THEORY PROGRAM **FNR - SUGGESTED ASNWERS**	FNR: **02** **AL - 2024**	**Discussed on:**

ATTEMPT. PRACTICE. LEARN. IMPROVE. ACHIEVE.

Part – [A]

Question	Answer	Question	Answer
01		**10**	
02		**11**	
03		**12**	
04		**13**	
05		**14**	
06		**15**	
07		**16**	
08		**17**	
09			

State whether the following statements are True (T) or False (F) **(01 mark each)**

(i)	Scarcity is a temporary situation in some societies.	
(ii)	Normative economics is free from value judgments	
(iii)	Salt water from the ocean is not a scarce good because there is more than the amount people want when it is available and free.	
(iv)	Inability to satisfy basic human wants shall create the complex economic problem of ‘Poverty’.	
(v)	Economics is one of the social sciences because it examines individual and social behavior.	
(vi)	Opportunity cost of free goods depends on the cost of the good given up for it.	
(vii)	The personal computer that my brother uses to play games on is a capital good.	
(viii)	An entrepreneur is a person who assumes the risks associated with undertaking a business venture.	

Part – [B]

Question [01]

(A) Briefly explain the three functions of the price mechanism.

1. Signaling / Information Function
2. Incentive Function
3. Rationing Function **[01 mark each, total 03 marks]**

(B) Sate the main conditions of 'Effective Demand' and 'Effective Supply' [06 marks]

Effective Demand:
1) The consumers' **want** or have a **willingness** to buy the given product
2) The consumers' have the necessary **purchasing power** to buy the product
3) The consumers have **planned** how to purchase the product

[01 mark each, subtotal 03 marks]

Effective Supply:
1) The producers' have the **resources** and **technology** (ability) to produce the product
2) The producers' have a **potential** to **earn a profit** by producing and supplying the product (willingness)
3) The producers' have **planned** to how to produce and supply the product

[01 mark each, subtotal 03 marks] [Total 06 marks]

Question [02]

Match the key terms given below with the most suitable statement.

Law of demand	Utils	Complementary goods
Substitute goods	Normal good	Opportunity Cost

A good whose demand increases when income increase.	
Hypothetical units for measuring utility.	
Inverse relationship between price and quantity demanded.	
Goods that can replace each other.	
Goods that are used together.	
The quantity of goods that must be given up obtaining a good.	

Question [03]

Define the following 'Concepts' (Ensure to provide a **complete** and **theoretically correct** definition, using the **correct technical terms**)

(1) Normal Goods
(2) Inferiror goods
(3) Giffen Goods **[03 marks each]**

[1] A normal good is a good for which, other things equal, an increase in income leads to an increase in demand. Accordingly, any good that has a positive or direct relationship with regards to income and demand is a normal good.

[02 marks]

In terms of a normal good the substitution effect is negative, income effective is positive and the overall price is negative. Accordingly normal goods have a demand curve downwards sloping from left to right.

[01 marks, total 03 marks]

[2] An inferior good is a good for which, other things equal, an increase in income leads to a decrease in demand. These are goods which represent a negative or indirect relationship between a change in consumer income and demand.

The distinction between an inferior good and normal good is highly subjective.

[02 marks]

In terms of an inferior good the substitution effect is negative, income effective is negative and less in power relative to the substitution effect, thus the overall price is negative. Accordingly inferior goods have a demand curve downwards sloping from left to right.

[01 mark, total 03 marks]

[3] A Giffen good is a special type of inferior good. A rise in price leads to an increase quantity demanded, when other non-price factors affecting demand are held constant. In other words, the price quantity demanded relationship is positive, thus the demand curve becomes upward sloping from left to right.

[03 marks]

In terms of a giffen goods a rise in price leads to a fall in quantity demanded because of the negative substitution effect but a rise in quantity demanded because of the negative income effect. However, the income effect outweighs the substitution effect, leading to rises in quantity demanded as price rises (i.e., positive price effect).

[01 mark, total 03 marks]