, or its real output per person. Economic growth comes from several sources: improvements in the education, experience and skill level of the workforce, sometimes called human capital; greater amounts of physical capital, that is, plant and equipment per worker; and improved technology. Economic growth is critical to job-creation and economic well-being. Economic growth slows down as the economy approaches its peak and becomes negative as it goes into recession. Economic growth begins increasing back toward zero as the economy approaches its trough and becomes positive as it begins its recovery.

c. give examples of how investment in education can lead to a higher standard of living

Economic development is a sustained increase in the standard of living of a country's population. Broadly understood, the standard of living includes a rise in the average incomes of the population as measured by real per capita GDP, and also improvements in health and education, some social protection from poverty, freedom, a rule of law and other social goals. Standard of living is defined as the level of subsistence of a nation, social class or individual with reference to the adequacy of necessities and comforts of daily life. Although economic development does focus on the material standard of living, it is a broader term than just economic growth. Economic development is facilitated by high investment levels in physical and human capital, higher productivity, competitive markets, low inflation, political stability and free trade. Incentives that increase factors contributing to economic development are greater economic freedom, protection of property rights and sound monetary policies.

Sample Resource Allocation Strategies

Strategy	Description	Advantage	Disadvantage
price	resource goes to those who use market mechanisms such as trade, barter, or price	<i>great for those who have money or a job with income</i>	<i>not good for those who have little or no income</i>
majority rule	resource goes to those who win an election; voting; consensus; largest number of people are satisfied	<i>great for those who are popular and those who have many members</i>	<i>not good for the unpopular; those who don't have the skills to form alliances</i>
contests	resource goes to the most competitive – winner of a race or arm wrestle; survival of the fittest	<i>great for those who are talented and skillful</i>	<i>not good for those who aren't competitive; unskilled</i>
Force	resource goes to the one who is strongest (physical, mental, political); most forceful	<i>great for those who are strong, powerful, bullish</i>	<i>not good for those who are weak, small, easily intimidated</i>
sharing	resource goes to multiple parties by dividing the resource	<i>great in that everyone gets an equal part; no one is left out</i>	<i>not good in that some resources can't be divided; no party may get enough; not everyone wants some of every resource</i>
Lottery	resource goes to the luckiest; random; fair	<i>great for those who are lucky and win things; everyone has an equal chance; random winners</i>	<i>not good for those who are unlucky or who "never win anything"</i>
command	resource goes where directed, ordered, told by another person	<i>great for those who are liked by the commander or if the planner is always fair</i>	<i>not good if the planner isn't fair</i>
first-come, first-served	resource goes to the early bird; first in line	<i>great for those who are quick, willing to get ahead of the crowd</i>	<i>not good for the procrastinator; those who are late in planning/preparing</i>
personal characteristics	resource goes to the one with the greatest tenure, the longest hair, the oldest, the youngest, the bluest eyes, etc.	<i>great for those who are able to set the personal characteristic to be awarded the resource</i>	<i>not good for those unable to influence the selection of the characteristic category</i>