KAMSAMOCK EXAMINATION 2022
P220/1 ECONOMICS PAPER 1 MARKING GUIDE

SECTION A (20MARKS)

1. a) i) **Reserve Price** is the minimum price below which a seller is not willing to sell his commodity. **(01mark)**

Or

It is the least possible acceptable price for the seller.

ii) **Determinants of reserve price in an economy.**

- Expected future price for the commodity
- Nature of the commodity/durability or perishability of the commodity.
- Storage cost in relation to future price of the commodity.
- Expected future demand for the commodity.
- Level of supply of the commodity.
- Cash requirements of the seller/need for liquid capital. **(Any 3x1 = 3 marks)**

b) **Non-tariff barriers to trade in an economy**

- Quotas
- Total ban
- Subsidies to local producers
- Devaluation
- Foreign exchange control
- Direct administrative control
- State trading
- Trade agreements. **(Any 4x1 = 4 marks)**

c) The **law of variable factor proportions** states that as more and more units of a variable factor are applied to a given fixed factor, the marginal product increases, reaches a maximum point and then diminishes/reduces. **(1mark)**

ii**) Assumptions of the law of variable factor proportions.**

- Existence of a fixed factor
- Existence of a variable factor.
- Technology is constant.
- Units of a variable factor are homogeneous and equally efficient.
- Short run period. **(Any 3x1 = 3 marks)**

d**) An inflationary gap** is a situation where aggregate demand exceeds aggregate supply at full employment level (of income /resources **(1mark)**

ii) Policies for closing an inflationary gap in an economy

- Restrictive monetary policy (e.g increasing the bank rate)
- Increasing direct taxes/taxes on income
- Reducing government expenditure
- Increasing imports
- Reducing exports.
- Controlling wages/wage freeze.
- Price control/fixing maximum prices. **(Any 3x1 = 3 marks)**

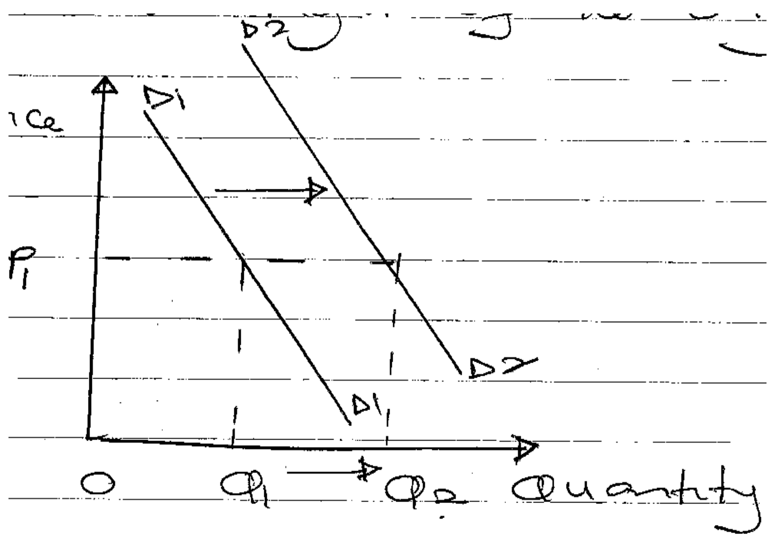
e) **A trade union** is an association of workers to pursue common objectives such as negotiating for higher wages and better conditions of work. **(1mark)**

ii) **The tools employed by trade unions to achieve their objectives;**

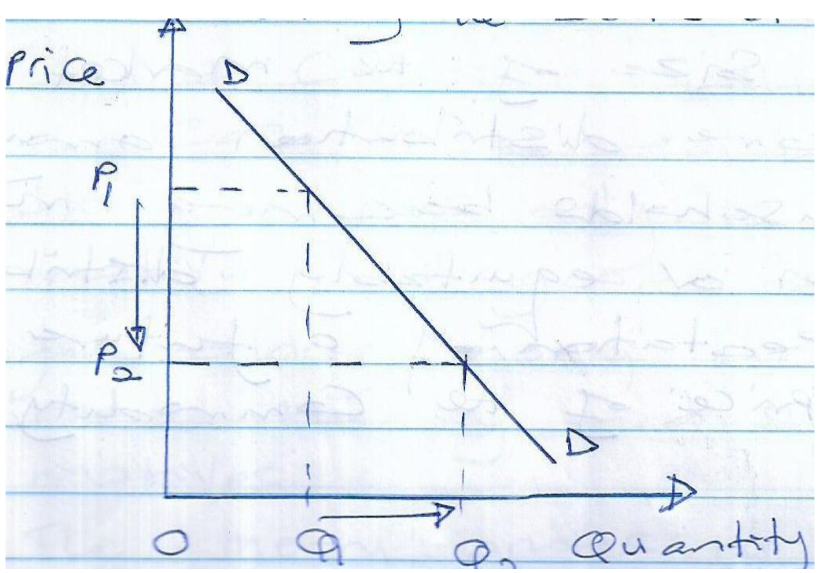
- Collective bargaining
- Go slow tactics.
- Sit down strikes
- Arbitration or mediation
- Industrial court action
- Picketing
- Demonstrations
- Boycott /sabotage
- Press or media wars **(Any 3x1 = 3 marks)**

SECTION B (80 MARKS)

2. a) **Increase in demand** refers to a situation when a constant price more of a commodity is demanded due to favourable changes in factors that affect demand. It involves a shift in the demand curve to the right of the original curve. **(1mark)**



Increase in quantity demanded is a situation when the amount of a commodity increases due to a decrease in the price of the commodity, other factors that affect demand remaining constant. It involves a downward movement along the same demand curve.



(1mark)

b) **The factors that lead to an increase in demand for a commodity;**

- Increase in the prices of substitute goods.
- A fall in the price of a complimentary good.
- Increase in the level of income of the consumer
- Increase in the level of advertisement
- Tastes and preferences of the consumer becoming more favourable. Changes in tastes and preferences of the consumer in favour of that particular commodity.
- Season becoming favourable for the commodity.
- Government policy becoming more favourable towards the commodity e.g reduced taxation and or increased subsidization.
- Increase in population size or size of the market. Income distribution among households becoming more even or equitably distributed.
- Expectation of a future rise in price of the commodity. **(Any 8x2 = 16 marks)**

3. a) **The Quantity theory of money** states that the general price level is determined by the quantity of money in circulation given that the velocity of money in circulation and the level of transactions are constant. **(2marks)**

   The theory is expressed by Irving Fisher's Equation of Exchange,

   $MV = PT$ Or $P = \frac{MV}{T}$ **(2marks)**

   Where

   M is the quantity of money in circulation.
   V is the velocity of money in circulation.
   P is the general price level
   T is the level of transactions that take place. **(2marks)**

b) Limitations of the Quantity theory of money

- It assumes that the velocity of circulation of money (V) and the level of transactions (T) is constant which is not the case in the real world.
- It considers only the transaction motive and ignores other motives for holding money like the precautionary and speculative motives.
- The theory ignores the existence of barter trade by assuming that all transactions take place by use of money as a medium of exchange.
- It does not take into account other causes of price increase/inflation e.g cost push and demand pull inflation.
- It does not take into haggling between buyers and sellers to reach an agreeable price.
- It ignores government control of prices through price legislation.
- It talks of a general price level which is unrealistic as there is nothing like a general price level but a series of price levels.
- The four variables M,V,P and T are not independent of one another because a change in one induces a change in others.
- It ignores the rate of interest influence.
- It does not take into account the demand for money but only looks at money supply.
- It is just a truism showing that M, V and T are related.
- The theory attempts to explain changes in the value of money but not how the value of money is determined.
- Where a country has many unemployed resources an increase in money supply leads to an increase in output which makes prices to fall.
- Where the MPS is high, the theory may not work because high savings reduce the velocity of money circulation leading to a fall in prices rather that an increase in prices as assumed by the theory.

(Any 7x2 = 14 marks)

4. a) **Economic growth** is the persistent/sustained increase in the country's volume of goods and services in a given period of time. **(2marks)**

Or

Economic growth is the persistent quantitative increase in GDP/GNP of an economy over time.

While

Economic development is the quantitative and qualitative increase in the productive capacity of an economy. It involves positive structural changes in the political, social and economic set up of the country**.** **(2marks)**

b) Under what circumstances may a country attain high levels of economic growth without attaining a corresponding high level of economic development?

- Where there is increasing income inequality.
- When there is increased production of capital goods at the expense of consumer goods.
- When there is increased production of poor quality goods.
- When there is increased expenditure on non-productive activities.
- When there are increasing unemployment levels.
- When there are high rates of inflation.
- When people are overworking and foregoing leisure.
- When there are increasing social costs e.g pollution.
- When there are increasing rates of taxation on people's income.
- When people's attitudes have not changed positively/ there is high rate of conservatism.
- When there is a high rate of dependence.
- When there is worsening B.O.P position.
- When there is no change in techniques of production.

(Any 8x2 = 16 marks)

5. a) **Denationalization** is the deliberate policy by government to return formerly nationalized enterprises to their original owners. **(2marks)**

While

Demonopolisation is the removal of unnecessary controls/restrictions or barriers on entry of private firms and individuals into sectors or areas to produce goods or services formerly exclusively provided by government e.g telecommunication **(2marks)**

b) **The implications of privatization of public enterprises in an economy**

- Reduces corruption in the enterprises
- Reduces expenditures by government
- Creates more employment opportunities in the long run
- Increases output hence economic growth.
- Improves quality of output due to competition
- Widens consumers' choices due to production of a wide variety of goods and services.
- Increases foreign investment and capital inflow.
- Reduces bureaucratic /red tape in the enterprises.
- Reduces inflation due to increased output.
- Increases foreign investment and capital inflow
- Reduces inflation due to increased output.
- Promotes innovations and inventions
- Improves efficiency in resource allocation/improves utilization of resources.
- Improves relations with the international community.

- Reduces dependence on imports.
- Improves B.O.P position.
- Increases labour skills

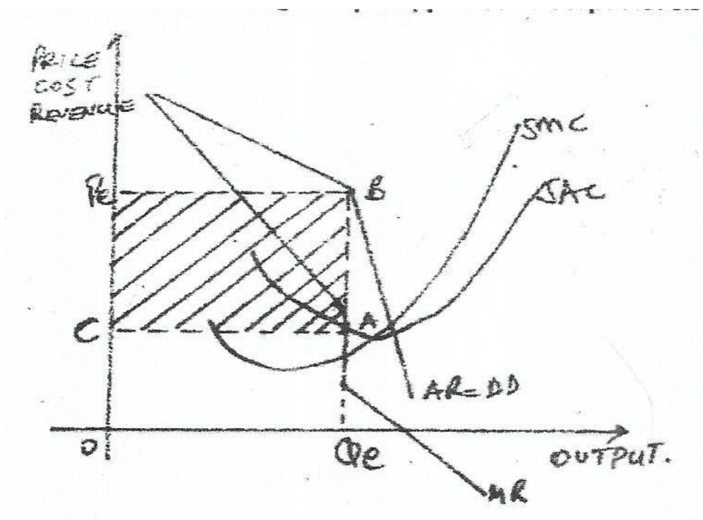
(Any 8x2 = 16 marks)

Negative implications of Privatization

- Increases consumer exploitation through high prices
- Causes unemployment in the short run
- Increases profit repatriation
- Leads to irrational exploitation of resources leading to quick resource depletion.
- Increases foreign control of the economy
- Worsens income and wealth inequalities.
- Results into reduced provision of some (essential) services.
- Results into losses to government through under valuation of the enterprises.

(Any 8x2 = 16marks)

6. a) An oligopoly firm maximizes profits in the short run at equilibrium where MC = MR **(1mark)**
   An illustration showing how an oligopoly firm maximizes profit in the short run.



- Output OQe i: **(1mark)**
- Price OPe is c AR or kicked demand curve **(1mark)**
- The firm earns abnormal profits represented by the shaded area CPeBA because AR >AC at equilibrium output OQe **(1mark)**

b) The forms of non-price competition employed by oligopoly firms.

- Aggressive/intensive advertising
- Offering free samples to customers.
- Provision of after sales services.
- Participating in trade fairs and exhibitions.
- Renovations of business premises or selling outlets
- Organizing raffle draws
- Attractive packaging
- Sponsoring sports events
- Use of appealing brand names.
- Use of one stop shopping centres.
- Provision of credit facilities / installments selling e.g hire purchase
- Use of consumer games e.g cash caps for soft drinks.
- Use of personal selling.

- Offering free gifts to customers.

(Any 7x2 = 14 marks)

7. a) **Debt Servicing** is the payment of interest on the loan contacted with or without part of the principal. **(2marks)**

While

Debt conversion is borrowing from cheaper sources to repay outstanding debts i.e acquiring soft loans to repay outstanding hard loans.

b) **The ways of managing a public debt in an economy.**

- Raising revenue by levying taxes.
- Use of accumulated profits from state enterprises.
- Sale of government securities e.g treasury bills and bonds
- Use of a sinking fund
- Disinvestment
- Operation of a surplus budget.
- Debt repudiation
- Debt rescheduling
- Debt conservation
- Negotiating for debt cancellation /relief waiver.
- Financial accommodation – printing more money
- Use of accumulated foreign reserves.
- Use of grants and donations.

(Any 8x2 = 16 marks)