***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* *It is not sustainable i.e. may be withdrawn before completion of some projects*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)*

1. *(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*

1. *(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*

1. *(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*

1. ***(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*

***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 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*
* *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*

*(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.*

1. *(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.*

1. ***(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***