ASK INTEGRATED TEACHER'S EXAMINATIONS BUREAU LTD – AITEL
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SECTION A

1. (a) (i)The law of demand states that other factors remaining constant; more of a commodity is demanded at a lower price than at a higher price.

OR

The law of demand states that, "the higher the price, the lower the quantity demanded of a commodity and the lower the price the higher the quantity demanded of a commodity, other factors remaining constant (ceteris paribus)".

OR

Assuming other factors constant (ceteris paribus), an increase in price is followed by a contraction in quantity demanded and a decrease in price leads to a rise in quantity demanded.

ii)

Presence of low income earners

Operation of the diminishing marginal utility

Various uses of certain commodities

Repulsion effect should be constant

The consumers should have perfect price knowledge

When there is real income effect

(b)(i) **Multiplier** is the number of times initial change in expenditure multiplies itself to give a final change in income.

(ii) The final level of income in an economy = change in income + original income. (1 mark)

$$\text{Multiplier(K)} = \frac{\text{change in income } (\Delta Y).}{\text{Initial change in expenditure } (\Delta E).}$$

From the above formula change in income = Multiplier(K)X Initial change in expenditure (ΔE).

But a Multiplier(K) = 1/MPS or 1/1-MPC. Since MPS= 1-MPC

Multiplier (K) $= \frac{1}{1-0.75} = 4$

Therefore, change in income = 4 X 200,000,000

= 800,0000,0000

Thus the final level of income in an economy = change in income + original income

= 800,000,000 + 500,000,000 (1 mark)

= 1,300,000,000 OR 1,300 million (1 mark)

(c) (i) Reserve price. This is the least possible acceptable price at which a seller can allow his commodity to be bought.

OR

This is the price below which the seller is not willing to sell his commodity.

(ii)

- Expected future price for a commodity.
- Nature of a commodity/degree of durability.
- Storage costs.
- Expected future demand for a commodity.
- Cash requirements of the seller/the need for liquid capital.
- Level of supply of a commodity.
- The cost of production
- The length of the gestation period

(d) (i)

NB:A candidate is supposed to use the needed key words; mainly, predominantly, dominated, basically.

- It's dominated by small scale firms which are individually owned.
- Production is mainly for domestic market.
- It uses mainly simple production techniques which are labour intensive.
- It produces mainly consumer goods.
- It mainly uses locally available inputs or raw materials.
- Limited accounting procedures such as formal book keeping and record management.
- It's mainly sub urban and urban based.
- Limited government control over the activities carried out in the sector.
- Mainly low quantity of output is produced by firms ie .there is generally low productivity.
- Dominated by sole proprietorships.
- Its mainly dominated by unskilled and semi-skilled labour.
- Mainly produces low quality goods.

(e) (i) An inflationary gap is a situation where aggregate demand exceeds aggregate supply at full employment level of national income.

While,

Stagflation refers to a situation in which high rates of inflation co-exists with high levels of unemployment in an economy.

OR

It refers to a situation where there exits both high levels of unemployment and high rates of inflation in an economy.

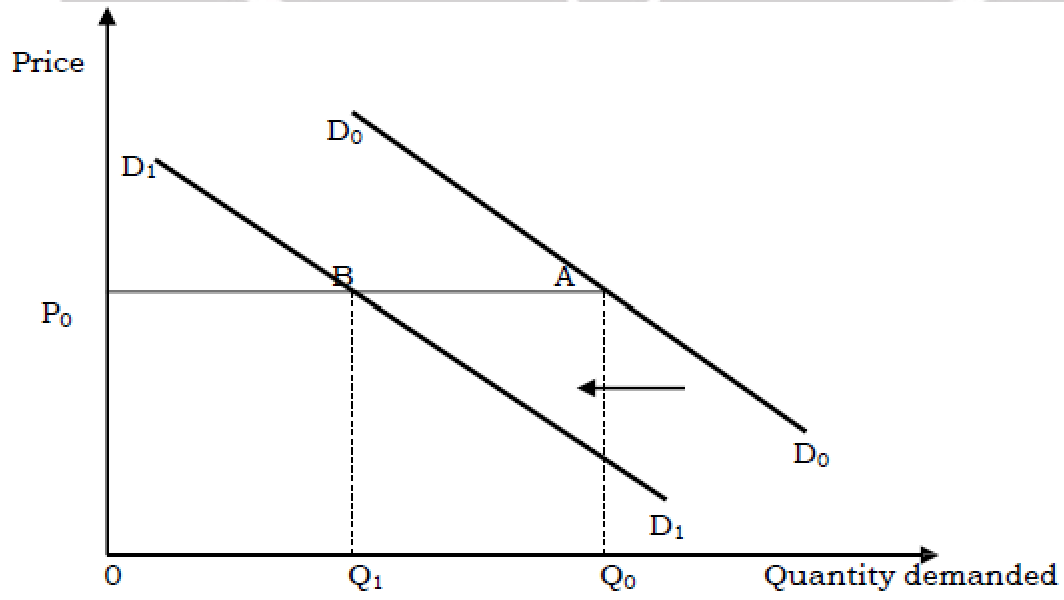
(ii)

- Use of restrictive monetary policy.
- Controlling wages/wage freeze
- Reducing exports of scarce goods.
- Increasing imports of scarce goods.
- Increasing direct taxes.
- Reducing government expenditure.
- Providing a favourable investment climate.
- Developing infrastructure

SECTION B

2. (a) A decrease in demand refers to a situation in which less quantity of a commodity is demanded due to other factors affecting demand when price is held constant. (02 mark)

An illustration



(1 mark)

A shift of the entire demand curve from right to the left i.e DoDo to D1D1 illustrates a decrease in demand.

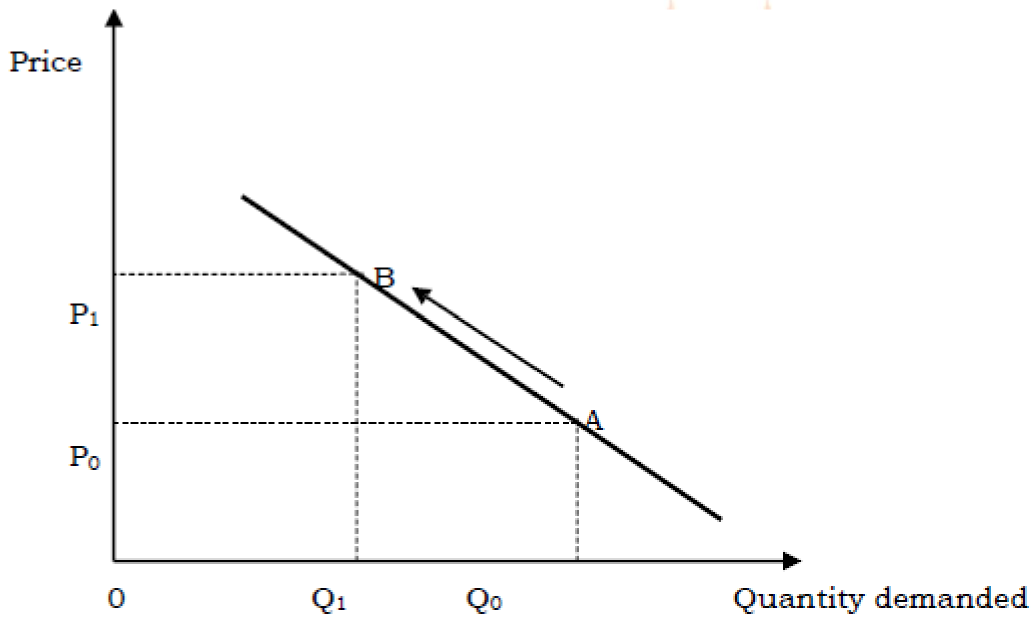
While,

Decrease in quantity demanded refers to a fall in the amount of a commodity demanded due an increase in price of that commodity, other factors affecting demand held constant.

OR

It is an upward movement along the same demand curve as a result of an increase in price of a commodity, other factors affecting demand held constant. (01 mark)

An illustration



(1 mark)

A movement from point A to B shows a decrease in quantity demanded as a result of an increase in price from OPo to OP1.

(b)

- ✓ The short time period of consumption, demand for a commodity tend to be inelastic because time is too short for the consumers to make adjustments from one commodity to another
- ✓ High level of consumer's income, consumers with high income levels respond less to price changes, i.e., they are less sensitive to price changes hence an inelastic demand
- ✓ Demand for necessity commodity. Price elasticity of demand for a necessity tends to be inelastic because it is indispensable for instance food, salt.
- ✓ Few or no substitutes for a commodity, a commodity with few or no substitutes tends to have inelastic demand because consumers do not have other possible substitutes to shift consumption to in case of a price increase.
- ✓ Complements/complementary goods. A commodity that is used with other commodities tends to have inelastic demand provided one has already been bought for example demand for fuel may not reduce even if price increases provided people still use vehicles

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- ✓ A small proportion of consumer's income spent on the commodity. A commodity which takes a small fraction of the consumers income tends to be price inelastic for instance match box, needles, razorblades because consumers tend not to feel an effect of an increase in price
- ✓ A commodity that is more convenient and easy to acquire by consumers tends to have inelastic demand for example a commodity sold in the school canteen or next door to your home.
- ✓ Habitual/addiction in the use of a commodity, a commodity consumed out of habit/addiction has inelastic demand for instance demand for cigarettes among hard core smokers because consumers feel they cannot do without them
- ✓ High level of advertising through persuasive/intensive advertising for a commodity leads to inelastic demand
- ✓ A durable commodity such as a radio, a television has inelastic demand because even if price of such a commodity falls by a big margin one may not buy another one when he already has one
- ✓ High future price expectation, if price of the commodity is expected to increase in future, demand becomes inelastic in the present because consumers prefer to buy now well knowing that the price would be higher in future.
- ✓ Limited or few uses of a commodity, a commodity with very few uses tends to have inelastic demand because as price changes quantity demanded remains almost the same.
- ✓ High level of consumer's ignorance about the market, Consumers buy a commodity at a higher price when they are ignorant without perfect knowledge about market conditions and this leads to inelastic demand
- ✓ Favourable season for a commodity makes its demand to be inelastic for example demand for rain coats during rainy seasons.
- ✓ A commodity whose demand cannot be postponed has inelastic demand. Any 8*2=16 marks

3.(a)

It states that the general price level (P) of goods and services in an economy is determined by quantity of money in circulation (M) provided velocity of circulation of money (V) and number/ level of transactions (T) are held constant.

The theory is expressed by Irving Fisher"s equation of exchange

PT = MV or P = MV/T

Where;

P = general price level for goods and services M= quantity/amount of money in circulation

T = volume/level of transactions

V = velocity of circulation of money.

A change in money supply (M) in an economy will lead to exact change in general price level (P) of goods and services provided the velocity of circulation of money (V) and number/level of transaction (T) remain constant.

If the quantity of money in circulation doubles, the general price level will also double with V and T remaining constant.

Velocity of money refers to the number of times a unit of money is used in transactions. According to Irving Fisher, by holding V and t constant, an increase in M will lead to an increase in P and a decrease in M will lead to a decrease in P.

Velocity of circulation of money refers to the number of times on average a unit of money is used in transactions in a given time. It is the speed at which a unit of money changes hands. **Any 1× 6= 06 marks**

(b) To smaller extent the theory is applicable as discussed below.

- ✓ It is true that money is mainly demanded for transaction motive i.e. individuals need money for day to day transactions
- ✓ Money today is the main medium of exchange as its mainly used in transactions than barter trade
- ✓ In capitalist economies, there is limited or no government intervention in price fixing as prices are determined through price mechanism.
- ✓ In reality too much money circulation in an economy leads to increased purchasing power which results excessive aggregate demand thus increase in price level.
- ✓ At full employment of resources, an increase in money supply has no effect on production as output cannot be increased further however much prices increase hence making the theory relevant.

However the quantity theory of money to a larger extent is not applicable in an economy due to its limitations.

1. The theory assumes that velocity of circulation of money (V) and level of transactions (T) are constant, but this is not the case because a change in one induces a change in the other.

2. The theory ignores a system of barter trade which does not involve the use of price and money supply and yet not all transactions are carried out through the use of money.

3. The theory attempts to attempt to explain changes in the value of money but does not clearly explain how it is determined since it only how changes in the value of money are brought about by a change in quantity of money in circulation.

4. This is not enough to explain the value of money.

5. It ignores the rate of interest on capital and yet this also influences supply of money, the theory cannot be complete without referring to interest rate. Low interest rate implies high borrowing hence investment and high output hence low price level but this is ignored by the theory.

7. The theory ignores demand for money and only considers supply of money in its equation and yet demand for money is also very important and may either increase or reduce general price level.

8. There is nothing like the general price level which the theory talks about but rather a series of price levels for goods and services in an economy.

9. Price changes take place at different time periods due to changes in money supply.

10. The theory does not work in case there is high marginal propensity to save since high savings reduce velocity of circulation of money leading to a reduction in general price level.

11. The theory does not consider price control where minimum and maximum prices are fixed by the government; the theory becomes irrelevant since changes in money supply will not lead to changes in general price level.

12. The theory does not explain other causes of changes in general price level such as changes in cost of production, shortages in supply apart from money supply.

13. The theory ignores possibilities of haggling/bargaining between buyers and sellers which determines an aggregate price level. The price may reduce due to bargaining even if money supply increases.

14. The theory considers only the transaction motive of holding money and ignores other motives for holding money such as precautionary and speculative motives.

15. The theory is a truism, it merely says that M, V, P and T are related, but there is no clear explanation about how they change.

16. It ignores the fact that where a country has many unemployed resources, an increase in money supply increases output of goods and services which causes a fall in general price level or no change at all. **Any 7× 2=14 marks**

4. (a) It refers to an industrial development strategy of producing domestically or internally the formally imported industrial goods.

OR

It refers to a strategy of establishing industries in the domestic economy to produce goods that were formed imported. **02 marks**

(b) Merits include.

Helps to save scarce foreign exchange

It reduces the extent of foreign dependence

Facilitates the development of the local skills.

It controls the imported inflation.

More domestic resources are exploited

Increases employment opportunities.

Improves on the balance of payment position.

Promotes and expands the industrial sector.

It facilitates the transfer of the technology and development.

Facilitates the infrastructural development

Widens the tax base which increases the government revenue.

Foreign exchange is earned I the long run through exports.

Encourages increased inflow of the foreign capital.

Creates linkages in the industrial sector.

Increases incomes of producers. Any 9*1= 9 marks

Demerits

Leads to the production of low quality goods due to protectionism

Leads to the high government expenditure on the subsidies.

Leads to the high domestic prices.

Leads to the production at the excess capacity due to the limited markets.

Increase capital outflow on the intermediate inputs.

Tends to concentrate on the production of the consumer goods than the capital goods.

Promotes monopoly tendencies.

Leads to the beggar-my-neighbour policy/retaliation.

Leads to the technological unemployment

Leads to the limited variety of goods and services on the market.

Leads to a fall in the government tax revenue.

Leads to a high profit repartition

Leads to high social costs such as pollution of air, water, land and water. **Any 9×1= 9 marks**

5.(a) Indicative planning. This is the planning where the government identifies appropriate investment areas, provides incentives and required information to individual economic units to achieve pre-determined targets.

Or

Is a planning process where the government identifies priority areas for resource allocation and provides incentives and conducive atmosphere to the private sector but without directing their decisions. **02 marks**

While,

This is planning by the central authority which determines resource allocation in the whole economy and directs implementation of plans in line with the set targets/objectives. **02 marks**

(b)

- Rate of inflation/general price level. High rate of inflation makes economic formulation and implementation unsuccessful while economic stability in form of low rate of inflation leads to effective economic formulation and implementation.
- Population growth rate. High population growth rate affects the limited resources for successful economic formulation and implementation whereas a low population growth rate makes economic formulation and implementation.
- Availability statistical data. Availability of enough statistical data about economic variables encourages effective economic formulation and implementation while limited statistical data about economic variables hinders effective economic economic formulation and implementation.
- Efficiency of the implementation machinery/quality of administrative staff. Presence of efficient administrative machinery in planning sections leads to successful economic formulation and implementation while inadequate efficient administrative machinery in planning unit limits economic formulation and implementation.
- Availability of financial resources/funds from within and abroad. Availability of enough financial resources makes economic formulation and implementation more effective which inadequate financial resources limits effective economic formulation and implementation.
- Level of corruption and embezzlement in planning process/level of accountability. High level of corruption and embezzlement in planning process hinders effective economic economic formulation and implementation while low level of corruption and embezzlement in planning process leads to effective economic formulation and implementation.
- Political climate. Poor political climate limits effective economic formulation and implementation whereas favourable political climate encourages effective economic economic formulation and implementation.

- Level of infrastructure development. High level of infrastructure development leads to successful economic formulation and implementation but underdeveloped infrastructure limits successful economic formulation and implementation.
- Level of dependence on nature/level of occurrence of natural calamities. Frequent occurrence of natural calamities hinders effective economic formulation and implementation while limited occurrence of natural calamities leads to successful economic formulation and implementation.
- Political will and support of the masses. Good political will and support from masses in planning process leads to successful economic formulation and implementation while limited political leads to unsuccessful economic formulation and implementation.
- Availability of trained manpower in planning/skills of planners. Increased supply of trained manpower in planning leads to successful economic formulation and implementation while limited supply of skilled manpower in planning limits successful economic formulation and implementation.
- Degree of responsiveness of the private sector. A rapidly growing non response private sector limits successful economic formulation and implementation compared to where the private sector is weak and responsive.
- Degree of dependence on external resources/aid for planning. High degree of dependence on external resources limits successful economic formulation and implementation while limited degree of dependence on external resources for planning leads to successful economic formulation and implementation.

6. (a)

1. Few firms and with many buyers and each firm has a considerable portion of the total market share.

2. Firms deal in either homogenous products under pure/perfect oligopoly or differentiated products under imperfect oligopoly.

3. Close interdependence between firms. The decisions of one firm affect the price and output decisions of other firms.

4. Entry of new firms into the industry restricted because of high costs of production involved and cartel arrangements among firms.

5. High degree of uncertainty among firms. Each firm cannot predict accurately the actions of rival firms regarding price and output. For instance when one firm decreases its price, then that actual firm is un aware of the reactions of other firms.

6. Firms of different size exist in the same industry depending on capital invested. Some firms are small while others are big depending on the amount of capital invested.

7. Use of non- price competition/intensive sales promotional activities. This is through branding, persuasive advertising, sponsoring events in order to capture a wider market.

8. Price rigidity which is well explained by a kinked demand curve. Prices remain stable despite changes in cost and demand.

9. The main goal of the firm is profit maximization at a point where MC=MR.

10. The demand curve is kinked because of high level of uncertainty, price rigidity and interdependence among firms.

11. No unique pattern of pricing by firms. There are various ways of pricing such as price leadership, collusive pricing and independent pricing by firms.

(b)

- ✓ Use of differentiated forms of packaging. Oligopoly firms try to use attractive packaging materials and brand names to convince the public to buy their commodities.
- ✓ Product quality improvement. Oligopoly firms normally improve on the quality of their output which helps to attract more customers even when the price is not changed.
- ✓ Undertaking promotional offers. Oligopoly firms come up with several promotions to increase demand for their product where customers are attracted to win given prizes which increases demand.
- ✓ These promotional offers are common among telecommunication companies, soft drinks industries and brewing firms.
- ✓ Provision of gifts to customers. Oligopoly firms such as telecommunication companies give out T- shirts, caps to various customers. This helps to attract more buyers of their products.
- ✓ Organizing trade fairs and exhibitions in various parts of the country. This is meant to attract various customers where customers are given extra attention on how the product works and this increases sales. This also helps to introduce new brands of differentiated commodities.
- ✓ Use of appealing slogans and attractive brand names. Oligopoly firms use attractive slogans to show consumers that the brand of given firm is more superior than that of other firms for instance MTN-very where you go, UTL- it is all about you.
- ✓ Opening branches or distribution points in different parts okf the country. This is accompanied by improved quality of shopping outlets which attracts more customers. For instance setting up new fuel stations.
- ✓ Free distribution of samples. These are given to potential customers to persuade them to start using more of the commodity and this increases sales.
- ✓ Provision of credit facilities or installment selling so as to attract customers and maintain the existing customers. This is normally offered to those who buy in bulk.
- ✓ Sponsoring events such as sports. They organize sports competitions and sponsor events to attract more demand from the public. For instance telecommunication companies such as MTN sponsor sport activities such as World cup 2010 by MTN, sponsoring local games.

- ✓ Provision of after sales services. Extra services rendered to consumers help to maintain such customers for instance washing car windscreens after fueling and free transport to consumers who buy in large quantities.
- ✓ Persuasive advertising to attract more sales. Oligopoly firms excessively advertise their products over the radios, televisions, newspapers, magazines, banners. There are excessive advertisements by telecommunication companies, brewing firms and soft drinks firms.
- ✓ Use of ruffle draws, this is when customers are given tokens and the more tokens one gets the higher the chances of winning thus increases sales of a firm

7. (a)

- ✓ When there's high demand for labour as compared to its supply
- ✓ When an individual worker has a strong bargaining power for a higher wage
- ✓ When workers have high level of experience or seniority
- ✓ When the job is risky
- ✓ When the labour is higherly talented
- ✓ When an employer has a high ability and willing to pay workers
- ✓ When labour works for long hours
- ✓ When a worker is favoured at work
- ✓ When there's a high cost of living
- ✓ When labour has a high level of education and skills
- ✓ When workers are in strong trade unions that are able to agitate for high wages for its members
- ✓ When a maximum wage is set by government
- ✓ When a worker has a high physicality especially with the piece rate system of wage payment

(b)

- ✓ Poorly organized trade unions remain weak.
- ✓ Weak trade union leaders are unable to agitate for given conditions on behalf of members which make trade unions weak.
- ✓ High levels of unemployment and under employment weaken trade unions
- ✓ Elastic supply of labour, trade unions become weak since demand for high wages is not easily achieved
- ✓ Limited members in trade unions which make them unable to have high bargaining power for higher wages.
- ✓ High level of government interference in the affairs of the trade unions such as declaring strikes illegal weakens the trade unions ability to demand for a rise in wages.
- ✓ Economic depression, Trade unions cannot succeed in demanding for higher wages during an economic depression
- ✓ Low level of labour productivity of trade union members makes trade unions weak and unable to demand for a wage rise.

- ✓ Elastic demand for products produced by trade union members weakens the trade union ability to demand for an increase in wages since employers get less revenue
- ✓ limited funds in trade unions weakens their ability to demand for an increase in wages