

## Suggested Answers [Marking Scheme Based]:

### Learning Key [6]

#### Structured Essay-type Questions [SEQs]

[Model/Past Paper based]

[6] Define 'Productive Efficiency' and 'Allocative Efficiency', outline the contrast in the PPF representation of these concepts.

[06 marks]

Productive efficiency refers to the process of using limited resources of an economy to produce the required combination of goods and services at the '**Lowest Production (or Resources) Cost**'.

Accordingly at productive efficiency an economy should be either, utilising their endowment of resources in order to generate the **maximum** level of **output** possible **OR** producing a given level of output, utilising the **minimum** possible level of resource **inputs**, under normal conditions.

[02 mark]

Since productive efficiency, essentially requires the attainment of **full employment** and **full production**, in such a situation the economy will **always operate** (produce) at a **point located on its production possibilities frontier**.

[01 mark] [Sub- total 03 marks]

#### Alternative Definition:

Productive efficiency is said to be created in a situation where, an economy is unable to increase the output of a given product category, without decreasing or foregoing the output of another product category. Such a situation infers the economy is operating on its PPC.

[02 marks]

Allocative efficiency is the process allocating limited resources of a society, towards the production of a combination of goods and services, **most required or needed** by the given **society**.

[01 mark]

It implies the given economy is **operating on a specific optimum point of output on its production possibilities curve** (i.e. at the 'Optimum Product Mix'). Such an optimum product combination is arrived at when the **Marginal Cost (MC)** of producing an incremental unit of output is **equal** to the **Marginal Benefit (MB)** or **Price (P)** of consuming an incremental unit [**MB = MC** or **P = MC**].

[01 mark] [Total 04 marks]

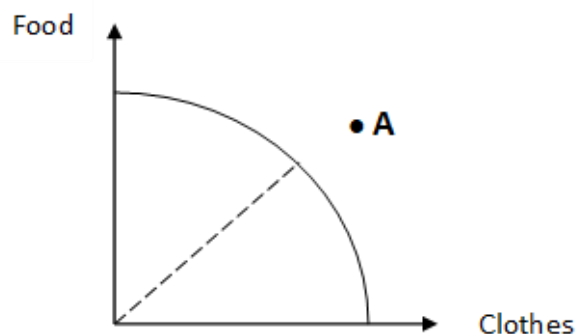
[7] **How does the Production Possibilities Frontier (PPF) illustrate the following concepts and issues:**

- (A) Problem of scarcity
- (B) Opportunity cost
- (C) General unemployment
- (D) Economic growth
- (E) Economic recession, caused by fall in Aggregate demand
- (F) Economic depression
- (G) Economic discrimination
- (H) Impact on a country's production capacity due to Covid-19 Pandemic
- (I) Embargoes on food product trade between India - Sri Lanka

[02 marks each]

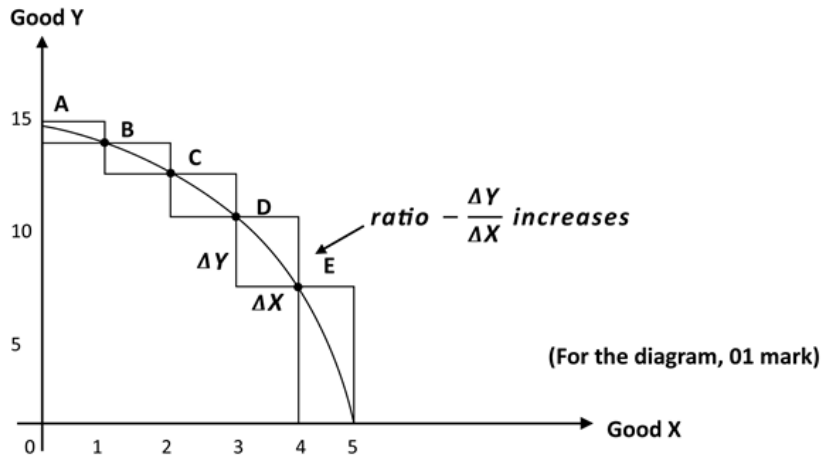
**(A)** Problem of scarcity

An alternative product combination or point located outside the PPF, indicating an unattainable point.

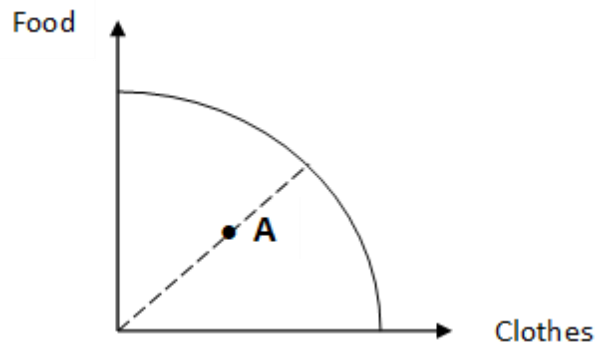


**(B) Opportunity cost**

Indicating foregone units as a rate of gained units (or the slope or gradient downwards along the PPF)

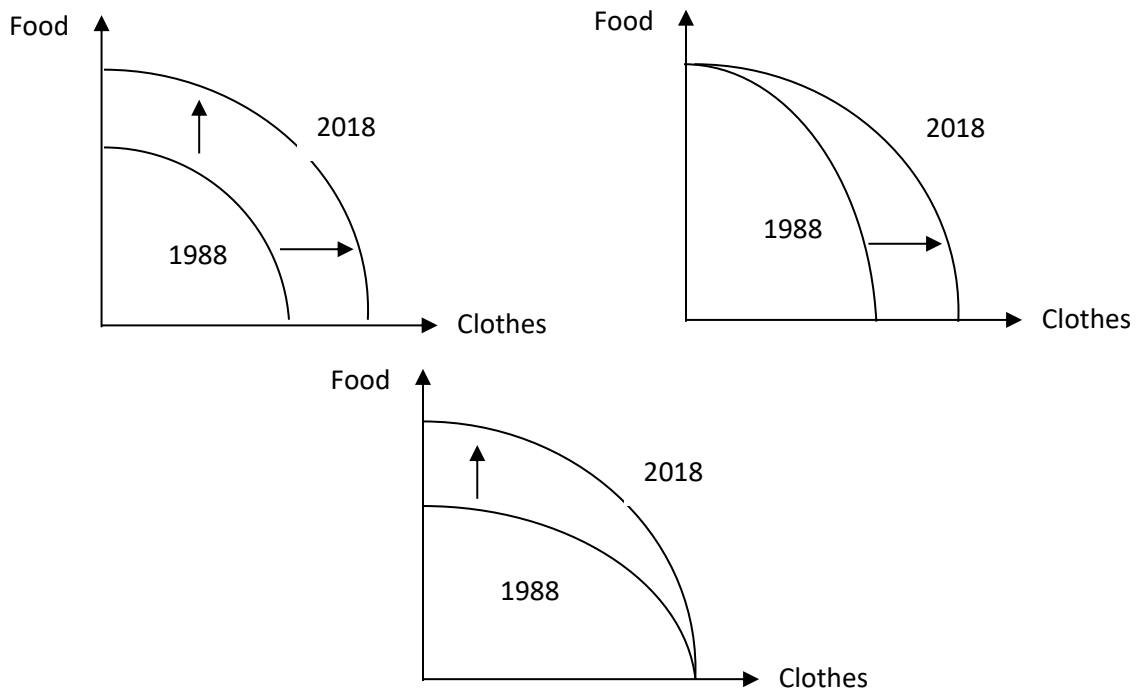


**(C) General unemployment:** A point located within the PPF

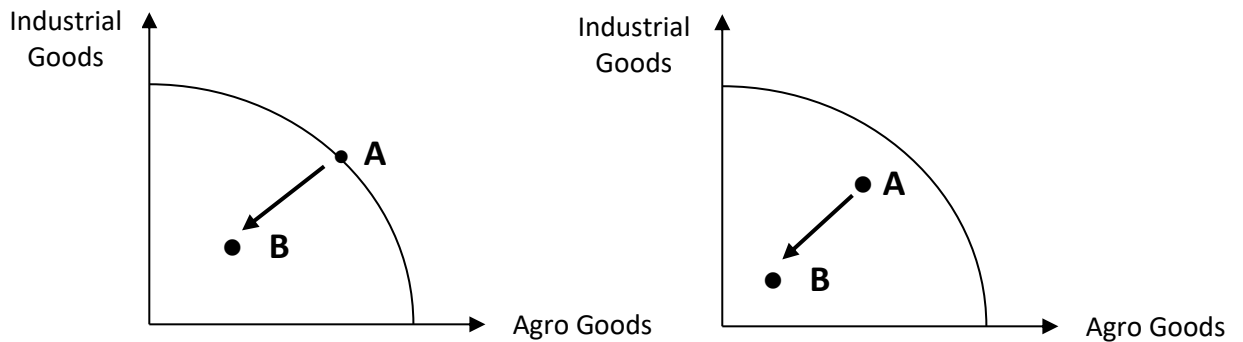


**(D) Economic Growth**

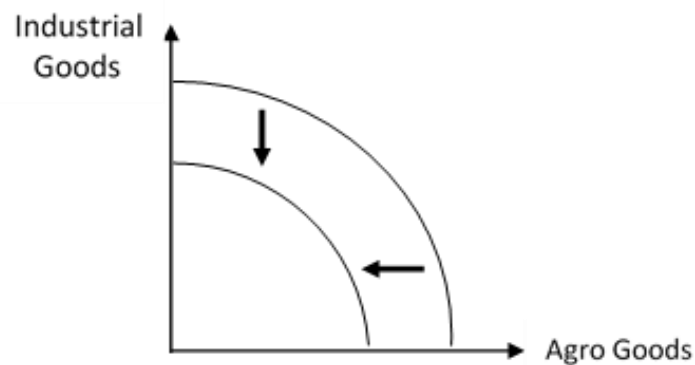
A **parallel** (ideal format) or proportionate outwards or rightwards shift of the PPF, direction of shift should be indicated using arrows.



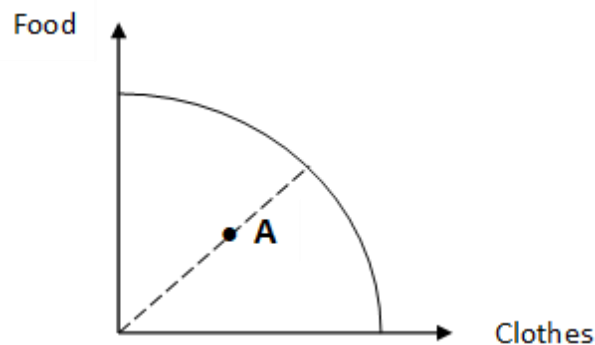
- (E) Economic recession caused by fall in AD  
 A point moving inside the PPF, indicated with an arrow (causes economic **recession**)



- (F) Economic Depression: Long-term contraction in AD and AS  
 Parallel inward shift of the PPF, direction of shift indicated with arrows (causes an economic **depression**)



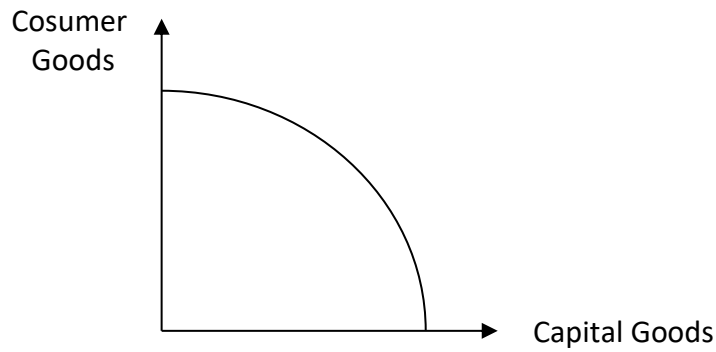
- (G) Economic discrimination  
 A point located within or in the area left of the PPF



**(H)** COVID 19 Pandemic Impact

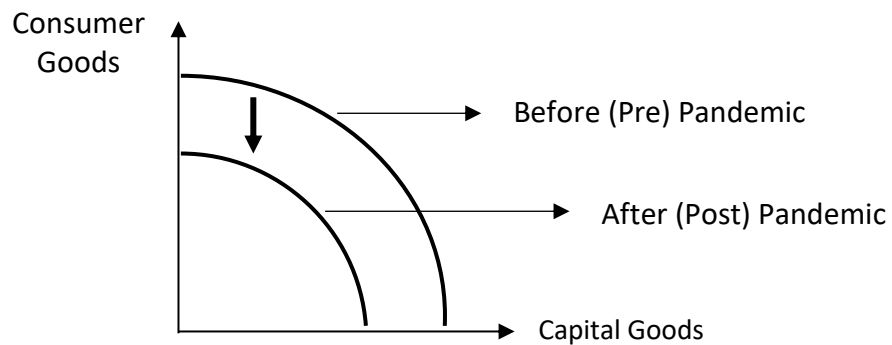
**If Labour Force and Productivity is not impacted [Short-term Impact]:**

PPC does not shift downwards, but the actual production level of the economy will be contracted as shown below.



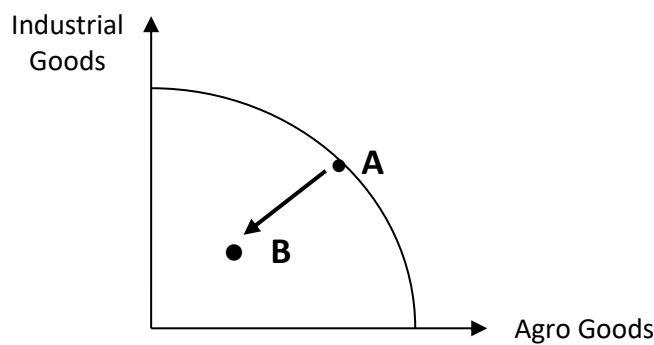
**If Labour Force and Productivity is impacted [Long term Impact]:**

PPC would shift downward to indicate the decrease in potential output



**(I)** Trade embargoes

A point moving inside the PPF, indicated with an arrow



**[02 mark each]**

## Learning Key [7]

### Structured Essay-type Questions [SEQs]

[Past Paper based]

[8] What are the main functions of an economic system?  
[2020 A/L] [03 marks]

(1) **What to produce, in which quantity**  
[Additional: allocation problem, production decision]

(2) **How to produce**  
[Additional: production problem, choice of techniques decision]

(3) **Whom to produce**  
[Additional: distribution problem, distribution decision]

[01 mark each] [Total 03 marks]

[9] List the three fundamental questions any economic system must answer and outline briefly the three basic economic system that have evolved to answer these questions  
[2018 A/L] [04 marks]

#### The Fundamental (Basic) Questions or Problems are

(1) **What to produce, in which quantity**

(2) **How to produce**

(3) **Whom to produce**

[Sub-total; 01 mark]

#### Basic Economic Systems:

[Solving basic economic problems, based on mechanism of resource allocation]

- Market Economic System
- Command (Centrally Planned) Economic System
- Traditional Economic System
- Mixed Economic System

[01 mark each, maximum 03 marks]

[Total 04 marks]

\*No marks if terms such as 'Socialist/Communist' or 'Capitalist' economic system is used

**[10]** How does a market economic system differ from a command economic system in solving the questions about resource allocation?

**[2019 A/L] [04 marks]**

**Key Note:**

- Make sure not to get overwhelmed, confused or discouraged due to the technical or in-depth nature of the suggested answers for this questions.
- Remember we are still in the beginning of the learning process, as you learn more and your economic knowledge improves, you will be able to write even better answer than the suggested answer.
- **As long as you understand the basic idea of the answer and are able to describe price mechanism and central planning mechanism as two alternative mechanism of resource allocation, that's perfect for now.**

**Suggested Answer:**

In a market economic system, decisions relating to resource allocation are made without any central direction or commands (i.e., in a decentralized manner). Such decisions however coordinated and resources are allocated. The main coordinating device or mechanism is the market determined prices or the price mechanism.

Market economy requires no centralized planning or a planning authority, no bureaucracy in order to allocate resources. The price mechanism works as a result of millions of decisions made by individual producers and consumers acting in their own self-interest.

The key to the whole process of resource allocation in a market economy is the role or functions of price, where by prices provide signals or information, incentives and help allocate resources.

In a command economic system the process of resource allocation is decided by a centralized authority or committee, which will make all decisions in terms of what to produce, how and whom to produce. Such economies are characterized by centralization of decision making.

Centralized decision making requires a comprehensive plan for the economy to solve the basic economic questions. Planners need to know the entire range technical possibilities for production (i.e., inputs) and what is the range of goods and services required by the society to create the expected level of social welfare. In order to find such important information the economic planners shall conduct a comprehensive input-output analysis. Accordingly medium and long term economic plans are prepared, resources are allocated and basic economic problems are solved.

However, planners often use prices for the distribution of output. The price of especially essential goods and services are decided by the planning authority in such a manner to ensure fairness and optimum common wellbeing.

**[01 mark each for any four differences, total 04 marks]**

#### **Alternative Answer:**

A **market economic system** deals with the problem scarcity, by formulating a mechanism to allocate limited resources, as described below:

In a market economic system is based on the **fundamental characteristics** of **private property ownership**, directing the economy through the coordination done through **markets** and **price mechanism**.

In this system all economic agents participating in market activities work towards optimising their **self-interest**. Thus all individuals and firms (institutions) engage in consumption and production in a manner that **maximises** their **satisfaction** or **profits**.

Production of goods and services, and supplying (offering) factor based services is based on each **individual's preferences** and **abilities**. Parties purchasing and supplying, goods and production factors, tend to **compete independently**, while the **economic decision making** process is **highly decentralised**.

The **government's role** in a market economic system is **limited** towards **protecting private property rights** and creating a **conductive environment** for the **efficient** functioning of **markets**.

**[02 marks]**



A **command economic system** deals with the problem scarcity, by formulating a mechanism to allocate limited resources, as described below:

In a command economic system **all property resources** are **owned** by the **government** and the economic decision making process is conducted based on a **centralised economic plan**. All **key economic decisions** pertaining to resource utilization, output composition, output distribution and organizing production activities are made by a **central planning committee or council** appointed by the government.

All **production organizations** are **owned** and managed by the **government**, and such institutions engage in production based on **government directives** (commands), i.e. **public sector entrepreneurship**.

The **central planning committee** shall determine the **production targets** of each production organization and the **amount resources allocated** to attain such targets.

The **composition** of **output** in terms of **capital goods** and **consumer goods**, and the manner in which **capital goods** are **distributed** among **different industries**, are decided by the **central planning committee** based on **long-term economic priorities**.

[02 marks] [04 marks]