

ITEM ONE:

The government wants to transition to an economic system where it owns resources and allocates them on behalf of its citizens. Policy makers have been engaged in an intense debate regarding the potential consequences of adopting such economic system.

Tasks:

- (a) Identify the features underlying such economic system to be adopted by the government.
- (b) Discuss the potential benefits and drawbacks of adopting such economic system? (20 Scores)

ITEM TWO:

In a certain town, a business man owns two production units, one for producing textile fabrics and another for producing plastic packaging materials. The demand for textile fabrics is high in the local market but plastic packaging materials fetch a higher price. His production plants have limited capacity making it challenging to meet the demand for both products.

Tasks:

- (a) Identify the fundamental economic problems being faced by the business man.
- (b) Explain how the business man can come up with an informed decision about allocating his production capacity. (20 Scores)

— END —

## POSSIBLE GUIDE FOR ITEM TWO:

(a) The business man is facing the following fundamental economic problems:

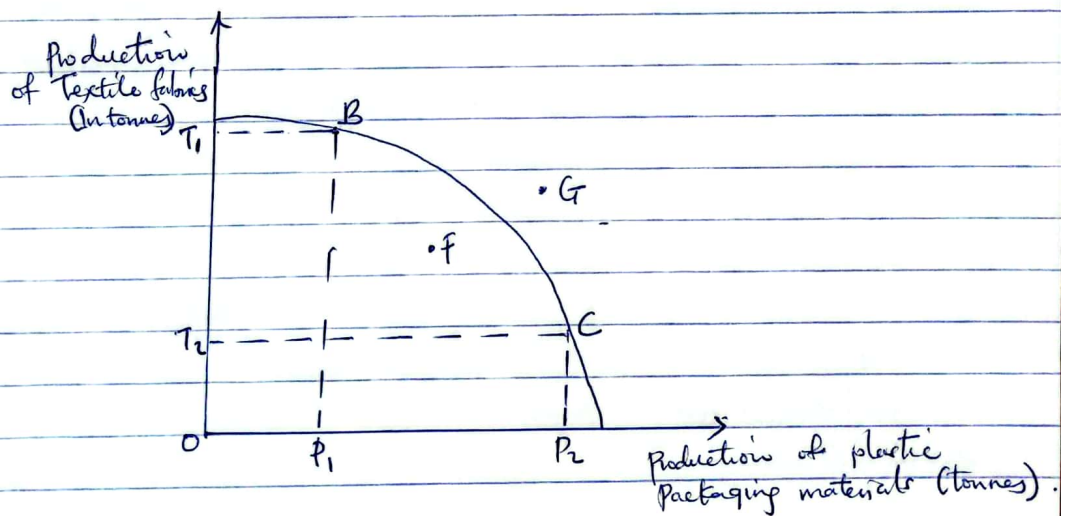
(i) Scarcity. There is limited supply of resources to produce goods and services (plastic packaging materials & Textile fabrics).

(ii) Choice. The act of making a right decision from the available alternatives in order to use limited resources.

(iii) Opportunity Cost. This refers to the alternative forgone when choice is made.

(b) The business man can come up with an informed decision about allocating his production capacity using knowledge of opportunity cost curve.

Opportunity Cost Curve refers to a curve showing all possible combinations of two commodities that can be maximally produced in an economy if all the available resources are fully and efficiently utilised. This is illustrated as below.



At point B, most of resources are directed to the production of textile fabrics and little to production of plastic packaging materials.

At point C, most of resources are diverted to production of plastic packaging materials and less of textile fabrics are produced.

Points B and C, show that resources are fully utilised and such points are attainable.

points above the ppf such as G are not attainable but desirable while points below the ppf such as F are attainable but not desirable thus show excess capacity production.

The enclosed area represents the business man's capacity to produce and this capacity may be small or large.

The opportunity cost curve shows the following fundamental economic problems.

(i) Scarcity.

Because the available resources are limited in supply, the business man cannot produce beyond the available resources, therefore he cannot produce beyond combinations B and C along the ppf in line with the available resources.

(ii) Choice.

At point B, he chooses to produce more textile fabrics than plastic packaging materials since their demand is high in the local market thus ranking higher on his scale of preference.

At point C, he chooses to produce more plastic packaging materials since they fetch a higher price on the local market thus ranking higher on his scale of preference.

Therefore he can choose to produce  $OT_1$  of textile fabrics and  $OP_1$  of plastic packaging materials or  $OT_2$  and  $OP_2$  but not both combinations at the same time.

(iii) Opportunity Cost.

From B to C, to produce  $P_1P_2$  more units of plastic packaging materials, you forego  $T_1T_2$  more units of textile fabrics. An increase in output of one commodity leads to a reduction in output of the other commodity.

Therefore, for the business man to produce a combination of the two commodities; to produce more units of plastic materials, he has to forego more resources that were used to produce textile fabrics.