ECONOMICS P220/1 MARKING GUIDE 2022

SECTION A

1. (a) (i) A centrally planned economy is the one where resources are owned and allocated by the state.

(ii) Features of a centrally planned economy

- *Ownership and control of resources is by the state government*
- *Welfare maximization is the main objective*
- *No private investment / all investments are publically owned*
- *There is centralized planning*
- *Existence of price control / price legislation*
- *Limited competition due to lack of profit motive*

(b) (i) Price inelastic demand is where a big percentange change in price results into a small percentage change in quantity demanded of a commodity
OR *Price inelastic demand where the ratio of change in price is greater than the ratio of change in quantity demanded.*

While / yet / whereas

Income elastic demand is where a small percentage charge in income of the consumer results into a big percentage change in quantity demanded of a commodity
OR
Income elastic demand is where the ratio of change in quantity demanded.

(ii) Causes of price inelastic demand

- *High degree of necessity*
- *Absence of substitute goods*
- *High degree of complementarily*
- *Remand for durable goods like household furniture, for set etc*
- *High degree of addiction towards the commodity*
- *High income of the consumer*
- *Small proportion of income spent on a commodity*
- *High level of advertisement*
- *Short run situations*
- *The commodity being conveniently accessible*
- *Few uses (single use) of the commodity*

- *High level of ignorance of the consumer*
- *Inability to postpone consumption of the commodity*
- *High level of price instability*
- *Expectation of high prices in nearby future.*

(c) (i) Foreign aid is the transfer of resources in form of assistance either directly from one country to another or through multi national agencies.

(ii) Dangers of relying on foreign aid.

- *Worsens balance of payment problems*
- *Lead to unemployment of local manpower*
- *Promotes laziness / discourages local initiatives*
- *Erodes cultural values of the recipient country*
- *It is not sustainable i.e. may be withdrawn before completion of some projects*
- *Distorts economic planning*
- *Leads to brain drain*
- *Leads to under utilization of local resources*
- *Leads to domination of the economy by foreigners*
- *Undermines political soverignity due to strings attached.*
- *Accelerate capital outflow due to debt servicing*
- *Sometimes pre – set conditions are disastrous*
- *Undermine capital formation*
- *External debt saving problem denies the nationals of essential goods and services.*

(d) (i) Inflation is the persistent increase in the general price level for goods and services over a given period of time.
While / yet / whereas
Reflation is the deliberate government attempt to force prices upwards to recover from a depression.

OR
Reflation is the deliberate government effort to stimulate production by increasing prices to recover an economy from a depression.

(ii) Instruments of a reflationary policy.
- *Tax reduction (reducing direct taxes)*
- *Increasing government expenditure*
- *(using) expansionary monetary policy*
- *Encouraging exports*
- *Raising wages of workers*

(e) (i) An operational plan is the one whose set objective are to be achieved within the period of one year.

While / yet / whereas
A partial plan is the one that covers part of few sectors of the economy.

(ii) Demerits of partial planning

- *Leads to regional and sectoral imbalance*
- *Worsens income inequality*
- *Leads to under utilization of resources*
- *Limits linkages between sectors*
- *Leads to sectoral / economic dependence*
- *Limits employment creation*
- *Limits government revenue (small tax base)*
- *Cause shortages / structural inflation*
- *Limits economic growth (small volume of output)*

2. (a) A monopolist maximizes profits at a point where MC = MR, this is illustrated as below;

- *Profit maximizing output is determined at point where MC = MR, that is point X and the output produce is…………..*
- *Price is determined where the output line intersects with AR curve at point A hence price is …………………………..*
- *The cost incurred per unit is determined at point B where the output line meets the AC curve hence cost ……..*
- *The AC being lower than AR at equilibrium output, the firm enjoys abnormal profits indicated by the shaded area…………………….*

(b) Effects of monopoly (monopolist) in a market economy

Positive effects
- *Economies of scale are enjoyed by the firm (monopolist)*
- *Minimizes duplication of activities*
- *Low income earners benefit from price discrimination*
- *Operational costs are usually low in monopoly markets*
- *Abnormal profits are invested in research and development hence increases research*
- *Abnormal profits encourage firm growth*
- *Produce on large scale hence faster economic growth*

- *Large employment creation due to operation on large scale.*

Negative effects

- *Excess capacity is encouraged*
- *Increases problems of wealth inequalities between producers*
- *Undermines growth of entrepreneurship due to limited entry*
- *Limits variety of goods and services*
- *Consumer exploitation through high prices*
- *Production of law quality goods*
- *Causes unemployment*
- *Limited innovation and invention*
- *Low rate of growth – restricted output*
- *Exploitation of workers through under paying*
- *Absence of touch with customers*
- *Distorts operation of price mechanism*

3. *(a)* *Multiplier theory of investment refers to the number of times the initial change in amount of investment expenditure multiples itself to generate a final change in income.*

OR

Is the number of times the initial amount of investment expenditure multiplies itself to give a final level of income.

While

Accelerator principle is the number of times an initial change in consumption expenditure multiplies itself to generate final change in investment.

(b) *Factors that influence effective operation of investment multiplier*

- *Level of income*
- *Interest rate on loans*
- *Level of development of infrastructure*
- *Level of savings*
- *Corporate profitability / the level of profits*
- *Political climate*
- *The land tenure system*
- *The existing stock of capital*
- *Size and quality of labour force*

- *Entrepreneurial abilities*
- *Size of the market*
- *The rate of inflation*
- *Degree of accountability / level of corruption*
- *Government policy on taxation and subsidization*
- *Level of exploitation of natural resources*
- *The population growth rate*
- *The degree of conservation / social factors*
- *Liquidity preference*
- *Marginal efficiency of capital*
- *The degree of liquidity preference*

4. (a) *Reasons for modernization of agriculture.*

- *To increase output hence economic growth*
- *To avoid seasonal unemployment / to create employment opportunities.*
- *To increase foreign exchange earnings / to improve balance of payment position*
- *To increase farmer's incomes or to reduce income inequality.*
- *To promote infrastructural development*
- *To raise more government revenue*
- *To release labour for other sectors*
- *To reduce regional imbalances through accelerating rural transformation or to reduce rural urban migration*
- *To attain price stability or to control structural inflation or to control price fluctuation*
- *To ensure food security for the growing population*
- *To promote growth of industrial sector by ensuring steady supply of raw materials*
- *To reduce dependency on few economic activities*
- *To enable production of high quality output*
- *To promote specialization and hence enjoy benefits of specialization*
- *To promote development of skills*
- *To increase exploitation of the land resource.*

(b) Suggested measures to modernize agriculture in developing countries.

- *Facilitate provision of affordable credit facilities*
- *Undertake land reforms*
- *Introduce better production methods or improve techniques of production or mechanise agriculture*
- *Provide extension services / provide training to farmers.*
- *Encourage research (introduce) better breeds and crop varieties*

- *Develop infrastructure*
- *Maintain political stability*
- *Strengthen fight against corruption or improve accountability*
- *Encourage diversification of agriculture*
- *Set up institution to promote agricultural strengthen cooperative societies*
- *Expand markets e.g. through regional economic integration*
- *Establish pilot projects and demonstration firms to offer farmers practical guidance*
- *Improve price policy or ensure fair and stable prices for agricultural products*

5. (a) The process of credit creation in a multi bank system.

- *Receiving of the initial deposit by the 1st commercial bank i.e. Bank A from the depositor*
- *Keeping a percentage of the deposit as cash ratio by the 1st bank i.e. bank A*
- *Lending the balance to a credit worthy customer by bank A*
- *Receiving the money lent out as a new deposit in the second bank i.e. bank B*
- *Keeping a percentage of the deposit by bank B as cash ratio.*
- *Lending the balance to a credit worthy customer by bank B*
- *The process continues till the initial deposit diminishes towards zero in the banking system*
- *At the end of the process, the total credit created is obtained from*

$$total\ credit\ created\ =\ initial\ deposite\ \ x\ \ \frac{1}{cash\ ration}$$

Alternatively

Assume a fixed cash ratio of 10% and initial deposit of 100,000/=

- *Receiving the initial deposit of 100,000/= by the first bank (Bank A) from the depositor*
- *Keeping a cash ratio of* $^{10}/_{100}\ \ x\ \ 100{,}000\ =\ 10{,}000 \neq$ *by bank A*
- *Lending out the balance of 90,000/= by bank A to a credit worthy customer.*
- *Receiving the loan of 90,000/= given by bank A as a new deposit in second bank (Bank B)*
- *Keeping a percentage as cash ratio by bank B of* $\frac{10}{100}\ \ x\ \ 90{,}000\ \ =\ \ 9{,}000 \neq$
- *Lending the balance of 81,000/ by bank B to another credit worthy customer*
- *The process continues until the initial deposit vanishes within the system.*
- *At the end of the process, total credit created is given as;*

  Total credit created = initial deposit $x\ \ \frac{1}{cash\ ratio}$

(b) Factors that limit ability of commercial banks to create credit

- *High cash ratio*
- *Absence of credit worthy customers / limited collateral security*

- *High interest rate on loans*
- *High liquidity preference*
- *Unpopularity of loans*
- *Restrictive monetary policy*
- *Poor accountability by bank officials*
- *Political instability*
- *High rate of inflation*
- *Low level of investment*
- *Large subsistence sector*
- *Uneven distribution of commercial banks*
- *Limited knowledge of commercial bank services*
- *Low savings or limited deposits from the public or low income of the population.*

6. (a) *Terms of trade is the rate at which a country's exports are exchanged for imports at a given time period.*

   OR

   Terms of trade is the ratio of price index of exports to the price index of imports of a country at a given period of time.

   While

   Balance of trade is the difference between the value of country's visible exports and the value of the country's visible imports during a given period.

   (b) *Causes of balance of payment deficits in developing nations*

- *Dominance of exports by primary products with low value added.*
- *Exportation of low quality goods*
- *Low volume of exports*
- *High marginal propensity to import or importation of high volume of manufactured and consumer goods.*
- *Trade restrictions in export markets*
- *Limited market because of flooding of markets by similar goods produced by LDCs.*
- *Political instability leasing to heavy expenditure on military equipment*
- *High profit and wage (income) repartriation*
- *High levels of debt servicing or high expenditure on debt serving and debt repayment*
- *Weak bargaining power of developing countries hence developed countries who are major buyers dictate prices of products from LDCs (fix low prices)*
- *Limited variety of exports*
- *Poor and ever fluctuating exchange rates making exports from LDCs less competitive*

- *Developing countries are importers of highly priced goods such as fuel, manufactured goods, medicine among other / LDCs are importers of expensive essential goods*
- *Excessive government expenditure on foreign travels and other foreign commitments such as foreign diplomatic mission and contributions to the running of international organisations.*

7. (a) The benefits of privatization in an economy

- *Increased output hence economic growth*
- *Increases government revenue through taxation*
- *Widened consumer choice due to production of variety*
- *Reduces government expenditure on subsidizing inefficient state enterprises*
- *Reduces dependene on imports as domestic production increases*
- *Attracts more foreign (private) investment*
- *Results into production of high quality goods*
- *Controls structural inflation due to increased domestic production*
- *Improves labour skills, encouraged on labour training*
- *Avoids bureaucracy and its negative effects*
- *Encourages creativity and innovation*
- *Allows government to concentrate on provision of essential services*
- *Avoids corruption tendencies associated with state enterprises*
- *Increases resource exploitation*

(b) Obstacles to privatization process

- *Corruption within the privatization unit*
- *Opposition from public due to ignorance*
- *Poor valuation or under valuation leading to losses*
- *Poor state of enterprises which scares away buyers*
- *Unscrupulous / dishonest / unserious buyers*
- *Under developed capital markets*
- *High cost of the process (expensive and extensive publicity)*
- *Small markets discourage potential buyers*
- *Political sabotage / opposition by politicians*
- *Poverty among nationals force government to sell to foreigners*
- *Limited skilled labor lead to undervaluation of state enterprises.*

END