

**H2 Economics Essay Question 1**

- a) Explain the relationship between scarcity, choice and opportunity cost. [8]  
b) Assess the extent to which these concepts are of relevance to the Singapore government when making its policy decisions. [17]

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Command	Content	Context
Explain	Relationship between Scarcity, Choice and Opportunity Cost	No context
Scarcity → Choice of “what”, “how” and “for whom” to produce. Making a choice → Opportunity cost		
Tools of economic analysis – Production Possibility Curve		

**Suggested answer scheme**

Scarcity arises because society’s resources are limited whereas human beings desires are unlimited. In other words, scarcity is defined as the condition whereby human wants and needs exceed production possibilities.

This is illustrated by the boundary of the Production Possibility Curve (PPC). The PPC shows the various combinations of goods and services that can be produced within the economy when all resources are fully and efficiently employed. Referring the Figure 1, given the limited resources of Economy A, the maximum amount of production is within the boundaries of its PPC.

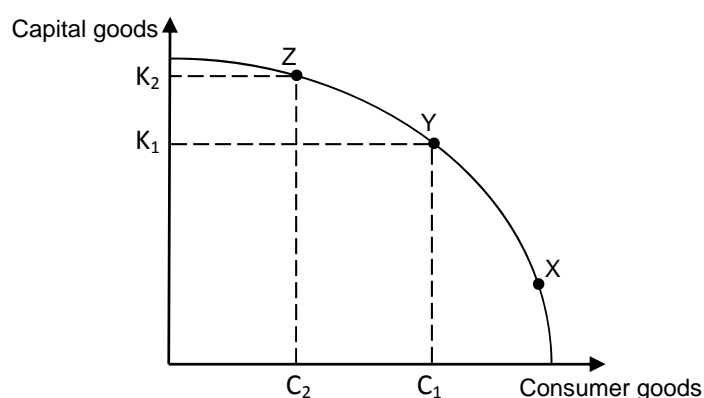


Figure 1: Production Possibility Curve of Economy A

Because resources are scarce, all societies face the problem of deciding what to produce, how to produce and for whom to produce. Therefore the problem of scarcity of resources implies the need for choice. Society has to decide how best to make use of their limited resources to try to meet the unlimited wants. For example, Economy A has to make a choice between production points X, Y or Z, indicating the choice of “what” and “how much” to produce – i.e. Capital goods vs Consumer goods and the corresponding amounts. Moreover, due to scarcity of resources, an economy also has to decide “for whom to produce”. Producing more consumer goods will imply producing more for consumers rather than for producers. Moreover, society also has to make a choice on “for whom to produce” based on the type of consumer goods to produce. Should more resources be diverted to producing

basic necessities or luxury goods? – the former being produced more for the average household while the latter caters more to the higher-income households.

The scarcity of labour resources and capital goods also necessitates the choice of “How to produce” – for example in Singapore where the size of the population is small, existing firms will have to make choices regarding whether to make greater use of machinery rather than labour as the main factor of production.

Just as scarcity implies the need for choice, making a choice implies the existence of opportunity cost. Opportunity cost can be defined as the next best alternative forgone. For example, point Y on the PPC (Figure 1) shows  $C_1$  consumer goods and  $K_1$  capital goods. But if the economy chooses to move its production point from Y to Z, the opportunity cost of increasing the production of capital goods from  $K_1$  to  $K_2$  is the fall in consumer goods from  $C_1$  to  $C_2$ .

In summary, the scarcity of resources necessitates the making of choices which will incur an opportunity cost.

L3	For an answer that clearly demonstrates the relationship between scarcity, choice and opportunity cost. Candidates should be able to explain the relationship between the 3 concepts with the use of the PPC and relevant examples.  Max.6 m if candidates did not use PPC as the key analytical tool.	6 – 8
L2	For an under-developed answer with limited depth in economic analysis.  Max. 4 m if candidates are only able to demonstrate the relationship between 2 out of the 3 concepts.	3 – 5
L1	Mere sputtering of points.	1 – 2

- b) Assess the extent to which these concepts are of relevance to the Singapore government when making its policy decisions. [17]

Relevance of concepts	Evaluation of extent of relevance
<p>Scarcity → faces resource constraints when trying to maximize the welfare of society (SOL)</p> <ul style="list-style-type: none"> <li>Main concerns of the government is on microeconomic objectives of efficient allocation of resources and macroeconomic objectives of low unemployment, low inflation and high and sustainable economic growth</li> </ul> <p>Due to the constraints of scarcity → Choice has to be made and therefore certain trade-off has to be considered in making policy decisions.</p> <p><b>Example 1:</b>  <u>Choice and trade off between economic growth and welfare</u></p> <ul style="list-style-type: none"> <li>Scarcity is illustrated by the boundaries of the PPC → Constraints of production within the boundary of the PPC</li> <li>As such every resource must be fully utilized, especially labour in Singapore context</li> <li>Need to increase the incentive to work amongst older generation → delayed retirement</li> <li>Example: Policy decisions on extension of retirement age → Longer working life → Increases income levels but reduces SOL</li> </ul> <p><b>Example 2:</b>  <u>Choice and Trade-off between unemployment and inflation</u></p> <ul style="list-style-type: none"> <li>When considering dd-mgt policies → need to consider trade-off between inflation and unemployment</li> <li>E.g. if increase AD to lower unemployment rate → higher GPL (illustrate with the use of diagram – Phillips Curve or AD-AS analysis are both accepted)</li> </ul> <p><b>Example 3:</b>  <u>Choice and trade-off between policies to pursue potential economic growth and welfare</u></p> <ul style="list-style-type: none"> <li>To expand productive capacity of the Singapore economy by increasing the</li> </ul>	<p><b>Evaluation 1:</b></p> <ul style="list-style-type: none"> <li>Issue of scarcity, choice and opportunity cost is relevant to a large extent in deciding on policies designed to move production points from within the PPC to a point on the PPC.</li> </ul> <p><b>Evaluation 2:</b></p> <ul style="list-style-type: none"> <li>The trade-off is to a large extent caused by scarcity of resources.</li> <li>Dd-pull inflation occurs due to the limited productive capacity of the Singapore economy. This is especially so due to land constraints that drive up rental cost as well as labour constraints that drives up wage cost.</li> </ul> <p><b>Evaluation 3:</b></p> <ul style="list-style-type: none"> <li>Main objective of the policy is to overcome the problem of scarcity in labour resources</li> </ul>

<p>quantity and quality of resources.</p> <ul style="list-style-type: none"> <li>• Policy decisions on inflow of foreign labour → increase quantity and quality of labour → outward shift of the PPC</li> <li>• Increase competition for jobs between local and foreign labour → higher potential growth may be experienced at the expense of welfare of citizens</li> </ul> <p><b>Example 4:</b> Openness to trade and other trade policies</p> <ul style="list-style-type: none"> <li>• Due to scarcity of resources</li> <li>• Heavy reliance on imported goods and raw materials</li> </ul>	<p><b>Evaluation 4:</b></p> <ul style="list-style-type: none"> <li>• Extended also to the reliance on exports</li> <li>• Scarcity means Singapore is not able to produce everything; need to consider relative comparative advantage and therefore opportunity cost in deciding on the focus of production.</li> </ul>
<p>Other factors affecting policy decisions</p> <ul style="list-style-type: none"> <li>• Equity <ul style="list-style-type: none"> <li>◦ Access to basic healthcare – e.g. certain vaccinations are provided free not because scarcity does not exist but more on the</li> </ul> </li> </ul>	<p>However,</p> <ul style="list-style-type: none"> <li>• Scarcity will always exist despite outward shift of PPC</li> <li>• Economic growth can also create new wants and also diminish available resources at a faster rate thus leading to further scarcity in the long run</li> <li>• As such, since scarcity is a central concern, all policy decisions that are undertaken on an economic basis tends to be influenced by the concepts of scarcity, choice and opportunity cost.</li> </ul>

L3	Well-developed discussion on the relevance of the various concepts on Singapore government's policy decision making.  Max. 9 if no Singapore context	9 – 11
L2	Under-developed discussion on the relevance of the various concepts on Singapore government's policy decision making.	6 – 8
L1	Sputtering of valid points.	1 – 5
E2	Judgment is based on economic analysis.	3 – 4
E1	Unexplained judgment.	1 – 2