Question 1: Define the term "scarcity." (2 marks)

Answer.

Scarcity refers to the fundamental economic problem of having limited resources to meet unlimited wants and needs. It arises because resources (land, labor, capital, and entrepreneurship) are finite while human desires and needs are virtually infinite. (2 marks)

Question 2: Explain the difference between positive and normative economics. (4 marks)

Answer:

Positive economics deals with objective analysis and statements about economic phenomena, focusing on "what is." It involves describing, explaining, and predicting economic events based on empirical evidence and facts. For example, "An increase in the minimum wage will lead to higher unemployment among low-skilled workers."

Normative economics, on the other hand, involves value judgments and opinions about what the economy should be like. It focuses on "what ought to be" and is subjective. For example, "The government should increase the minimum wage to reduce income inequality." (4 marks)

Question 3: With the help of a diagram, explain the concept of opportunity cost. (6 marks)

Answer:

Opportunity cost refers to the value of the next best alternative foregone when making a decision. It is the cost of choosing one option over another and represents the benefits that could have been obtained from the next best alternative.

Diagram: (A basic production possibility frontier (PPF) diagram should be drawn, showing two goods, such as guns and butter. Points inside the curve, on the curve, and outside the curve should be labeled.)

Explanation: The PPF shows the maximum possible output combinations of two goods that can be produced with available resources and technology. Points on the curve represent efficient production levels, while points inside the curve represent inefficient use of resources, and points outside are unattainable.

When moving from one point to another on the PPF, the opportunity cost is represented by the amount of one good that must be sacrificed to produce more of the other good. For example, moving from point A to point B on the PPF (producing more butter) requires sacrificing some quantity of guns, which is the opportunity cost. (6 marks)

Question 4: Discuss how the concept of scarcity leads to the need for choices and trade-offs in an economy. (8 marks)

Answer:

Scarcity necessitates choices and trade-offs because resources are limited, and not all wants and needs can be satisfied simultaneously. Individuals, firms, and governments must make decisions on how to allocate these limited resources to maximize satisfaction and efficiency.

For individuals, scarcity means choosing how to spend their income on various goods and services. For instance, spending money on education may mean foregoing a vacation. This trade-off reflects the opportunity cost of their choice.

Firms face scarcity in terms of resources like labor, capital, and raw materials. They must decide what to produce, how to produce it, and for whom to produce. For example, a car manufacturer might have to choose between investing in new technology or expanding its production capacity. The trade-off involves opportunity costs, such as the benefits of new technology versus increased output.

Governments also confront scarcity when determining how to allocate budgetary resources among various public goods and services, such as healthcare, education, and defense. They must prioritize certain areas over others, leading to trade-offs and opportunity costs. For instance, allocating more funds to healthcare might mean less spending on infrastructure.

In summary, scarcity forces all economic agents to make choices and trade-offs, weighing the opportunity costs to allocate resources efficiently and achieve the best possible outcomes given the limitations. (8 marks)

Question 5: Evaluate the role of economic models in understanding economic concepts and solving economic problems. (10 marks)

Answer:

Economic models are simplified representations of reality that help economists understand complex economic concepts and analyze economic problems. These models use assumptions to focus on specific relationships and mechanisms within the economy, making it easier to predict and explain economic behavior.

Advantages:

1. Simplification: Models reduce the complexity of the real world, allowing economists to focus on key variables and their relationships. This simplification aids in understanding how different factors interact within an economy.

2. Prediction: By using models, economists can make predictions about future economic events and trends. For example, supply and demand models can predict the effects of price changes on quantity demanded and supplied.

3. Policy Analysis: Models provide a framework for evaluating the potential outcomes of different economic policies. Governments and policymakers can use models to assess the impact of fiscal or monetary policies on inflation, unemployment, and economic growth.

4. Communication: Models help communicate economic concepts and theories clearly and concisely to both economists and non-economists, facilitating a better understanding of economic issues.

Limitations:

1. Simplifying Assumptions: The assumptions made in models may oversimplify reality, leading to inaccuracies. For example, assuming perfect competition or rational behavior may not reflect actual market conditions.

2. Static Nature: Many models are static and do not account for changes over time. Dynamic aspects of the economy, such as technological advancements or evolving consumer preferences, may be overlooked.

3. Data Limitations: The accuracy of models depends on the quality and availability of data. Incomplete or outdated data can lead to incorrect conclusions.

4. Subjectivity: The choice of assumptions and variables in a model can be subjective, influenced by the economist's perspective or theoretical bias.

In conclusion, while economic models play a crucial role in understanding economic concepts and solving problems, it is essential to recognize their limitations. Models should be used as tools to guide analysis and policy decisions, complemented by empirical evidence and real-world observations. (10 marks)