THEORY PROGRAM **FNR – SUGGESTED ANSWERS**	FNR: **06** **2024 A/L**	**Viewed SA (VR) on:**

ATTEMPT. PRACTICE. LEARN. IMPROVE. ACHIEVE.

Part – [A]

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Part – [B]

Question [01]

(A) **Briefly 'Define'** Human Needs and Human Wants

In the study of economics human needs are defined as essential or necessary requirements to live one's life in a socially acceptable manner, as a human being.

Needs are indispensable, especially basic human needs are essential for survival. Such needs tend to be basic and limited in nature.

[02 marks]

Human wants in the study of economics are defined as various ways and means chosen by people to fulfil their needs. Wants are the different ways of expressing or indicating a particular need of a person.

The fulfilment of wants is optional (wants are a luxury) and tend to be diverse. Humans have unlimited wants by nature.

[02 marks] [Total 04 marks]

(B) **Outline** the link and distinction between human needs and wants

Human **needs derive wants** and wants show the **different ways of fulfilling** ones **needs.**

Human needs are **basic**, essential, and **limited in nature**, while human wants are complex (diverse), **luxury** and **unlimited in nature.**

[02 marks each] [Total 04 marks]

Question [02]

(A) **'Define'** the following **'Basic Economic Concepts':**

(1) Relative Scarcity
(2) Alternative Uses of Resources
(3) The Problem of Choice
(4) Opportunity Cost

[03 marks each] [Also assessed in FNR 03]

(1) **Scarcity** in economics is the limitedness or insufficiency of the available stock of productive resources in comparison or relative to the unlimited human wants of a given society.

[02 marks]

Relative scarcity is a **central** or fundamental and **universa**l economic problem or concept.

[01 mark] [Total 03 marks]

(2) **Alternative Uses** is a given resource or combination of resources representing more than one (or multiple) productive uses (i.e., can be used to produce different goods and services/ for different purposes).

[02 marks]

Alternative uses are a quality or attribute common to many resources. This is also known as (AKA) 'Competing Ends'. Alternative uses of resources is one of the reasons for the creation of a 'Problem of Choice'

[01 mark] [Total 03 marks]

(3) The **Problem of Choice** in economics is broadly a decision of Allocating scarce resources with alternative uses to satisfy a society's unlimited wants.

All societies face Unavoidable tradeoffs due to relative scarce resources with alternative uses. Therefore, economics is known as a science of choices.

[02 marks]

There are three basic economic problems or choices faced by any society in the process of resource allocation:

- What to produce in what quantity
- How to produce
- Whom to produce

[01 mark] [Total 03 marks]

(4) The **Opportunity Cost** is the value (real value) of the next or second best alternative foregone, when a choice must be made among alternative choices or activities.

[02 marks] Alternative definitions are acceptable.

Opportunity cost is a highly **subjective** and **real concept**. Cost in economics is opportunity cost and, in some situations, may include external cost.

[01 mark] [Total 03 marks]

(B) **Briefly explain** the link between the **'Basic Economic Concepts'** **[04 marks]**

During a given period of time the available stock of productive resources held by a country is relatively scarce (i.e., insufficient to produce all the goods and services, to fulfil society's unlimited wants). Such limited resources have alternative productive uses.

[02 marks]

Accordingly, in the process allocating scarce resources with alternative uses, making choices, or facing tradeoffs becomes unavoidable. Making such choices results in opportunity cost.

[02 marks] [total 04 marks]

Question [03]

(A) **Distinguish** by **'Defining'** the following concepts connected to Demand Theory:

(1) Demand (i.e., Effective Demand)
(2) Individual Demand
(3) Market Demand
(4) Quantity demanded. **[02 marks each]**

[Technically correct and Standard 'Definition' is expected]

(1) **Demand in economics is essentially effective demand.**
Demand (D) is the quantities of a given product, consumers in the market *want, has the purchasing power and planning to purchase, at a range of alternative prices in the market, when all other factors affecting demand are held constant (ceteris paribus), during a given period of time.*

[02 marks]

(2) **Individual demand** is the quantities of a given product, an **individual consumer** in the market *want, has the purchasing power, and planning to purchase, at a range of alternative prices in the market, when all other factors affecting demand are held constant (ceteris paribus), during a given period of time.*

[02 marks]

(3) **Market demand** is the sum of all the quantities of a given product, all consumers operating in the market *want, has the purchasing power, and planning to purchase, at a range of alternative prices in the market, when all other factors affecting demand are held constant (ceteris paribus), during a given period of time.*

[02 marks]

(4) **Quantity demanded (Qd)** is the amount or quantity of a given product, consumers in market *want, has the purchasing power, and planning to purchase, at a **'specific or particular price'** in the market, when all other factors affecting demand are held constant (ceteris paribus), during a given period of time.*

[02 marks]

(B) **State the** specific and generic factors determining the quantity of rice demanded by consumer**s** in Sri Lanka

- Price of rice
- Price of related products (such as wheat flour, bread, other instant or processes food items, grains, vegetables, coconuts, cooking oil, electricity, cocking fuels)
- Rice consumers nominal income
- Consumers taste or preference towards rice
- Social and demographic trends affecting rice consumers (such as urbanization, occupation, lifestyle, health status)
- Size of the market (number of rice consumers) and the age structure of the population
- Future expectations of price and availability of rice stocks

[01 mark each, total 06 marks]

Question [04]

(A) **Distinguish** by **'defining'** between Government **'Price Ceilings'** and **'Price Floors'**, provide two Sri Lankan context examples for each

A price ceiling is a maximum legal price set by the government for a commodity (*generally essential goods, and services*) for which the existing free market price is deemed (believed) to be too high by the authorities and thus consumers need some help to make the product reasonable in price (or affordable).

An effective price ceiling is set below the existing free market price and selling the product at any price above the ceiling price is illegal. An essential outcome of an effective price ceiling is an excess demand and a shortage of the good in the market.

[02 marks]

Examples:

- Setting maximum prices for some essential consumer goods such as rice, milk powder, eggs, bread, passenger transport, LP gas
- Maximum interest rate controls, Rent controls

[01 mark] [Total 03 marks]

A price floor is a minimum legal price set by the government for a commodity (*generally essential agricultural good or other services*) for which the existing free market price is deemed (believed) to be too low by the authorities and thus producers or farmers need some help to make the product reasonable in price (*or reasonably profitable to produce*).

An effective price floor is set above the existing free market price and trading the product at any price below the floor price is illegal. An essential outcome of an effective price floor is an excess supply and a surplus of the good in the market.

[02 marks]

Examples: Setting a minimum wage
Setting guaranteed prices for agro crops

[01 mark] [Total 03 marks]

(B) **State** the main **'Economic Consequences'** of Government **'Price Ceilings'** and **'Price Floors'**

Government **'Price Ceiling or Maximum Legal Price Controls'**

- The creation of a product shortage (or excess demand of the product)
- The tendency for black markets to be created, where the product in shortage will be sold at prices higher than the control price.

- The inevitable emergence of non-price rationing methods
  [Long ques, rationing card system etc]
- The high cost of searching for goods in shortage: time and money spent
- Welfare effects: the producer surplus shall decrease and consumer surplus may increase.
- Inefficiency in resource allocation
- Parties facing poverty, and parties who are not economically empowered are able afford essential goods under the price control, they were previously unable to buy.
- Producers' revenue shall decrease, as they are forced to sell the product at a lower price

- The government will have to incur additional expenditure to solve the product shortage and make the price ceiling meaningful. In this process the government will have to redirect resources (funds) from other essential services to provide subsidies to the producers of the good under the price control.

[01 mark each, total 03 marks]

Government **'Price Ceiling or Maximum Legal Price Controls'**

- **Creation of Excess Supply**
  Since the quantity supplied exceeds the quantity demanded there will be continues surplus or excess of goods with in the market.

- **Unique problems when solving excess supply**
  The creation of a unique problem when attempting to solve an excess supply or surplus in the market of a Service (especially Factor-based services), caused due to a price floor.

  Example:
  Issues faced when trying to solve unemployment, due to a minimum wage controls

- **Creation of unethical and unfair trade practice**
  Certain traders or suppliers in an industry subject to minimum price controls may consider the price floor as a mere nominal price and offer their goods at discounted prices, leading unfair (unethical) trade practices.

- **Allocative inefficiency in investment flow**
  The government induced, artificially high price within an industry may lead to the possibility of a highly inefficient over allocation or inflow or investment (resources) towards the industry

[01 mark each, total 03 marks]