ECONOMICS

REVISION KIT

TOPICALLY ARRANGED

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PAST PAPERS WITH ANSWERS

CONTENT

MICROECONOMICS

1. Introduction to economics

- Definition of economics
- Basic economic concepts: economic resources, human wants, scarcity and choice, opportunity cost, production possibility curves/frontiers Scope of economics: Micro and macro economics
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2. MACROECONOMICS

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- Structural Adjustment Programmes (SAPs) and their impacts on the LDCs

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PAST PAPERS ANSWERS

TOPIC 1

INTRODUCTION TO ECONOMICS

QUESTION 1

December 2021 Question One D

Outline seven advantages of a free market economic system (7 marks)

QUESTION 2

August 2021 question Six C

i. Define the term "free enterprise economic system." (1 mark)
ii. Highlight four economic advantages of free enterprise economic system. (4 marks)

QUESTION 3

May 2021 Question One A

Evaluate four ways in which the government could influence allocation of resources in a country. (8 marks)

QUESTION 4

May 2021 Question One C

i. Define the term "Consumer Sovereignty" as used in economics. (2 marks)

ii. Summarize six limitations of consumer sovereignty in an economy (6 marks)

QUESTION 5

November 2020 Question One B

Using suitable examples, differentiate between the following terms as used in economics:

i. "Basic human wants" and "secondary human wants" (4 marks)
ii. "Public good" and "merit good" (4 marks)
iii. "Suitable equilibrium" and "unstable equilibrium" (4 marks)

QUESTION 6

November 2020 Question Two B

Citing four examples, explain the significance of mobility of factors of production. (8 marks)

QUESTION 7

November 2019 Question One A

Examine four limitations of a planned economic system (4 marks)

QUESTION 8

November 2019 Question One B

With the aid of a diagram, explain the concept of production possibility curve. (5 marks)

QUESTION 9

November 2019 Question Two A

Evaluate three fundamental economic issues that a society has to address to minimise the problem of scarcity of resources. (6 marks)

QUESTION 10

May 2019 Question Two A

i. Enumerate five characteristics of a free market economic system. (5 marks)
ii. State five advantages of a free market economic system. (5 marks)

QUESTION 11

November 2018 Question One A

Differentiate between economic resources and non-economic resources. (1 mark)

QUESTION 12

November 2018 Question One B

i. Explain the term "consumer sovereignty" as used in economics. (1 mark)
ii. Outline eight factors that hinder consumers' sovereignty. (8 marks)

QUESTION 14

November2017 Question

Enumerate five advantages and five disadvantages of a planned economic system. (10 marks)

QUESTION 15

May 2017 Question One A

Highlight four steps followed in the scientific method used in economics. (4 marks)

QUESTION 16

May 2017 Question One D

Summarize five applications of opportunity cost in decision making. (5 marks)

QUESTION 17

November 2016 Question One B

Outline six advantages of a controlled market system. (6 marks)

QUESTION 18

May 2016 Question One B and C

With the aid of a diagram, explain the production possibility frontier. (5 marks)

QUESTION 19

May 2016 Question One B and C

Summarize five ways through which the government could influence the allocation of resources in a free market economy. (5 marks)

TOPIC 2

DEMAND, SUPPLY AND EQUILIBRIUM

QUESTION 1

December 2021 Question One A, B and C

i. Using a suitable example, explain the term "composite supply". (2 marks)
ii. Summarise five factors that cause persistent market disequilibrium in an economy. (5 marks)
iii. Highlight six reasons why the demand of a commodity might not increase following (6marks)

QUESTION 2

December 2021 Question Seven B

QUESTION 3

August 2021 Question One A

i. Highlight four factors that determine the supply of a good or service. (4 marks)
ii. Using appropriate diagrams, explain the difference between "a movement along a supply curve" and "a shift in a supply curve". (8 marks)

QUESTION 4

August 2021 Question Two C

The government has given a subsidy on the consumption of commodity Y. Using a diagram for illustration, explain the effect of the above action on market equilibrium for commodity Y. (5 marks)

QUESTION 5

August 2021 Question Four D Given the demand function:

Quantity (Q) = 40 + 15Q – 202 + 10/Q

Required:

i. Point elasticity of demand

When;

Quantity (Q) = 75

Price (P) = 10 (3 marks)

ii. Interpret your results. (1 mark)

QUESTION 6

May 2021 Question One B

Explain using formulae, the difference between "arc elasticity" and "point elasticity" of demand. (4 marks)

QUESTION 7

May 2021 Question One B

Identify four reasons why governments intervene with the operations of price mechanism. (8 marks)

QUESTION 8

May 2021 Question Two C

QUESTION 9

November 2020 Question One C

With the aid of a well labelled diagram, illustrate the effect of a simultaneous increase in the income of the consumer and increase in fuel prices. (4 marks)

QUESTION 10

November 2019 Question One D

The following equations are given:

Q=-10+6P…………………equation (i)

Q=20-4P………………….....equation (ii)

Required:

i. Giving reasons, identify the demand function and the supply function. (2 marks)
ii. Determine the equilibrium price and quantity. (4 marks)

QUESTION 11

May 2019 Question Two B

Summarise five factors that could lead to a leftward shift of the supply curve of a commodity. (5 marks)

QUESTION 12

May 2019 Question Three C

Discuss four applications of elasticity of demand in economic decision making. (8marks)

QUESTION 13

November 2018 Question One C

Enumerate five factors that determine the price elasticity of demand of a commodity. (8marks)

QUESTION 14

November 2018 Question Two A

With the aid of an appropriate diagram, explain the concept of "shortage" as used in market equilibrium. (4 marks)

QUESTION 15

November 2018 Question Two B

Discuss seven effects of price decontrol m an economy. (7 marks)

QUESTION 16

November 2018 Question Two C

The demand and supply functions of commodities x and y are given as:

$Qdx = 4 – Px + 0.5 Py$

$Qdy=10+Px- Py$

$Qsx = - 3 + 4Px$

$Qsy = - 18 + 4 Py$

Where:

Qdx is the quantity demanded of x in thousands of units.

Qdy is the quantity demanded of y in thousands of units.

Q ax is the quantity supplied of x in thousands of units.

Qsyx is the quantity supplied of y in thousands of units.

Px is the price of x in thousands of shillings.

Py is the price of y in thousands of shillings.

Required:

i. The equilibrium price and quantity of commodity x. (4marks)
ii. The equilibrium price and quantity of commodity y. (4 marks)
iii. Explain the nature of relationship between commodity x and commodity y. (1 mark)

QUESTION 17

May 2018 Question three A

The demand of a certain product is represented by the following function:

Q=200+5P+ P2

Where:

Q is quantity of the product

P is the price orate product

Required:

(i) Determine the point elasticity of demand at P Sh.20. (5 marks)
(ii) Interpret your result in (a) (i) above, (1 mark)

QUESTION 18

May 2018 Question Five A

Explain the term "partial equilibrium" as used in economics. (2 marks)

QUESTION 19

May 2018 Question Six A

With the aid of well labelled diagrams, distinguish between "price floors" and "price ceilings". (8 marks)

QUESTION 20

November 2017 Question Two C

The data provided below relate to the quantities demanded of commodities A, B and C at different price levels:

Commodity A		**Commodity B**		**Commodity C**	
Unit Price (sh.)	Quantity demanded (units)	Unit Price (sh.)	Quantity Demanded (units)	Unit Price (sh.)	Quantity demanded (units)
75	923	14	350	28	540
52	1568	21	620	24	600

Required:

i. Elasticity of demand for commodities A, B and C. (6 marks)
ii. Using the results obtained in c) (i) above, advise the government on the commodity that should be considered for a tax increase. (1 mark)

QUESTION 21

November 2017 Question Seven A

Explain the difference between "inelastic demand" and "unitary elasticity of demand". (2 marks)

QUESTION 22

May 2017 Question Five E

The following information relates to the demand of a commodity in relation to the 737 income of a consumer:

Income	**Demand**
(Sh.)	(units)
15,000	16
29,000	7

Required:

The income elasticity of demand of the commodity. Interpret your result. (3 marks)

QUESTION 23

May 2017 Question Five B

Enumerate four exceptions to the law of supply. (4 marks)

QUESTION 24

May 2017 Question Four C

The demand and supply functions of a certain commodity are given as follows:

$Qd = 300- 0.4p$

$Qs = 400+0.6p$

Where:

Qd is the demand function.

Qs is the supply function.

P is the unit price of the commodity.

Required:

The equilibrium price and quantity of the commodity (4 marks)

QUESTION 25

May 2017 Question Three C

State three reasons why the demand curve slopes downwards. (3 marks)

QUESTION 26

May 2017 Question Two A

With the aid of a well labelled diagram, describe the cobweb model as used in economics. (5 marks)

QUESTION 27

May 2017 Question Two C

i. Explain the term "cross elasticity of demand." (1 mark)
ii. The following data relate to a consumer in a certain market:

Price of commodity x (Sh.)	Quantity of commodityy y (Units) .
16	100
20	120
24	140
28	160

Required:

The cross elasticity of demand. Comment on the relationship between commodity x and commodity y. (4 marks)

QUESTION 28

May 2017 Question One B

Enumerate five factors that determine the price elasticity of supply of a commodity. (5 marks)

QUESTION 29

November 2016 Question One A

(i) Explain the term "price control" as used in economics. (1 mark)
(ii) Highlight eight reasons for price controls in an economy. (8 marks)

QUESTION 30

November 2016 Question Two A

Enumerate six factors that could lead to a rightward shift of the supply curve. (6 marks)

QUESTION 31

November 2016 Question Two C

Summarise eight factors that could affect own price elasticity of demand of a commodity. (8 marks)

QUESTION 32

May 2016 Question One D

Explain how the concept of elasticity of demand guides economic decision making in the following areas:

(i) Government tax policy on household consumption. (2 marks)
(ii) Devaluation policy. (2 marks)
(iii) Price discrimination by a monopolist. (2 marks)

QUESTION 33

May 2016 Question Two C

A certain market for commodity x contains 1,000 identical consumers, each having a demand function given as:

$Qdx = 12-2px$

The market contains 100 identical producers of commodity x, each with a supply function given by $Qsx = 20px$

Qd, is the quantity demanded of x.

Qsx is the quantity supplied of x.

Px is the price of x.

Required:

i. The market demand and market supply functions of commodity x. (4 marks)
ii. Using indifference curve analysis, illustrate the effect of a government subsidy on commodity x to low-income earners. (7 marks

QUESTION 34

May 2016 Question Three B

Using a well labelled diagram evaluate the effect of simultaneous increase in demand and decrease in supply on equilibrium price and quantity of a commodity. (5 marks)

QUESTION 35

November 2015 Question One A

With the aid of a diagram, describe the concept of unstable market equilibrium.

(5 marks)

QUESTION 36

November 2015 Question One B

"All giffen goods are inferior goods but not all inferior goods are giffen goods". Using a relevant diagram, explain the above statement. (5 marks)

QUESTION 37

September 2015 Question Five C

Briefly explain the concept of elasticity of demand in the economic management policy decision making. (6 marks)

QUESTION 38

September 2015 Question Seven A

Briefly explain five factors that could affect the price elasticity of supply. (5 marks)

TOPIC 3

THE THEORY OF CONSUMER BEHAVIOUR

QUESTION 1

December 2021 Question Two B

Using indifference curve analysis, derive the Engel curve of a normal good. (8 marks)

QUESTION 3

May 2021 Question Three A

Using indifference curve analysis, demonstrate how an individual's equilibrium point is attained. (4 marks)

QUESTION 4

May 2021 Question Three B

With particular interest on inferior goods, use the indifference curve analysis to demonstrate and explain the income and substitution effect of a fall in price. (6 marks)

QUESTION 5

November 2020 Question Two A

With the help of a diagram, discuss the concept of an individual angel curve as applied in the theory of consumer behaviour. (5 marks)

QUESTION 6

November 2019 Question One C

With the help of a diagram, illustrate the concept of surplus as applied in the theory of market equilibrium. (5 marks)

QUESTION 7

November 2019 Question Three A

Highlight four assumptions of consumer rationality. (4 marks)

QUESTION 8

May 2019 question Three A

i. Explain the difference between the "cardinal approach" and the "ordinal approach" to measuring utility. (2 marks)
ii. Outline four limitations of the cardinal approach to measuring utility. (4 marks)

QUESTION 9

November 2018 Question Three B

Examine six applications of indifference curve analysis in an economy. (6 marks)

QUESTION 10

May 2018 Question Four A

With the aid of a well labelled diagram, explain the law of diminishing marginal utility. (6 marks)

QUESTION 11

May 2018 Question Four B

Outline four properties of indifference curves. (4marks)]

QUESTION 12

May 2018 Question Five D

With the aid of a diagram, explain why isoquants are negatively sloped. (5 marks)

QUESTION 13

November 2017 Question One B

Highlight three exceptions to the law of diminishing marginal utility. (3 marks)

QUESTION 14

November 2017 QuestionFour B

Using appropriate illustrations, describe consumer equilibrium under the following approaches to the theory of consumer behaviour:

i. Cardinal approach. Some (5 marks)
ii. Ordinal approach. (5 marks)

QUESTION 15

November 2017 Question Six A

With the aid of a diagram, explain the term "surplus" as applied in the theory of market equilibrium (6 marks)

QUESTION 16

May 2017 Question One C

Using indifference curve analysis, derive the Engel's curve of a normal good. (6 marks)

QUESTION 17

May 2017 Question Three B

Outline four limitations of the cardinal approach to the theory of consumer behaviour. (4 marks)

QUESTION 18

November 2016 Question One C

With the aid of a diagram, explain the concept of consumer surplus. (5 marks)

QUESTION 19

May 2016 Question One A

Outline four assumptions underlying consumer equilibrium. (4 marks)

QUESTION 20

September 2015QuestionFive

Using the indifference curve margins, discuss how the consumer's equilibrium is obtained. Use an appropriate diagram to illustrate your answer. (6 marks)

QUESTION 21

September 2015 Question Five B

With the help of well-illustrated diagrams, draw the substitution effect and income effect of:

(i) A normal good. (8marks)

(ii) An inferior good.

TOPIC 4

THEORY OF A FIRM

QUESTION 1

December 2021 Question Two A

Examine six features of capital as a factor of production. (6 marks)

QUESTION 2

December 2021 Question Three C

Discuss five technical economies of scale. (10 marks)

QUESTION 3

December 2021 Question Four C

The marginal cost function of a certain firm is given by:

MC = 6Q + 4

Where = MC is the marginal cost function

Q is the level of output

Required:

i. The total cost function. (2 marks)
ii. The average fixed cost function. (2 marks)
iii. The average variable cost function. (2 marks)
iv. The level of output that would minimise the average variable cost. (3 marks)

QUESTION 4

Explain the following terms in relation to labour as a factor of production.

i. Participation rate (2 marks)
ii. Real wages (2 marks)
iii. Labour productivity (2 marks)
iv. Derived demand (2 marks)

QUESTION 5

August 2021 Question Two A

Explain the term “marginal factor cost” (2 marks)

QUESTION 6

August 2021 Question Two D

With the help of a well labelled diagram, distinguish between “economic rent” and “quasi rent”. (6 marks)

QUESTION 7

May 2021 Question Five A

The total cost and demand functions of a firm operating under monopolistic competition are represented as follows:

TC = 850 – 8Q + 10Q2

P = 200

Where;

TC = Total Cost

Q = Output

P = +Price

Required:

i. Fixed cost function (1 mark)
ii. Variable cost function (1 mark)
iii. Average variable cost function (1 mark)
iv. Marginal cost function (2 mark)
v. Marginal revenue function (2 mark)
vi. The level of output which the firm beaks-even (3 marks)

QUESTION 8

May 2021 Question Six C

With the use of a diagram, illustrate the optimal point of a firm. (4 marks)

QUESTION 9

May 2021 Question Seven B

With a well labelled diagram, illustrate the concept of economic rent. (5 marks)

Explain how economic rent might be used as a good base for taxation. (3 marks)

QUESTION 10

November 2020 Question five C

Summarise four factors that might lead to an inward shift in the optimal point of a firm. (4 marks)

QUESTION 11

November 2019 Question Two B

Explain five factors that lead to the external economies of scale in an economy. (10 marks)

QUESTION 12

November 2019 Question Two C

Describe two assumptions of the law of variable proportions. (4marks)

QUESTION 13

November 2019 Question three B

With the aid of a well labelled diagram, explain the concept of a backward bending supply curve of labour. (6 Marks)

QUESTION 14

May 2019 Question one C

Highlight six factors that might lead to a rightward shift of the optimal point of a firm. (6 marks)

QUESTION 15

May 2019 Question Two C

The demand and average cost functions of a hypothetical firm are represented by the following functions (in thousands):

$P = 50 – Q$

$AC = \frac{100}{Q} - 16 + 2Q$

Where:

P is the unit price in shillings.

Q is the quantity of output in units.

AC is the average cost in shillings.

Required:

(1) The total cost function. (1 mark)
(2) The variable cost function (1 mark)
(3) Total profit of the firm when Q=10 units (3 marks)

QUESTION 16

May 2019 Question Three B

Highlight six factors that determine the effectiveness of trade unions in a society. (6 marks)

QUESTION 17

May 2019 Question Four C

Suggest five policy measures that could be adopted by a government to enhance geographical mobility of labour within a country. (5 marks)

QUESTION 18

May 2019 Question Four D

The table below shows the quantity of units produced by a certain firm and the

Corresponding total cost:

Units produced	Total cost (Sh."000")
0	77
2	216
4	235
6	319
8	348
10	382

Required:

i. The average variable costs when the units produced are 2, 6 and 10 respectively. (3 marks)
ii. The marginal costs of production for the 4^{th} and 8^{th} units respectively. (2 marks)

QUESTION 19

May 2019 Question seven B

With the aid of an appropriate diagram, explain the relationship between the short run average cost curve and the long run average cost curve. (4 marks)

QUESTION 20

November 2018 Question one D

Highlight five barriers to occupational mobility of labour. (5 marks)

QUESTION 21

November 2018 Question Three A

Summarize six characteristics of capital as a factor of production. (6 marks)

QUESTION 22

November 2018 Question Three C

Discuss four cases advanced by trade unions for increase in the wages of their members. (8 marks)

QUESTION 23

May 2018 Question Seven C

The demand and total cost functions for a hypothetical firm are represented as follows:

P=100

TC=50 + 8Q2

Where:

P is the price

TC is the total cost

Q is the quantity

Required:

i. The marginal cost function. (2 marks)
ii. The average fixed cost function. (2 marks)
iii. The marginal revenue function. (2 marks)
iv. The profit maximising level of output. (4 marks)

QUESTION 24

November 17 Question Three A

Outline four factors that determine the supply of labour in an economy. (4 marks)

QUESTION 25

November 17 Question Five A

The data below relate to the total cost function of a firm operating under perfect competition:

C = 5,000+500Q+150Q2+5Q3

Where:

C = Total cost in thousands of shillings.

Q = Output in units.

Required:

Assuming an output level of 10 units, determine:

i. Total cost of production (1 mark)
ii. Average variable cost of production (2 marks)
iii. Marginal cost of production (2 marks)

QUESTION 26

November 17 Question Six B

Analyze six factors that influence the cost behaviour of a firm. (6 marks)

QUESTION 27

May 2017 Question Two B

With reference to the theory of production, discuss five factors that could lead to:

i. Increasing returns to scale. (5 marks)
ii. Decreasing returns to scale. (5 marks)

QUESTION 28

May 2017 Question Three A

Explain the difference between real and pecuniary economies of scale of a firm. (1 mark)

QUESTION 29

November 2016 Question Two B

State six assumptions of the marginal productivity theory of wage determination. (6marks)

QUESTION 30

November 2016 Question Four B

Using an appropriate diagram, describe the expansion curve of a firm as applied in the theory of production.
(5marks)

QUESTION 31

November 2016 Question Five B

The table below shows the total variable costs of Ujuzi Limited at different levels of output

Level of output(units)	Total variable cost(sh.)
0	0
1	80000
2	130000
3	200000
4	270000
5	310000
6	510000
7	530000
8	580000

Required

The total fixed cost of the company is Sh. 150,000. (4 marks)

The marginal cost of producing each level of output. (4 marks)

The maximum attainable profit. (4 marks)

QUESTION 32

May 2016 Question Three C

Discuss five causes of the U-shaped long-run average cost curves of a firm. (10 marks)

QUESTION 33

May 2016 Question Four A

Enumerate six barriers to occupational mobility of labour. (6 marks)

QUESTION 34

November 2015 Question One C

Argue five cases for and five cases against specialisation as a method of production. (10 marks)

QUESTION 35

November 2015 Question Two 2

Outline four arguments upon which trade unions base their demand for increase in wages for unionisable employees. (4 marks)

QUESTION 36

November 2015 Question Two

State six effects of price decontrols to an economy. (6 marks)

QUESTION 37

November 2015 Question Two

Analyze six uses of elasticity of demand in decision making**.** (6 marks)

QUESTION 38

November 2015 Question Two 2

The following information relate to the price per unit and quantity supplied of of a certain product:

Price per unit	12	10	8	5	2
Quantity supplied	12000	11000	9000	6000	0

Required:

Price elasticity of supply when price decreases from Sh. 10 per unit to Sh.5 per unit.

Interpret your result. (4 marks)

QUESTION 39

November 2015 Question Three A and C

Explain the term “optimal size of a firm”. (2 marks)

QUESTION 40

November 2015 Question Three A and C

i. Summarizes seven barriers to geographical mobility of labour as a factor of production. (7 marks)
ii. Highlight six measures that could be adopted by a government to enhance mobility of labour. (6 marks)

QUESTION 41

September 2015 Question Three A

Giving examples, distinguish between “fixed costs” and “variable costs”. (4 marks)

QUESTION 42

September 2015 Question Three B

A firm operating in the short-run period has a fixed cost of Sh.8,600. The table below shows its total variable cost and the units of output.

Units of output	0	1	2	3	4	5	6	7	8	9	10
Total variable cost	0	3040	5680	8000	10080	12000	14000	16240	18960	22480	26880

Required:

For each level of output, calculate the firm's total cost, average total cost, average variable cost, average fixed cost and marginal cost giving your solution in columnar form/tabular form.(10 marks)

QUESTION 43

September 2015 Question Three A, B and C

Using an appropriate diagram for each case, explain the three properties of isoquants. (6 marks)

QUESTION 44

September 2015 Question Seven B

State the law of diminishing marginal returns. (2marks)

With the aid of a diagram, explain the three stages of production according to this law. (8 marks)

QUESTION 45

September 2015 Question Seven C

Highlight five functions of trade unions. (5 marks)

TOPIC 5

MARKET STRUCTURES

QUESTION 1

December 2021 Question Two C

State six conditions that are necessary for effective price discrimination by a monopolist. (6 marks)

QUESTION 2

December 2021 Question Six A

Discuss five differences between monopoly and monopolistic market structures. (10 marks)

QUESTION 3

August 2021 Question Five A and B

i. Collusion may be a feature of an oligopolistic market.

With reference to the above statement, explain the term "collusion". (2 marks)

ii. Collusive practices may be undermined by price wars.

Assess three benefits that might accrue to consumers as a result of price wars by firms. (6 marks)

QUESTION 4

August 2021 Question Six A

(a) (i) Explain the term "price discrimination". (2 marks)

(ii) Using examples in each case, examine three types of price discrimination. (9 marks)

QUESTION 5

November 2020 Question Three A

Examine three sources of monopoly power. (6 marks)

QUESTION 6

November 2020 Question Three B

With the aid of a well labeled diagram, explain the equilibrium level of a firm operating under monopolistic market structure in the long run. (6 marks)

QUESTION 7

November 2019 Question Three C

1. A firm operating under perfect competition observed that:
2. At a unit price of Sh.20 of product "R", 600 units were sold.
3. At an increased price of Sh.70, the sales 6 product "R" decreased by 500 units.
4. The relationship between the price of product R and the quantity sold of product "R" is linear.
5. Total al cost (TC)of product "R" is given by the function:

$$TC = 0.9q2 + 30q + 1{,}000$$

Where q is the quantity of product "R" produced and sold.

Required:

(i) The revenue function of product "R". (4 marks)
(ii) The profit earned at equilibrium. (4 marks)
(iii) The equilibrium price. (2 marks)

QUESTION 8

May 2019 Question One B

(i) Distinguish between "perfect oligopoly" and "imperfect oligopoly". (2 marks)
(ii) Describe three methods used in fixing prices under the oligopoly market structure. (6 marks)

QUESTION 9

November 2018 Question Four B

State four advantages and four disadvantages of a monopoly market structure in an economy. (8 marks)

QUESTION 10

November 2018 Question Four D

A firm operating under a monopoly market structure has the following demand and cost functions

P = 140 – 2Q

TC 10 + 5Q2

Where:

P is the price in thousands of shillings.

Q is the quantity of output in thousands of units. TC is the total cost in thousands of shillings

Required:

The maximum level of profit of the firm. (4 marks)

QUESTION 11

November 2018 Question Five C

Using appropriate diagrams, analyse the following levels of output of a monopolist firm in the short-run period:

i. The profit maximising level of output. (5marks)
ii. The loss-making level of output. (5 marks)

QUESTION 12

May 2018 Question Three C

With the aid of a well labelled diagram, explain a normal profit-making firm under oligopoly in the short-run. (5 marks)

QUESTION 13

May 2018 Question five C

With the help of a diagram, justify why the condition that marginal revenue equals to marginal cost (MR=MC) is only a necessary but not a sufficient condition for maximization. (6 marks)

QUESTION 14

November 2017 Question A

Explain the following types of development plans:

(i) Short term plans. (1 mark)
(ii) Medium term plans. (1 mark)
(iii) Long term plans. (1 mark)

QUESTION 15

November 2017 Question Four A

State five advantages and five disadvantages of a perfectly competitive market structure. (10 marks)

QUESTION 16 0707

May 2017 Question Three E

With the aid of an appropriate diagram, explain the condition under which a firm operating under perfect competition market structure would make supernormal profits in the short-run. (5 marks)

QUESTION 17

May 2017 Question Four A

Highlight four salient features of a monopolistic competition market structure. (4 marks)

QUESTION 18

May 2017 Question Six B

P = 25-50Q

TC = 100-15Q+ 60Q2

Where:

P is the price in shillings.

Q is the quantity in units.

TC is the total cost.

Required:

The level of output that would maximize profit. (5 marks)

The level of output that would maximize cost. (3 marks)

QUESTION 19

November 2016 Question Three A

With the aid of well labelled diagrams, discuss the short run and long run equilibrium positions of a firm operating under monopolistic competition. (12 marks)

QUESTION 20

November 2016 Question Three B

A monopolist sells his product in two distinct markets, A and B. The cost function of the monopolist is given as:

$C = 100Q$

Where:

Q is the total production in units

C is the total cost function

The demand functions of the two distinct markets are given as

$QA = 50 - 0.2PA$

$QB = 100 - 0.5PB$

Where;

QA is the demand of the product in market A.

QB is the demand of the product in market B.

PA is the price of the product in market A.

PB is the price of the product in market B.

Required:

i. The equilibrium level of price and quantity of the product in market A. (4 marks)
ii. The equilibrium level of price and quantity of the product in market B. (4 marks)

QUESTION 21

May 2016 Question Two B

Highlight five disadvantages of the monopoly market structure. (5marks)

QUESTION 22

May 2016 Question Four B

Illustrate the close down price of a firm operating under perfect competition. (6 marks)

QUESTION 23

May 2016 Question Six B

With the aid of an appropriate diagram, explain the condition under which a firm operating under oligopoly market structure would make losses in the short-run. (6 marks)

QUESTION 24

November2015QuestionThreeB

With the aid of an appropriate diagram, explain the condition under which a firm operating under oligopoly market structure would make super normal profits in the short-run. (5 marks)

QUESTION 25

September 2015 Question Two A

Highlight five features of a firm under perfect competition.

QUESTION 26

September 2015 Question Two B

With the aid of a diagram, show that MC=MR is just a necessary but not sufficient condition for profit maximization. (4 marks)

QUESTION 27

September 2015 Question Two C

In the short-run, a monopolist does not necessarily have to make profits; he can make losses. Whether he makes a profit or a loss depends on the position of the short-run total cost curve (SATC) at the short-run equilibrium.

Using an appropriate diagram, discuss the conditions for the loss minimisation of a monopolist. (5 marks)

QUESTION 28

September 2015 Question Two D

Under monopolistic competitive markets the products are usually differentiated yet they are very close substitutes for one another.

Explain the main types of product differentiation in monopolistic competitive market. (6 marks)

TOPIC 6

NATIONAL INCOME

QUESTION 1

December 2021 Question Six B

The following data relate to the nominal and real gross national product (GNP) levels for a hypothetical economy for the years 2011 and 2019:

Year	National GNP	Real GNP
	SH. Billion	**SH. Billion**
2011	1185.90	1185.90
2019	2633.00	1474.00

Required:

i. The implicit GNP price deflator for the years 2011 and 2019. Interpret your results. (5 marks)
ii. The inflation rate of the economy, using year 2011 as the base year. (5 marks)

QUESTION 2

August 2021 Question Three B

With the aid of an illustration, describe the circular flow of income for a closed economy with the existence of the government. (8 marks)

QUESTION 3

August 2021 Question Four A and C

i. Identify three uses of consumer surplus. (6 marks)
ii. Highlight five implications of a deflationary gap in an economy. (5 marks)

QUESTION 5

The data below represents the national income of a certain economy in trillions of shillings:

$Y = C+I+G+ (X – M)$

$C = 100 + 0.6Yd$

$T= 10+0.2Y$

$I=40$

$G = 50$

(X- M) = 30

Where:

Y=National income

C=Consumption expenditure

I = Investment

G = Government expenditure

Yd = Disposable income

T = Taxes

X = Exports

M = Imports

Required:

i. The equilibrium level of:
ii. National income. (5 marks)
iii. Consumption. (3 marks)
iv. Taxes. (2 marks)

QUESTION 6

November 2020 Question five B

i. Explain the relationship between the multiplier and the accelerator. (4marks)
ii. Evaluate four benefits that might accrue to an economy as a result of accelerator effect. (8 marks)

QUESTION 7

November 2019 Question Four A

The per capita income of a hypothetical country increased by 20% from the year 2015 to year2018.

Despite this increase in per capita income, the residents of the country felt that their living standards were deteriorating.

Required:

Discuss five reasons that might have led to this feeling by the residents. (10 marks)

QUESTION 8

November 2019 Question Four B

Describe three methods that could be used to measure the national income of a country. (6 marks)

QUESTION 9

November 2019 Question Four B

The following are the consumption and investment functions of country Y in Sh. "Billion"

C= 200 + 0.8Y

I=400

Where:

C is Consumption

Y is Income

I is Investment

Required:

Calculate the aggregate spending at equilibrium level. (4 marks)

QUESTION 10

May2019 Question five D

The following data relate to the consumption function of a hypothetical economy in millions of shillings:

C = 300 + 0.6y

Where:

C is the consumption function

Y is the national income.

Required:

i. The investment function. (1 marks)
ii. Discuss seven factors that determine the level of consumption in an economy. (7 marks)

QUESTION 11

May 2019 Question seven A

Argue six cases to against the use of national income statistics to compare the standards of living between countries (6 marks)

QUESTION 12

November 2018 Question Four C

The marginal propensity to save of a certain hypothetical economy is given as 0.25.

Required:

The change in the equilibrium level of national income, if the level of investments for the economy increases by Sh.300 million. (3 marks)

QUESTION 13

November 2018 Question Six B

Examine seven determinants of the level of national income of a country. (7 marks)

QUESTION 14

November 2018 Question seven C

The data provided below represent economic transactions for a hypothetical country in billions of shillings:

	Total output	**Intermediate purchases**
Agricultural sector	55000	24000
Manufacturing sector	96000	63000
Service sector	71000	42000

The indirect taxes and fixed assets depreciation amount to Sh.22,000 billion and Sh.26,000 billion respectively.

Required:

i. Gross National Product using the value added approach. (2 marks)
ii. Net Domestic Product at market price. (2 marks)
iii. Net Domestic Product at factor cost. (2 marks)

QUESTION 15

May 2018 Question Six B

In a hypothetical economy X. autonomous consumption equals to 800 and the marginal propensity to save equals to 0.25.

Required:

i. Formulate the consumption function. (2 marks)
ii. If the level of investment increased by Sh. 1,000 million, determine the change in equilibrium national income. (4 marks)

QUESTION 16

November 2017 Question Six C

Using well labelled diagrams, distinguish between "inflationary gap" and "deflationary gap" as used in national income statistics. (10 marks)

QUESTION 17

November 2017 Question Seven C and D

The data provided below represent estimated national income figures for a hypothetical economy in millions of shillings:

Gross National Product (at market price)	3,992
Depreciation allowance	570
Indirect taxes less subsidies	524
Business taxes	214
Personal income taxes	763
Government transfers	693
Retained profit	230

Required:

i. Net National Product at market price. (2 marks)
ii. Net National Product at factor cost. (2 marks)
iii. Personal income. (2 marks)
iv. Disposable income. (2 marks)

QUESTION 18

November 2017 Question Seven D

Outline six challenges encountered by economic planners when using the income approach to estimate the level of national income in developing countries. (6 marks)

QUESTION 19

May 2017 Question Three D

The following data relate to the nominal and real gross national product (GNP) levels of a certain economy for the years 2011 and 2016:

Year	**National GNP**	**Real GNP**
	Sh. Billion	**Sh. billion**
2011	1.805	1.085
2016	1.850	1.275

Required:

i. The gross national product implicit price deflator for the years 2011 and 2016.

Interpret your results. (3 marks)

ii. Using year 2011 as the base year, determine the inflation rate for the economy. (4 marks)

QUESTION 20

May 2017 Question five D

i. Distinguish between the "multiplies" and "the accelerates" as used in national income statistics. (2 marks)
ii. Explain four factors that could limit the application of the multiplier in developing countries. (4 marks)
iii.

QUESTION 21

November 2016 Question Four C

Discuss ten limitations of using national income statistics to compare the standards of living between different countries. (10 marks)

QUESTION 22

November 2016 Question Seven D

The economy transactionforahypotheticaleconomyinthousandsofshillingsaregiven737 as follows:

Sector	Total output	Intermediate purchaser
	Sh. "000"	Sh. "000"
Service	76000	37000
Agricultural	55000	23000
Manufacturing	111000	69000

Indirect taxes and fixed assets depreciation amount to Sh.21,000,000 and Sh.22,000,000 respectively.

Required:

GNP using the value added approach. (2 marks)

NDP at market price. (1 mark)

NDP at factor cost. (1 mark)

QUESTION 23

May 2016 Question Five A

Explain five factors that determine the macroeconomic level of consumption in an economy.
(10 marks)

QUESTION 24

May 2016 Question Five B

The following data relate to the commodity and money markets of a hypothetical closed economy without government intervention, in millions of shillings:

C= 204 + 0.7Y

1 = 300-100r

MDT= 0.25Y

MDs= 248-200r

Ms = 600

Where:

C is the consumption function.

Y is the national income.

I is the investments function.

R is the rate of interest.

MDT is the precautionary and transactionary demand for money.

Mps is the speculative demand for money. Ms is the money supply.

Required:

(i) Equilibrium level of interest rate. (7 marks)

(ii) Equilibrium level of national income. (3 marks)

QUESTION 25

November 2015 Question Four A

Outline five problems associated with the expenditure approach of measuring the national income of a country. (5 marks)

QUESTION 26

November 2015 Question Four C

The following information relates to savings and investments of a certain economy in millions of shillings:

S = - 500+0.36Y

I=8,000

Where:

S = Savings function.

Y = National income.

I= Investments function.

Required:

i. The consumption function. (3marks)
ii. The equilibrium level of national income. (3 marks)
iii. The multiplier. Interpret your result. (4 marks)

QUESTION 27

November 2015 Question Seven C

The data provided below represent estimated national income figures for country -X" in trillion of shillings:

Gross National Product (at market price)	620.4
Government transfers	78.6
Business taxes	18.2
Personal income taxes	16.1
Depreciation allowance	42.3
Indirect taxes less subsides	36.5

Required:

(i) Net National Income at factor cost. (2 marks)
(ii) Net National Product at market price. (1 mark)
(iii) Personal income. (1 mark)
(iv) Disposable income for country "X". (1 mark)

QUESTION 28

September 2015 Question One A

i. Distinguish between "gross domestic product" and "gross national product". (4marks)
ii. Give the reasons for the lower value of the gross national product in the less developing countries. (1 mark)

QUESTION 29

September 2015 Question One A and B

The following data represents economic transactions of a hypothetical economy: Sh. "million"

General government final expenditure	6,750
Taxes on expenditure	4,250
Transfer payments	675
Social security contributions	2,500
Net property income from abroad	250
Consumers expenditure	18500

Subsidies	750
Gross domestic fixed capital formation	5750
Corporate income tax	750
Undistributed profits	500
Personal income tax	1,000
Imports of goods and services	9,250
Exports of goods and services	8,750
Depreciation	3500

Required:

Calculate:

i. Gross national product. (2 marks)
ii. Net national product. (2 marks)
iii. National income. (2 marks)
iv. Personal income. (2 marks)
v. Disposable income. (2 marks)

TOPIC 7

ECONOMIC GROWTH, ECONOMIC DEVELOPMENT AND ECONOMIC PLANNING

QUESTION 1

December 2021 Question Four B

Outline five factors that determine the economic development of a country. (5 marks)

QUESTION 2

August 2021 Question Six B

Identify four effects of Covid-19 pandemic on the world economy. (4 marks)

QUESTION 3

May 2021 Question Three C

Kenya, which is currently ranked as a developing country, came up with an economic blueprint geared towards realising economic development by the year 2030.

Required:

Describe five factors that might hinder Kenya from realising the above objective. (5 marks)

Outline measures, that might be put in place in order to overcome the impediments in c (i) above. (5 marks)

QUESTION 4

May 2021 Question Six A

Describe the term "economic integration". (2 marks)

Highlight six factors that limit successful economic integration in developing countries. (6 marks)

QUESTION 5

May 2021 Question Seven C

With the aid of a diagram distinguish between "actual economic growth" and "potential economic growth. (5 marks)

QUESTION 6

November 2020 Question Four C

Explain the term “economic planning” (2 marks)

QUESTION 7

November 2020 Question Four D

Highlight six characteristics of a good economic planning. (6 marks)

QUESTION 8

November 2019 Question Seven A

Enumerate five causes of inequalities in the distribution of income and wealth in an economy. (5 marks)

QUESTION 9

November 2019 Question Seven B

Explain five benefits of development planning in an economy. (5 marks)

QUESTION 10

May 2019 Question Four B

With the aid of a well labelled diagram, explain the equilibrium level of a firm operating uunder an oligopolistic market structure. (5 marks)

QUESTION 11

May 2019 Question Six C

Explain six causes of high levels of external debt in developing countries. (6 marks)

QUESTION 12

November 2018 Question Seven B

Analyze six obstacles to industrial development in developing countries. (6 marks)

QUESTION 13

May 2018 Question Three D

Highlight five determinants of economic development in a country. (5 marks)

QUESTION 14

November 2017 Question Two B

Examine eight policy measures that could be adopted to minimise the problem of rising external debt in developing countries. (8 marks)

QUESTION 15

May 2017 Question Four B

Suggest six economic reforms that could be put in place to boost the growth of the 2737 informal sector in developing countries. (12marks)

QUESTION 16

November 2016 Question Four A

Highlight five strategies that could be implemented by governments in developing countries to spur growth in the industrial sector. (5 marks)

QUESTION 17

November 2016 Question seven C

Summarise eight challenges that hinder successful achievement of national development targets set by developing countries. (8 marks)

Sector	Total output	Intermediate purchaser
Sh. "000"	Sh."000"	Sh."000"
Service	76,000	37,000
Agricultural	55,000	23,000
Manufacturing	111,000	69,000

Indirect taxes and fixed assets depreciation amount to Sh.21,000,000 and Sh.22,000,000

rrespectively

Required:

i. Gross national product using the value-added approach. (2 marks)
ii. Net domestic product at market price. (1 mark)
iii. Net domestic product at factor cost. (1 mark)

QUESTION 18

May 2016 Question Three A

Discuss five policy measures that developing countries could adopt to reduce regional imbalances.
(5 marks)

QUESTION 20

November 2015 Question Six B

Outline six causes of high levels of external debts in developing countries. (6 marks)

Summarise six policies that could be adopted to combat the problem of high levels of external debts in developing countries. (6 marks)

QUESTION 21

September2015Question Four B

Distinguish between "economic growth" and "economic development". (4 marks)

TOPIC 8

MONEY AND BANKING

QUESTION 1

December 2021 Question Three A and B

Summarize four effects of expansionary fiscal policy in an economy. (4 marks)

Describe six qualities of money as a medium of exchange. (6 marks)

QUESTION 2

December 2021 Question Five C

Analyze three factors that limit independence of the central bank in carrying out its mandate in an economy. (6 marks)

QUESTION 3

August 2021 Question Three C

Analyze three factors that may limit independence of the central bank in carrying out its mandate in an economy. (6 marks)

QUESTION 4

August 2021 Question Seven A

(a) (i) Explain the term "credit creation". (2 marks)

(ii) Evaluate four factors that limit the effectiveness of credit creation by commercial banks. (8 marks)

QUESTION 5

May 2021 Question Two A

Highlight the effects of removing interest rate capping in an economy. (5 marks)

QUESTION 9

November 2020 Question Five A

Enumerate four factors that determine the velocity of money in circulation. (4 marks)

QUESTION 10

November 2020 Question Six A

Justify five reasons for differential interest rates in an economy. (5 marks)

QUESTION 11

November 2020 Question Six B

With the aid of a diagram, describe the concept of liquidity trap (4marks)

QUESTION 12

November 2020 Question Six C

Using suitable examples, provide three reasons for interest rate decontrol in an economy. (6 marks)

QUESTION 13

November 2020 Question Six D

Summarise five reasons that make it possible for commercial banks to create credit. (5 marks)

QUESTION 17

May 2019 Question seven C

The ffollowing information relates to the commodity and money closed economy in millions of shillings:

Commodity market

C = 200 + 0.4y

I=1,900-12r

Money market

MDT =0.5y

MDS = 100-10r

Ms=1,500

Where:

C = Consumption function

Y = National income

I = Investment function

R = Rate of interest

MDT = Precautionary and transactionary demand for money

MDs=Speculative demand for money

Ms =Money supply

Required:

i. The IS function. (3 marks)
ii. The LM function. (3 marks)
iii. The equilibrium level of interest rate. (3 marks)

(iv) The equilibrium level of national income. (2 marks)

QUESTION 18

November 2018 Question Five A

Explain five negative effects of a contractionary monetary policy in an economy. (5 marks)

QUESTION 19

May 2018 Question Two A

Examine four determinants of money supply in an economy. (8 marks)

QUESTION 20

May 2018 Question Five B

Suggest three methods that the government of a country might adopt to strengthen its currency. (3 marks)

QUESTION 21

May 2018 Question Five C

Explain five differences between the "quantity theory of money" and the "liquidity preference theory of money". (10 marks)

QUESTION 22

November 2017 Question One C

Describe four functions of money in an economy. (4 marks)

QUESTION 23

November 2017 Question Two A

Analyse the relevance of interest rates in an economy. (5 marks)

QUESTION 24

November 2017 Question Seven B

Suggest four contractionary monetary policy measures that could be used to combat high level of inflation in a developing country. (4 marks)

QUESTION 26

May 2017 Question Five C

Recently, there have been deliberate attempts to control the rate of interest in some of the developing countries.

In view of the above statement, explain five advantages of interest rate decontrols in an economy. (5 marks)

QUESTION 27

November 2016 Question Six A

Outline five factors that determine the rate of exchange of a country's currency. (5 marks)

QUESTION 28

November 2016 Question Six B

Enumerate five roles of the central bank in an economy. (5 marks)

QUESTION 29

November 2016 Question seven B

State six advantages of a floating exchange rate system in an economy. (6marks)

QUESTION 30

May 2016 Question Two A (II)

Differentiate between the following sets of terms as used in economics:

(ii) "Narrow money" and "broad money". (2 marks)

QUESTION 31

May 2016 Question Four C

Outline eight roles of commercial banks in boosting the economic development of a country. (8 marks)

QUESTION 32

May 2016 Question Six C

Examine six roles of non-banking financial institutions in an economy. (6 marks)

QUESTION 33

May 2016 Question Six D

Describe three ways in which a government could use fiscal policy to stimulate economic growth. (6 marks)

QUESTION 34

November 2015 Question Five A

Describe five instruments of monetarypolicythatcouldbeusedtocontrolthelevelof73 money supply in an economy. (10marks)

QUESTION 35

November 2015 Question Five B

Discuss five factors that limit the effectiveness of monetary policies in developing countries. (10 marks)

QUESTION 37

November 2015 Question seven B

Describe five differences between commercial banks and non-banking financial institutions. (10 marks)

QUESTION 38

September 2015 Question C

Briefly explain five functions of money. (5 marks)

QUESTION 39

September 2015 Question A

One of the main functions of a central bank is the effective implementation of the monetary policies.

Discuss the main instruments of monetary policies. (10 marks)

TOPIC 9

INFLATION AND UNEMPLOYMENT

QUESTION 1

December 2021 Question Four A

Citing an example, explain the term "hidden unemployment**".** (2 marks)

QUESTION 2

December 2021Question Seven A

Define the term inflation targeting. (1 mark)

State four disadvantages of inflation targeting in a country. (4 marks)

QUESTION 3

August 2021 Question Two C

Justify five reasons why devaluation in developing countries tends to be inflationary. (5 marks)

QUESTION 4

May 2021 Question Four C

Assess seven reasons why developing countries are concerned about the high rate of unemployment in their countries. (7 marks)

QUESTION 5

November 2020 Question Four B

Differentiate between "seasonal unemployment" and "frictional unemployment". (4 marks)

QUESTION 6

November 2019 Question Five D

With the aid of a well labelled diagram, explain the trade-off between inflation and unemployment level (4 marks)

QUESTION 7

May 2019 Question A

Differentiate between "demand deficient unemployment" and "disguised unemployment" as used in economics. (2 marks)

QUESTION 8

May 2019 Question B

Enumerate four effects of inflation on the functions of money. (4 marks)

QUESTION 9

November 2018 Question Six A

Suggest six measures that developing countries could adopt to curb against high levels of urban unemployment. (6 marks)

QUESTION 10
November 2018 Question Seven A

i. Explain the term "hyperinflation" as used in economics. (1 mark)
ii. With the help of a diagram, describe demand pull inflation. (4 marks)
iii. Highlight three causes of demand pull in an economy. (3 marks)

QUESTION 11

May 2018 Question One A

Discuss five negative effects of inflation in an economy. (10 marks)

QUESTION 12

May 2018 Question One A

Explain five conditions that could favour effective use of price discrimination in an economy. (10 marks)

QUESTION 13

May 2018 Question Four C

Discuss five ways in which inflation 'night cause unemployment in an economy. (10 marks)

QUESTION 16

May 2017 Question Seven C

Summarise nine reasons why unemployment is a major policy issue in developing countries.
(9 marks)

QUESTION 17

November 2016 Question Six C

Suggest five policy measures that could be adopted to reduce the level of unemployment in a developing country. (10 marks)

QUESTION 18

November 2016 Question seven A

Explain the relationship between money supply and the level of inflation in an economy. (2 marks)

QUESTION 19

May 2016 Question seven A(i)

Differentiate between the following sets of terms in economics:

Structural unemployment and Keynesian unemployment. (2 marks)

QUESTION 20

May 2016 Question Seven A

Summarize five causes of inflation in developing countries. (5 marks)

QUESTION 21

November 2015 Question Six A

Explain four effects of inflation on the functions of money. (8 marks)

QUESTION 22

September 2015 Question Four C

Briefly explain the effects of high levels of inflation in an economy. (6 marks)

QUESTION 23

September 2015 Question Six B

Explain three types of unemployment. (6marks)

QUESTION 24

September 2015 Question Six C

Using the Phillips curve, explain the relationship between unemployment and inflation. (4 marks)

TOPIC 10

AGRICULTURE AND INDUSTRY

QUESTION 1

August 2021 Question Two E

Using a suitable example, explain the term “transfer payments”. (2 marks)

QUESTION 2

August 2021 Question Three A

Highlight six economic factors that may contribute to poor performance of the agricultural sector in developing countries. (6 marks)

QUESTION 3

November 2020 Question one A

Explain four methods asused by the government to stabilise agricultural prices. (4 marks)

QUESTION 4

May 2019 Question Four B

Summarise five reasons why the prices of agricultural products fluctuate more than the prices of manufactured products. (5 marks)

QUESTION 5

May 2018 Question three B

Suggest your reasons why waves in the agricultural sector tend to be lower than wages in the industrial sector. (1 mark)

QUESTION 6

November 2017 Question Three B

With the aid of well labelled diagrams, analyse the effects of each of the following situations on the market equilibrium price and quantity of an agricultural product X:

i. A reduction in the price of product Y which is a close substitute for product X. (4 marks)

ii. A successful promotional campaign by producers showing the nutritional benefits of product X. (4 marks)

iii. Discovery of a new use for product X by consumers, accompanied by bad weather condition. (4 marks)

iv. Simultaneous increase in government subsidy on product X accompanied by a reduction in the price of the substitute. (4 marks)

QUESTION 7

November 2017 Question five C

Highlight ten problems that are faced by the agricultural sector in developing countries.
(10 marks)

QUESTION 8

November 2015 Question Four B

Enumerate five changes in the tax policy that could be implemented by a government to spur growth in the agricultural sector. (5 marks)

TOPIC 11

INTERNATIONAL TRADE

QUESTION 1

December 2021 Question Five A and B

(a) Highlight five advantages of using a free exchange rate system in an economy. (5 marks)

(b) Enumerate seven criticisms levelled against the theory of comparative advantage. (7 marks)

QUESTION 2

December 2021 Question Seven C

Outline seven limitations of regional economic integration in developing countries.
(7 marks)

QUESTION 3

August 2021 Question Five D

Discuss three roles played by the International Monetary Fund (IMF) in the world economy.
(6 marks)

QUESTION 4

May 2021 Question Five B

Examine five reasons for deteriorating terms of trade for developing countries.

(10 marks)

QUESTION 5

May 2021 Question Six B

Examine four advantages of currency devaluation to a country's economy. (8 marks)

QUESTION 6

November 2020 Question seven A

Summarise six corrective measures that developing countries should institute to correct the persistent deficits in their balance of payments position. (6 marks)

QUESTION 7

November 2020 Question seven B

Discuss four policy recommendations that developing countries should institute to reduce regional imbalances in their economies. (8 marks)

QUESTION 8

November 2020 Question seven C

Justify six reasons why external debt problems is a major policy issue in developing countries. (6 marks)

QUESTION 9

November 2019 Question Five B and C

Explain six factors that determine the level of induced investments in an economy. (6 marks)

QUESTION 10

November 2019 Question Five C

The value of money varies inversely with the level of prices.

With reference to the above statement, justify six positive economic effects of a prolonged fall in the value of money in an economy. (6 marks)

QUESTION11

November 2019 Question Six A B and C

Identify four reasons against international trade restrictions. (8 marks)

QUESTION12

Summarize four functions of world Trade Organisation. (4 marks)

QUESTION 13

November 2019 Question Six C

The Investment citizens of your country have raised concern over the increased rate of Foreign Direct Investment in your country.

Required:

Assess four cases in favour of and four cases against Foreign Direct Investment in an economy.
(8 marks)

QUESTION 14

November 2019 Question Seven C

Distinguish between "depreciation of a currency" and "demonetisation of the currency". (4marks)

QUESTION 15

November 2019 Question Seven C

Highlight six possible effects of demonetisation of the currency, (6marks)

QUESTION 16

May 2019 Question Five C

Outline six limitations of the theory of comparative advantage as used in internationalmarks13

QUESTION 20

November 2018 Question Six C

Discuss seven disadvantages of adopting an import substitution strategy to control unfavourable balance of payments in a developing country. (7 marks)

QUESTION 21

May 2018 Question Two B

Explain six reasons why a country might impose international trade restrictions. (6 marks)

QUESTION 22

May 2018 Question Two C

Analyse three roles of International Monetary Fund (IMF)to member countries.

(6marks)

QUESTION 23

November 2017 Question Five B

Explain five advantages of implementing exports promotion strategy in developing countries.
(5 marks)

QUESTION 24

May 2017 Question Six A

Argue the case for and against regional economic integration by developing countries.
(12 marks)

QUESTION 25

May 2017 Question Seven B

Describe five causes of balance of payment deficits in developing countries. (5 marks)

QUESTION 26

May 2017 Question Seven B

Outline six limitations of the theory of comparative advantage. (6 marks)

QUESTION 27

November 2016 Question Five A

The United Kingdom (UK) recently withdrew its membership from the European Union

(EU), a process referred to as "Brexit". Analyse the likely economic effect of Brexit on the United Kingdom's:

(i) Exchange (2 marks)
(ii) Interest rates (2 marks)
(iii) Inflation rate (2 marks)
(iv) Sacrifices exchange market (2 marks)

QUESTION 29

September 2015 Question Six A

Most developing countries experience deficits in their balance of payments.

Explain the various methods that could be used by these countries to correct deficits in their balance of payments. (10 marks)

PAST PAPER

ANSWERS

TOPIC 1

INTRODUCTION TO ECONOMICS

QUESTION 1

December 2021 Question One D

Advantages of a free market economic system.

A free market system is where the people in an economy are free to engage in economic activities and transactions without government interference.

Advantages

- Efficient allocation of resourceskenya.com
- Competition
- Innovation and economic growth
- More choice
- Absence of red tape
- The free market economy naturally promotes equality
- Free market economies regulate themselves naturally

QUESTION 2

August 2021 Question Six C

i. **Definition of the term "free enterprise economic system."**

Refers to an economic system where the price mechanism is given a free reign in resource allocation. Competition is the driving force of free enterprises, resulting in greater efficiency and lower prices for the consumer.

ii. **Economic advantages of free enterprise economic system.**

1. Absence of red tape
2. Freedom to innovate
3. Customers drive choice

Incentive: people are encouraged to work hard because opportunities exist for individuals to accumulate high levels of wealth.

QUESTION 3

May 2021 Question One A

Ways in which the government could influence allocation of resources in a country

- **Indirect taxes:** indirect taxes can be used to raise the price of de-merit goods an products with negative externalities designed to increase the opportunity cost of consumption and thereby reduce consumer demand towards a socially optimal level.
- **Subsidies:** subsidies to consumers will lower the price of merit goods. They are designed to boost consumption and output of products with positive externalities remember that a subsidy causes an increase in market supply and leads to a lower equilibrium price.
- **Provision of goods and services**: Because of privatization, the state owned sector of the economy is much smaller than it was years ago. State funding can also be used to provide merit goods and services and public goods directly to the public.
- **Tax relief**: the government may offer financial assistance such as tax credits for business investment in research and develop nent. Or a reduction in corporation tax designed to promote new capital investment and extra employment.
- **Legislation and regulation** e.g. employment laws may offer some legal protection for workers by setting maximum working hours or by providing a price floor in the labor market through the setting of a minimum wage regulation may be used to introduce fresh competition into a market- for example breaking up the existing monopoly power of service provider.

QUESTION 4

May 2021 Question One C

i. **Term "Consumer Sovereignty" as used in economics. (Nov 2018 1B)**

This is an economic belief that societal welfare is maximized when consumers are at liberty to choose goods to satisfy their needs. Simply, the consumer is the best judge of their product choices.

ii. **Limitations of consumer sovereignty in an economy.**

- Government policy through taxes and subsidies can influence choices made by consumer.
- Nature of economic system e.g. in a command economy, government dictates what a consumer should do.
- Irrationality of consumer
- Advertising also restricts the consumer's choice.
- Type of market e.g. in monopolies consumers have limited guy and the choices of the Income of consumer products are only made for rich
- Poor are never considered
- In availability of goods means consumers has to use what is available.
- Technical factors may impinge on freedom of consumer. For example the existing technology may not allow producers to make goods desired by
- Consumers.
- Habit individual consumers have different and are reluctant to charge

QUESTION 5

November 2020 Question One B

Differentiation of terms

i. **"Basic human wants" and "secondary human wants".**

Basic human wants are the essential needs in life such that one cannot do without them. They include food, shelter and clothing. They have the following characteristics: they cannot be postponed, they are felt needs, they are satisfied before secondary wants and one cannot do without them.

Secondary wants are requirements for comfortable and luxurious life. Comforts provide good life, beyond the mere survival; it includes such needs like education, medicare and security. Luxuries include even much more flamboyant needs like a sleek car, a mansion, studying abroad and such kind of things.

ii. "**Public good" and "merit good".**

Public goods are products where for any given output consumption by additional consumers does not reduce the quantity consumed by existing customers e.g. law, parks, street lighting and defence.

Merit goods are those goods and services that the government feels that people will under consume and which ought to be subsidized or provided free at the point of use so that consumption does not depend primarily on the ability to pay for the good or services e.g. Education and healthcare

Public good	**Merit good**
Normally funded and provided by the gov't	Provided by both public and private sector
Largely unconstrained by supply	Limited in supply
Non-rival	Rival
Non-excludable	Excludable
Non-rejectable	Rejectable by those unwilling to pay
Marginal cost of supply close to zero	Positive marginal cost to supply to extra users

iii. **"Stable equilibrium" and unstable equilibrium".**

Equilibrium is a point whereby forces of demand and supply are equal.

Stable equilibrium is an equilibrium that is restored if distributed by an external force. Most economic models have equilibrium that is stable, reflecting the observation that the real-world adapts to changes and maintains a fair degree of stability.

Unstable equilibrium refers to equilibrium where a slight disturbance evokes further disturbance so that the original position is never restored. In this case, there is a tendency for the object to assume newer and newer positions once there is a departure from the original position e.g. cobweb model

QUESTION 6

November 2020 Question Two B

Significance of mobility of factors of production

***Factor mobility** refers to the ability to move factors of production in (labour, capital or land) out of one production process to another. Mobility may involve the movement of factors between firms* *within an industry; movements of factors across industries within a country and mobility may involve the movement of factors between countries either within industries or across industries.*

It has the following significance:

- Mobility of labour helps in increasing efficiency and productivity of workers when workers moved to occupations which they are suited best.
- Mobility of labour also increases worker's income when they shift from low-paid to high paid jobs.
- Labour mobility solves the unemployment problem when workers move to places where they are wanted e.g. when one immigrates from Dubai to look for greener pastures.
- Mobility of Labour helps in economic development when unemployed labour shifts to public works like dams, roads, canals and factories
- Mobility may also be deemed to be significant in that workers are occasionally allowed to perform various tasks and are capable of performing them, then they are less likely to experience the monotony often associated with specialisation attributed by its accompanying negative effects.
- Mobility of factors of production enables the benefits of economic growth of a country to be spread evenly throughout. Thus, many industries are located in urban areas primarily because of the urban market and economies of scale. If all industries can be encouraged to locate in rural areas through incentives, then the benefits of industrial development in a particular country can be spread evenly. Mobility enables different factor combinations to be made into use. For instances, more capital and labour can only be used if either of these factors is mobile to facilitate a change in the production techniques. This enables the producers to search for a least cost method of production

QUESTION 7

November 2019 Question One A

Limitations of a planned economic system

A planned economics system refers to a system where all major economic decisions are made by a government ministry or planning organization

Limitations of planned economic system are:

- Consumers cannot choose and only those goods and services are produced are those which are decided by the government.
- Lack of profit motive may lead to firms being inefficient.
- Lots of time and money is wasted in communicating instructions from the 737 government to the firms.

- Command economies discourage innovation. They reward business leaders for following directives. This doesn't allow for taking the risks required to create new solutions
- Goods production is not always matched to demand and poor planning often leads to rationing
- Rapid change can completely ignore society's needs, forcing the developing of a black market and other coping strategies.

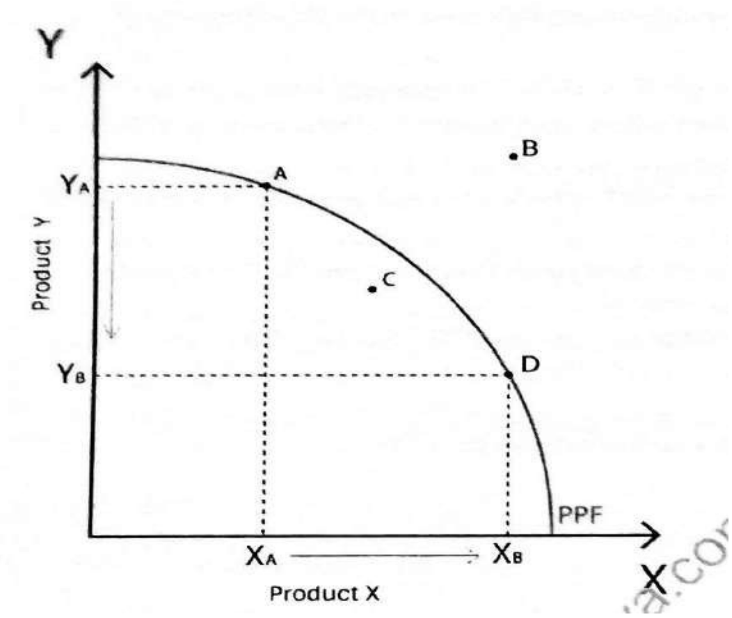
- The task of assessing the available resources and deciding on what and how much to produce and how to produce and distribute can be too much for the central planning committee.
- Also the maintenance of such a committee can be costly

QUESTION 8

November 2019 Question One B

Concept of Production possibility curve

This is a graph which indicates the various production possibilities open fixed, because of the fixed resources the production one commodity can only be at the expense of another



- To produce more of X, quantity produced of Y must be reduced.
- Both A and D result in same output, though quantity produced of X and Y differ
- Point a represents under utilization of available resources whereas point D is unachievable given existing technology and resources.

QUESTION 9

November 2019 Question Two A

Fundamental economic issues that a society has to address to minimize the problem of scarcity of resources

1. **Economic Growth:** Economic Growth is an increase in the ability to produce goods and services. If the society has more resources they produce more good and services and satisfy more of their wants. This reduces scarcity and gives m satisfaction (more goods and services).

2. **Reducing Wants**: If the society doesn't want so much then there would be scarcity. The option of reducing wants is one of the options that societies have dealing with scarcity, but it is not a very good option.
3. **Using existing resources wisely**: Societies can reduce scarcity by using its existing resources wisely

QUESTION 10

May 2019 Question Two A

i. **Free market economic system**

This is an economic system based on supply and demand with little or no government control e.g. united states

Characteristics of a free market economic system

- Ownership of production means: individuals are at liberty to own means of production i.e. land, capital and enjoy income from them in terms of rent, profits and interest.
- Reliance on the price mechanism: decisions on what? Who and how are subject to forces of demand and supply
- Self interest is the primarily motivator for all economic decisions.
- There is voluntary production and consumption of goods, with overall freedom for every individual to make their decisions.
- Competition creates overall efficiency and low prices.
- Limited government role e.g. to preventing monopolies, allowing fair and equal access to markets for all, protecting the nation and its marks through military means.
- Profit is the main motive for businesses

ii. **Advantages of a free market economic system**

Incentive: people are encouraged to work hard because opportunities exist for individuals to accumulate high levels of wealth.

Choice: people can spend their money how they want, they can choose to set up their own firm of they can choose for whom they want to work.

Absence of bureaucracy: because free markets reduce cost and minimize red tape, they may lead to more innovation and development. Entrepreneurs do not have to wait for the government to tell them what to do. They study demand, research trends and meet their customer's needs through innovation. Independence also encourages competition among firms to improve their products and services.

Optimal allocation of resources: resources in the market are better distributed and allocated. Since consumers are willing to buy certain quantity of a product, producers are willing to pay to acquire the raw materials to produce the product.

Otherwise, producers are likely to produce too much of a good in same way, it also encourages firms to be more efficient as they seek to produce a price possible to maximize their profits.

- There no resources wasted in planning as no planning is required
- No wastage of resources on unreliable projects: this is because investment decisions will be based on profitability.
- A free market also responds well to changes in consumer wishes, that is: it is flexible. Because the decision happens in response to change in the market there is no need to use additional resources to make decisions, record them and check on whether or not they are being carried out. The size of the civil service is reduced.

QUESTION 11

November 2018 Question One A

Difference between "economic resources" and "nor economic resources

Economic resources are those resources that are scarce and therefore command a price. e.g. land, labor, entrepreneurship and capital. **Non- economic resources** are those that are abundant in nature and thus do not command a price. E.g. air

QUESTION 12

November 2018 Question One B

i. **Explanation of the term "consumer sovereignty" as used in economics**

Consumer sovereignty implies that the consumer is the best judge of their needs and they should be left to make their choices without any influence whatsoever.

ii. **Factors that limit consumer sovereignty**.

- Government policy through taxes and subsidies can influence choices made by
- Consumer.
- Nature of economic system e.g. in a command economy, government dictates what a consumer should do.
- Irrationality of consumer
- Advertising also restricts the consumer's choice.
- Type of market e.g. in monopolies consumers have limited choice. 0707 Income of consumer products are only made for rich guy and the choices of the poor are never considered
- In availability of goods means consumers has to use what is available.
- Technical factors may impinge on freedom of consumer. For example the existing technology may not allow producers to make goods desired by consumers.
- Habit individual consumers have different and are reluctant to charge

QUESTION 13

November 2018 Question Four A

Characteristics of a mixed economy

A mixed economy is one in which government and private sector take part in productive activities in the economy. Attributes include:

Profit motive and social welfare: in mixed economy system, there are both profit motive like capitalism and social welfare as in socialist economy.

- **Price mechanism and controled prices** under this system, price mechanism and regulated price operate simultaneously
- In consumer goods industries **price mechanism is generally followed however**, at the time of big shortages or during national emergencies prices are controlled and public distribution system has to be made effective.
- **Private property is allowed**: in mixed economy, private property is allowed. However, here it must be remembered that there must be equal distribution of wealth and income. It must be ensured that the profit and property may not concentrate in a few pockets
- **Personal freedom**: under mixed economy, there is full freedom of choice of occupation, although consumer does not get complete liberty but at the same time government can regulate prices in public distribution system.
- **Co-existence of private and public sector**: under this system there is coexistence of public and private sectors. In public sector industries like defence, power, energy, basic industries etc. Are set up on the other hand, in private sector all the consumer goods industries, agriculture small scale industries are developed. The government encourages both the sectors to develop simultaneously.
- Economic planning: in a mixed economy government always tries to promote737 economic development of the country. For this purpose, economic planning is adopted. Thus, economic planning is essential under this system.
- Control of monopoly power: under this system, government takes initiatives to control monopoly practices among the private entrepreneurs through effective legislative measures. Besides government can also take over these services in public interest.

QUESTION 14

November 2017 Question One D

Advantages and disadvantages of a planned economic system

A planned economy is a type of production and the allocation of capital goods take place according to economy – wide economic plans and production plans. Also called a command economy

Advantages of a planned economic system

1. It is easy to implement government policies, as the government is in direct control of production
2. It can lead to efficiency in production. This is because production is directed by the state in order to achieve social objectives.
3. It promotes social welfare. The objective of production is not profit maximisation, but achieving the best for the community.
4. It promotes economic stability. All economic decisions are carried out by the central planning authority.
5. Consumers are protected from exploitation. Essential services are cheaply provided by the state.

Disadvantages of planned economic system

1. Planned economy is characterised by production of poor quality products. This is due to absence of competition from the private sector and failure to respond to consumers' demands. A planning authority sets out production targets.
2. Limited Innovation in the production process.
3. Central planning under a planned economy results into bureaucracy. 0707 This leads to delays in decision making, thereby wasting time and promoting inefficiency.
4. There is lack of consumer sovereignty in a planned economy. The right of a consumer to determine the process of resource allocation does not exist in a planned economy. Freedom of choice is also limited.
5. It increases administrative costs on the part of the government. Government agencies will be actively involved in resource allocation and distribution, all of which increases costs to the government.
6. This system tends to be characterised by mismanagement of resources. This is because corruption and nepotism are always rampant.

QUESTION 15

May 2017 Question One A

Steps followed in the scientific method used in economics

- **Definition of concepts**: ideas are stated in such a way that they can be measured in order to test theory against fact.
- **Formation of hypothes**is A hypothesis is an educated guess. It is based on actual observations and some underlying assumptions.
- **The use of hypothesis to forecast**: if correct, then it should follow, that when certain things are done, certain things are set to happen.
- **Hypothesis testing**: gathering real life data to test the practicality of hypothesis

QUESTION 16

May 2017 Question One D

Application of opportunity cost in economic decision making

- Opportunity cost is the value of best alternative forgone. Its applications include.
- Opportunity cost assists policy makers to make decisions of investing scarce resources in more viable projects and avoid unnecessary investments.
- Opportunity cost helps the government with limited resources to forgo some projects to develop others e.g. between a decision to build a hospital and a new school, the hospital would be a priority.
- Opportunity cost helps consumers when allocating their limited income among alternative goods and services to purchase e.g. students would opt to buy textbooks instead of such shoes.

- Opportunity cost emphasizes economic problems of choice by measuring the real rather than the money cost of obtaining an extra unit of an item.
- Opportunity cost assists producers to make decisions on what quantities to produce for the market.

QUESTION 17

November 2016 Question One B

Advantages of a controlled market system

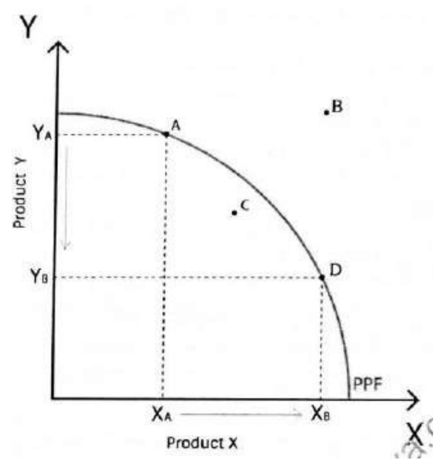
- Elimination of waste resulting from competition between firms.
- Low levels of unemployment as the government employment to provide employment to everyone
- There is no duplication as the allocation of resources is centrally planned.
- Prices are kept under control and thus everybody can afford to consume goods and services.
- Large scale production: economies of scale become possible due to mass production taking place.
- Public services: "Natural monopolies" such as the supply of domestic power or defense can be provided efficiently through central planning.

QUESTION 18

May 2016 Question One B

Production possibility frontier

This is a graph which indicates the various production possibilities open fixed, because of the fixed resources the production one commodity can only be at the expense of another product.



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QUESTION 19

May 2016 Question One C

Ways in which government can influence allocation of resources in a free market economy

- **Indirect taxes**: indirect taxes can be used to raise the price of de-merit goods and products with negative externalities designed to increase the opportunity cost of consumption and thereby reduce consumer demand towards a socially optimal level.
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TOPIC 2

DEMAND, SUPPLY AND DETERMINATION OF EQUILIBRIUM

QUESTION 2

December 2021 Question Seven B

Causes of a demand-pull inflation in an economy.

- Over-expansion of money supply: Too much money chasing too few goods Discretionary fiscal policy: Government spending drives up demand according to Keynesian economic theory
- Strong branding: Marketing can create high demand for certain products, a form of asset inflation
- Foreign aid: The volume of foreign aid is also increasing with passage of time. Almost every year we receive million dollars aid. When this aid is used inside the country, it increases the demand.
- The expectation that inflation will rise often leads to arise in inflation. Workers and firms will increase their prices to “Catch up” to inflation.
- A quick increase in consumption and investment along with extremely confident firms.
- A sudden increase in exports which might lead to a huge under-valuation of your currency

QUESTION 3

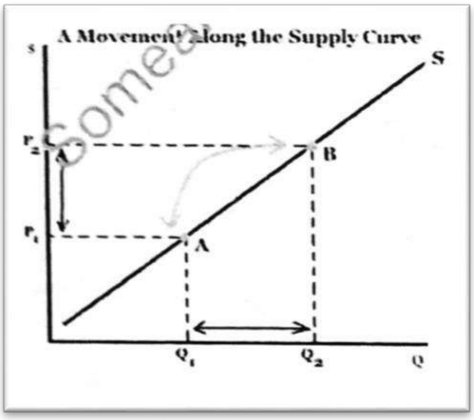
Factors that determine the supply of a good or service.

Supply refers to the amount of a goods or service that suppliers are willing and able to supply to the market at the various prices during a period of time. Supply is influenced by following factors.

1. **Price of good**: The higher the price, the higher the supply
2. **Price of related goods**: For compliments, if price of a good increases, then the firm will increase supply.
3. **Price of factors of production**: production of a good involves then many costs. If there is a rise in the price of a particular factor of production, then the cost of making goods that use a great deal of that factors experience a huge increase. The cost of production of goods that use relatively smaller amounts of the said factor increases marginally. Therefore, the change in price of one factor of production causes changes in the relative profitability of different lines of production. This causes producers to shift from one line to another, leading to a change in the supply of goods.
4. **State of technology**: Technological innovations and inventions tend to make it possible to produce better quality and / or quantity of goods using same resources. Therefore, the state of technology can increase or decrease supply of certain goods.
5. **Government policy**: e.g giving producers subsidies will reduce cost of production and make producers to make more goods.
6. **Natural factors**: e.g favourable weather can lead to production of more goods

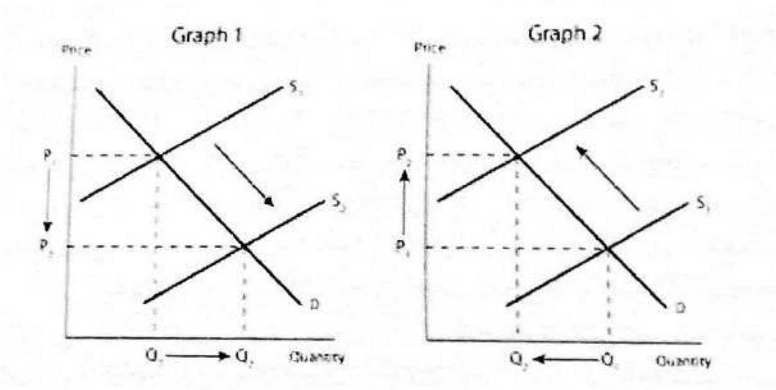
"A movement along a supply curve" and "A shift in a supply curve".

A movement in supply curve is caused by changes in price of a product.



Initially, equilibrium point is at point A. When price of commodity X increases from P1 to P2, supply increases from Q1 to Q2

A shift in a supply curve to change in supply of a commodity brought about changes in factors like government policy while price of a commodity remains constant

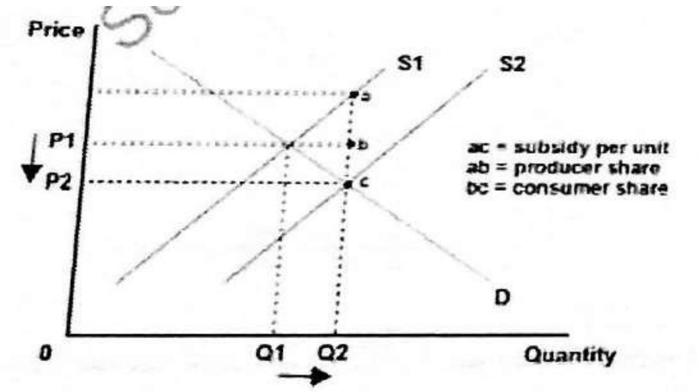


When technology deteriorates holding price constant, supply of commodity X reduces, causing a spike in price

QUESTION 4

Effect of the subsidy on market equilibrium.

A subsidy is a benefit given to an individual, business or institution usually by government. The subsidy is typically given to remove some type of burden and it is often considered to be in the overall interest of the public, given to promote a social good or an economic policy.



A subsidy will lower cost of production for producers, which will make them produce more of commodity thus increasing supply from S1 to S2 thus resulting to a price decline from Pl to P2.

QUESTION 5

i. **Point elasticity of demand**

PED $=\frac{\Delta Q}{\Delta P}\times\frac{P}{Q}$

$\frac{\Delta Q}{\Delta P}$=15-4Q-10Q^-2

PED=15-(4×75)-$\frac{10}{75\text{^}2}\times\frac{10}{75}$

=-285×$\frac{10}{75}$=-38

ii. **Interpret your results**.

An increase in price by one unit will lead to a reduction in demand by 38 units

QUESTION 6

May 2021 Question One B

Difference between "arc elasticity" and "point elasticity" of demand

- **Arc elasticity**-refers to the average elasticity between two given points on

$$\text{Arc PED}=\frac{Q_2-Q_1}{(Q^2+Q_2\div 2}\times\frac{P_1+P_2)\div 2}{P^2-P_1}$$

- **Point elasticity** – this measures elasticity at a particular point and is only valid or based on small movements.

$$PED=\frac{\Delta Q}{\Delta P}\times\frac{P}{Q}$$

QUESTION 7

May 2021 Question Two B

Reasons why governments intervene with the operations of price mechanism

- Government regulation can protect the environment, workers and consumers.
- Limit monopoly power
- Protect long term interest of the environment
- Reduce in equality and poverty through tax and benefit system 07
- Provide merit goods like education and health which are under provided in free markets.
- Provide public goods e.g. law and order not supplied in the market
- Disaster relief – only government can solve major health crisis such as pandemics
- Macroeconomics intervention – intervention to overcome prolonged recession and reduce unemployment.

QUESTION 8

May 2021 Question Two C

Factors that influence the elasticity of supply of a commodity

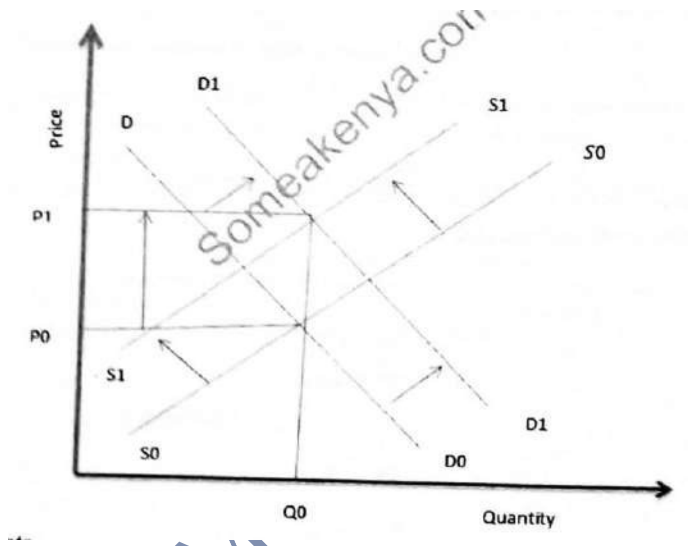
- **Number of producers** – more producers mean that the output can be increased more easily. The supply is more elastic.
- **Stock of finished goods** – in industries where there are high inventories / stocks of finished goods, the suppliers can easily supply more as the price rises. Thus, the price elasticity supply for theses goods will be elastic.
- **Time period of training** – where a company invests in capital the supply is more elastic in its response to price increases.
- **Reaction of costs** – if costs increase slowly it will stimulate an increase in quantity supplied. If cost rises rapidly the stimulus to production will be choked off quickly.
- **Length of production period** – quick production response to a price increases easily
- **The availability of spare capacity** – if fixed factors of production are being used to the fullest extent, however great the increase in price, the supply will be inelastic. If however, a firm is operating below capacity and there are unemployed resources the supply will be elastic.

- **Improvement in technology** – in industries where there is rapid 737 improvement in technology, the price elasticity of supply of such goods will be more elastic as compared to industries where there is not much in improvement of technolog
- **Adjustment time** – in the short run supply will be less elastic and in the long run supply will be elastic.

QUESTION 9

November 2020 Question One C

Effect of a simultaneous increase in the income of the consumer and increase in fuel prices



Effects

1. An increase in consumer's income (being a condition of demand) increases demand for product due to increase in purchasing power of consumer denoted by shift of demand Curve from Do Do to D_1D_1
2. An increase in fuel prices (being a factor of supply) will lead to shift of supply Curve to S_1S_1 from SoSo
3. All above will lead to an increase in equilibrium price from Po to P1
4. As regards equilibrium quantity, it's change depends on magnitude of change in price and income

QUESTION 10

November 2019 Question one D

i. **Demand function and the supply function**

Q = - 10 + 6P … … … (i)

$\frac{\Delta Q}{\Delta P}$=6

Since the slope is positive, then the equation above is a supply function

Q = 20 – 4p……………..(ii)

$\frac{\Delta Q}{\Delta P}$=4

Since the slope is negative, then the equation is a demand function

ii. Equilibrium price and quality

Equilibrium arises where the quantity demanded equals to quantity supplied.

Thus, - 10 + 6P = 20 – 4P

6P + 4P = 20 + 20

$\frac{10P}{10}=\frac{30}{10}$

P= Sh. 3

Equilibrium quantity

Thus, Q = - 10 + 6P

= - 10 + (6×3)

= - 10 + 18

= 8 units

QUESTION 11

May 2019 Question Two B

Factors that could lead to a leftward shift of the supply curve of commodity Poor technology

- Natural factors such as drought and flood
- Unfavourable change in government policy e.g. increase in taxes
- Increase in production cost
- Shortage of production factors
- Reduction in number of producers' suppliers
- Increase in profitability of alternate goods
- Reduction in productive capacity

QUESTION 12 akenya.com

May 2019 Question Three C

Applications of elasticity of demand in economic decision making

Elasticity of demand refers to the responsiveness of demand to change in factors such as price, income among others. Application of elasticity of demand in economic decision making:-

- For purpose of regulating farm incomes and to predict consequences of bumper harvests of crops.
- From the point of view of wage bargaining among workers and employers and the government when fixing minimum wage legislation.
- It's crucial for business persons who need to know the effects that changes in price
- Will have on the sales revenue for example, if they that demand for their product is relatively inelastic then increasing prices might help them to increase revenue. It on the other hand they are aware that source of their products have a high price elasticity of demand they will be more cautious when considering price increases for fear of losing revenue.
- Helps government to estimate the yield of a prospective tax: Critical for devaluation policy that aims at improving the balance of payments. Can only Succeed if imports and export demand is elastic. If that be the case, then devaluation will spur high demand for exports in foreign markets and lower local import demand
- Competition and pricing: If a firm is in a competitive industry there would be a high cross elasticity between its products and those of other firms. For such a firm, it may be beneficial to lower prices in order to attract customers. From other firms. This is because the price elasticity of demand for its products is very elastic due to the availability of substitutes.
- Protection policy: The concept of cross elasticity of demand is useful to the government in predicting the effects of its protection policy, for example, if the government imposes a tariff on an imported product like clothes with the intention of protecting the local industry, then the local and imported products must be close substitutes for the government to achieve its objectives
- Fluctuation of agricultural product prices: The more inelastic the demand for agricultural products are, the more widely prices will fluctuate with changes in output from period to period

QUESTION 13

November 2018 Question One C

Factors that determine the price elasticity of demand of a commodity

This is the responsiveness of demand to change in price of commodity.

Determinants of price elasticity of demand

- Adjustment time. In the short run demand will be inelastic while in the long run demand will be elastic.
- Habit forming products like beer and cigarettes will have inelastic demand
- Availability of substitutes: the greater the elasticity of demand.
- Proportion of income spent on commodity. If small proportion of income is spent on commodity then demand will be price inelastic like matchboxes & salt.

- Number of uses, the greater the number of uses to which a commodity can be put, the greater would be its elasticity of demand. This is because many units of the commodity are needed. For example, coat has several uses like heating, cooking and lighting. When the price of electricity increases, the consumer can use coal for eating and cooking and lamps for lighting. People could also save on the usage of such goods.
- Level of price. Price elasticity of demand is different at different levels of price. At higher levels of price, demand is price elastic and at lower levels of price demand is price in elastic.

- Nature of the commodity: generally the demand for luxuries will tend to be price elastic while that of necessities will tend to be price inelastic.
- Durability: the greater the durability of a product, the greater its elasticity of demand will tend to be, for example, if the price of salt increases it cannot be made to last longer so demand would be price inelastic. However, furniture can be made to last longer through careful use and so demand would be relatively elastic

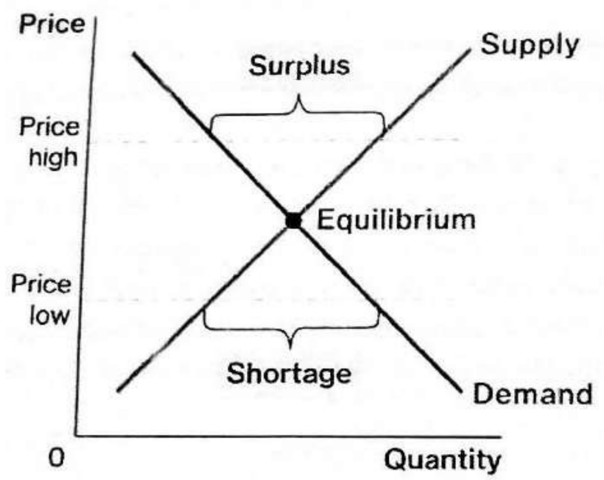
QUESTION 14

November 2018 Question Two A

Concept of "shortage" as used in market equilibrium

A **shortage**, also called excess demand, is the amount by which the quantity of a good demanded by consumers is greater than the quantity supplied by producers and occurs when prices are below the equilibrium price. If a producer prices his Goods at too low of a price and the quantity demanded exceeds the quantity supplied, a shortage is created. That is, a shortage occurs when demand for a good exceeds supply of that good at a specific price. Note that a shortage occurs at prices below the equilibrium price.

When graphed, A shortage is shown on a graph; its size is the quantity gap between the demand curve and supply curve at a price below the equilibrium price.



A surplus also called excess supply, occurs when the supply of a good exceeds demand for that good at a specific price. Note that a surplus occurs at prices above the equilibrium price.

It can also be is shown at a price above the equilibrium price; the size of the surplus is equal to the quantity gap between the supply curve and demand curve at that price.

QUESTION 15

November 2018 Question Two B

Effects of price decontrol in an economy.

Price decontrol entails removal of maximum price controls or minimum price controls and then leaving prices to be determined by forces of demand and supply.

Effects of price decontrol

- It encourages competition which will lead to lower consumer prices.
- In the long run many firms enter decontrol lines of production which will lead to increased government revenue since producers will produce more.
- It's likely to lead to more efficient long run allocation of resources because of absence of shortages and surpluses.
- In case of price floors price will reduce towards equilibrium.
- In case of a price ceiling the prices will increase towards equilibrium.
- There may be increase in employment when minimum wages are eliminated.
- Consumers will end up paying more in case of removal of price ceiling.
- It will reduces producers income in case of removal of minimum prices.

QUESTION 16

November 2018 Question Two C

i. **The equilibrium price and quantity of commodity x**

Equilibrium exists when quantity demand equals to quantity supplied

$$4 - Px + 0.5Py = -3 + 4Px$$

$$10 + Px - Py = -18 + 4Py$$

$$4Px + Px - 0.5Py = 7$$

$$5Px - 0.5Py = 7 \text{ … ……….. } \times 10$$

$$-Px + 5Py = 28 \text{ … … … … …. } \times 1$$

$$50Px - 5Py = 70$$

$$-Px + 5Py = 28$$

Using elimination method add above

$$\frac{49Px}{49}=\frac{98}{49}$$

Px = sh 2,000

Therefore

(50×2)-5Py=70

100-5Py=70

Py=sh.6,000

Equilibrium quantity commodity X

= (-3 + 4×2) ×1000

= (-3 + 8) ×1000 = 5,000 units

ii. **The equilibrium price and quantity of commodity y**

Equilibrium price Y = sh. 6000

Equilibrium quantity Y

= (-18 + 4 × 6) × 1000

= (-18 + 24) ×1020 = 6000units

iii. **nature of relationship between commodity x and commodity y**

Partial derivative Qdy with regard to Px

ThereforeQdy=10Px-Py

$$\frac{Qdy}{\Delta Px}=+1$$

Therefore commodity X and Y are substitutes due to positive slope.

QUESTION 17

May 2018 Question Three A

i. **Point elasticity of demand at P Sh.20**

Q = 200 + 5P + p2

$$\frac{\Delta Q}{\Delta P}=5+2P$$

Q where P = Sh. 20

Therefore, Q = 200 + 5 × 20 + 20^2

$$= 200 + 100 + 400 = 700$$

Point elasticity of demand $=\frac{\Delta Q}{\Delta P}\times\frac{P}{Q}$

$$=(5+2\times20)\times\frac{20}{700}$$

$$=45\times\frac{20}{700}$$

$$=1.29$$

ii. **Interpretation of the above results**

The product above has elastic demand which implies a small change in price translates to a more than proportionate change in quantity demanded.

QUESTION 18

May 2018 Question Five A

Explanation of the term "partial equilibrium" as used in economics

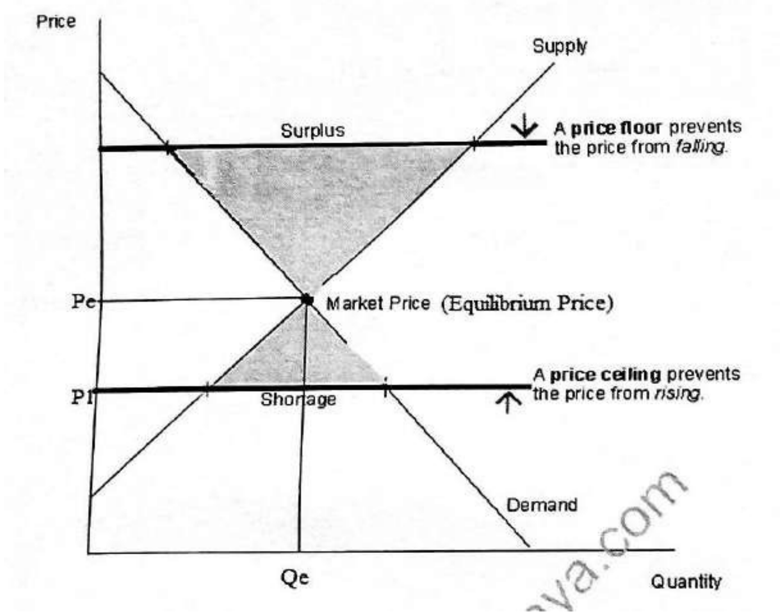
Partial equilibrium: this is a condition of economic equilibrium which takes into account only a part of the market ceteris paribus to attain equilibrium e.g. supply and demand model is a partial equilibrium model where the clearance on the market of some specific goods is obtained independently from prices and quantities in other markets. This makes analysis much simpler than in a general equilibrium model which includes an entire economy.

QUESTION 19

May 2018 Question six A

Distinction between "price floors" and "price ceilings"

Price floors



A Price floor is the minimum price below which the government can't allow market price of product to decline past.

Effects of price floors

- Consumers pay a higher price for same goods
- Suppliers get paid more for their produce, which makes them increase production leading to excess supply in the market.
- Reduce income inequalities by balancing welfare through imposition of minimum wages.

Price ceiling

- Also called maximum prices
- It is also illegal limit on how high a product price can be.

Effects of price ceiling

- Control the exploitative /unscrupulous practices of natural monopolies and / or those created by government policies.
- Protect the purchasing power of consumers especially low income earners
- Generate a conducive and selective political support base, industrial peace, minimal or absence of food riots and other forms of security.

As presented in the diagram above government sets a price usually below equilibrium price (Pe) since it deems current equilibrium prices are too high.

QUESTION 20

November 2017 Question Two C

i. **Elasticity of demand (ED)**

$$ED = \frac{\Delta Q}{\Delta P} \times \frac{P}{Q}$$

$$\text{Elasticity A} = \frac{1568 - 923}{52 - 75} \times \frac{75}{923}$$

$$= \frac{645}{23} \times \frac{75}{923}$$

$$= -2.28$$

Elasticity of demand product B

$$\frac{620 - 350}{21 - 14} \times \frac{14}{350} = \frac{270}{7} \times \frac{14}{350}$$

$$= \frac{600 - 540}{24 - 28} \times \frac{28}{540} = \frac{60}{-4} \times \frac{28}{540}$$

$$= -0.78$$

ii. **Advise to the government on the commodity that should be considered for a tax increase**

Government should increase tax on commodity B because increase in price does not hunt its demand

QUESTION 21

November 2017 Question Seven

Difference between "inelastic demand" and "unitary elasticity of demand"

Inelastic demand in economics is when people buy about the same amount whether the price drops or rises. The demand is said to be unitary elastic if percentage change in quantity demanded is equal to the percentage change in price.

QUESTION 22

May 2017 Question Five E

- Income elasticity of demand calculation

$$EY = \frac{\Delta Q}{\Delta P} \times \frac{Y}{Q}$$

$$= \frac{7-16}{29000-15000} \times \frac{15000}{16}$$

$$= \frac{-9}{14000} \times \frac{15000}{16} = -0.603$$

Commodity above is an inferior good due to negative income elasticity of demand

QUESTION 23

May 2017 Question Five B

Exceptions to the law of supply

- Where the supply of money is controlled by the government.
- Agricultural products since the production of agricultural products cannot be increased beyond a certain limit, the supply can also not be increased beyond this limit even if the prices are higher: the producer is unable to offer more quantities
- Backward bending supply curve of labour where it reaches a point a worker feels rich enough & substitutes work for leisure artistic and question goods. The supply of such goods cannot be increased or decreased according to demand. Thus, it is difficult to offer more quantities even if prices shoot up. Immediate requirement of funds: the seller may face at a time when there is
- Future expectations of a fall in price: if producers expect the price to fall in future, they will supply more now even at lower prices in order to clear the goods.
- Legislation restricting quantity; suppliers cannot offer to sell more quantities at higher prices where the government has put some regulations on the quantity of the good to be produced or the price ceiling at which the good is to be sold in the market.
- Perishable goods: in cases of perishable goods, the supplier could offer to sell more quantities at lower prices to avoid losses due to damage of the product. Competition: other market structures like oligopoly and monopolistic competition may be facing more competition, therefore offering to sell more quantities at lower prices and negating law of supply.
- Monopoly: may not necessarily offer a larger quantity supplied even though the price of goods is higher. Market control by the monopoly allows it to set market price based on demand in the market.
- Change in business: it may happen that the seller may plan to enter into an entirely new business by existing the current one. So, when the present business is on the verge of closure then the seller may sell his goods at lower prices to clear them off.

QUESTION 24

May 2017 Question Four C

The equilibrium price and quantity of the commodity

At equilibrium quantity supplied

(Qs) = Quantity demands (Qd)

300 – 0.4p = - 400 + 0.6p

$$0.6p + 0.4p = 300 + 400$$

$$P = 700$$

Therefore equilibrium price sh. 700

Then equilibrium quantity

$$Qd = 300 – 0.4p$$

$$= 300 – (0.4 \times 700)$$

$$= 300 – 280$$

$$= 20$$

QUESTION 25

May 2017 Question Three C

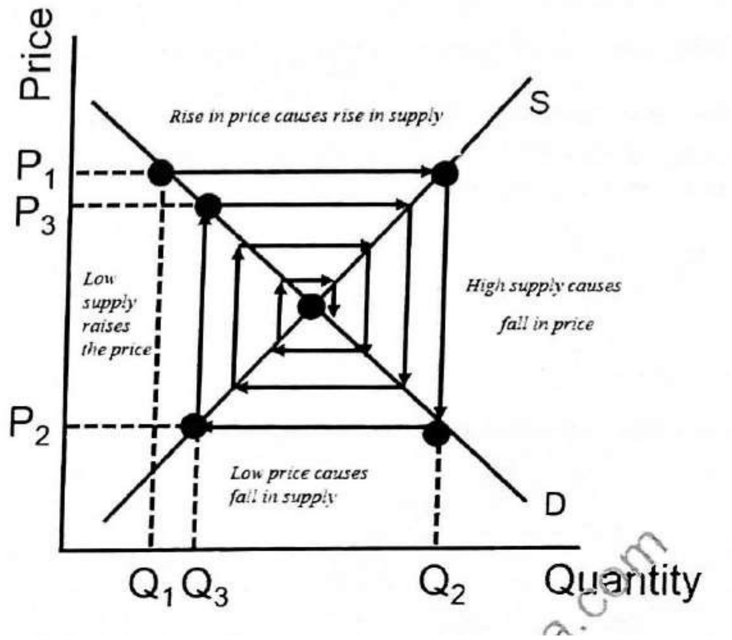
Reasons why demand curve slopes downwards

- Law of diminishing marginal utility
- Substitution effect
- Income effect because of negative relationship between price and quantity

QUESTION 26

May 2017 Question Two A

Cob web model in economics



A period of market instability that is initiated by a supply side shock but converges back to equilibrium over several cycles because demand is more elastic than supply.

Below is a diagram to show how a disequilibrium converges to an equilibrium over time in a specific agricultural market.

A poor harvest in period 1 means supply falls to Q1 so that prices rise to P1. If producers plan their period 2 production under the expectation that this high price will continue, then the period 2 supply will be higher, at Q2. Therefore, prices fall to P2 when they try to sell all their output. As this process repeats itself i.e. between periods of low supply with high prices and then high supply with low prices, the price and quantity trace out a spiral. In the figure below, the economy converges to the equilibrium where supply and demand intersect. However this process can also work in the reverse in a diverging case – but that only happens when the supply curve is more elastic than the demand curve.

QUESTION 27

May 2017 Question Two C

i. **Cross elasticity of demand.**

This refers to the degree of responsiveness of the quantity demanded of one good(B) to changes in the price of another good A.

ii. **The cross elasticity of demand and comment on the relationship between commodity x and commodity y**

$$\text{Ex}=\frac{\Delta QY}{\Delta PX}\times\frac{PX}{QY}$$

$$=\frac{100-80}{16-12}\times\frac{12}{80}$$

$$=\frac{20}{4}\times\frac{12}{80}=\frac{3}{4}=0.75$$

Due to positive cross elasticity of demand, commodity X and Y are substitutes.

QUESTION 28

May 2017 Question One B

Determinants of price elasticity of supply of a commodity

- The availability of spare capacity: If fixed factors of production are being used to the fullest extent, however great the increase in price, the supply will be elastic. If however, a firm is operating below capacity and there are unemployed resources supply will be elastic.
- The availability of variable factors of production: if variable factors of production are not easily available then supply will be elastic even if the firm has spare capacity in its fixed factors of production. A firm should be able to employ variable factors of production easily and combine these with spare fixed factors that are available before the supply becomes elastic.
- The case with which resources can be shifted from one industry to another: that is, factor mobility: In both the short and long run, in the absence of excess capacity and unsold stocks, an increase in supply necessitates the shifting of factors of production from one use to another. This may be costly because the price of factors may have to be raised to attract them to move and because of barriers to the mobility of labour.
- The level of unsold stocks: if suppliers are holding large stocks, supply will be737 elastic and an increase in demand can be met by running down stocks. If one the other hand stocks are depleted it may be difficult to increase output and supply them will be in elastic. It follows therefore that the higher the level of unsold stocks the more elastic will be the supply.
- The adjustment time: given that it takes time for firms to adjust the quantities they produce, the supply is likely to be more elastic the longer the period of time under consideration. In the momentary period, supply cannot be increased even if there is a substantial rise in price. In the short run, supply can be increased by employing more variable factors of production can be increased.
- The number of firms in the industry: The greater the number of firms, the more elastic the supply of the commodity.
- Length of production period: quick production responds to a price increase easier.
- Time period of training: where a firm invests in capital the supply is more elastic in its response to price increases.
- Reaction of costs: if costs increases slowly it will stimulate an increase in quantity supplied. If costs rise rapidly the stimulus to production will be choked off quickly.

QUESTION 29

November2016QuestionOneA

i. **Explanation of the term "price control" as used in economics**

These are government mandated legal minimum or maximum prices set for specified goods. They are usually implemented as a means of direct economic intervention to manage the affordability of certain goods.

ii. **Reasons for price controls in an economy**

- To Make some goods expensive e.g. food to increase revenue of farmers or discourage demand for demerit goods
- To stabilize prices e.g. prevent rapid fluctuations in the price of electricity and fuel.
- Make some goods cheaper e.g. to make sure housing is affordable.
- Promote self sufficiency in domestic promote self sufficiency in domestic production of goods and services.
- Reduce income inequalities by balancing welfare through imposition of minimum wages
- Generate a conducive and selective political support base, industrial peace, minimal or absence of food riots and other forms of insecurity.
- Control the exploitive /unscrupulous practices of natural monopolies and or those created by government policies.
- Protect domestic industries against the highly competitive foreign influence

QUESTION 30

November 2016 Question Two A

Factors that could lead to a rightward shift of the supply curve

- A change in cost of factors of production e.g. reduction in cost of raw material
- A price in the price of other goods (alternatives and complements).
- Technological progress.
- Production.
- Government subsidies may lead to a reduction of cost of production and hence quantity of goods available for supply increases and hence a shift.

QUESTION 31

November 2016 Question Two C

Factors that could affect own price elasticity of demand of a commodity

- This is the responsiveness of demand to change in price of commodity.
- Determinants of price elasticity of demand
- Adjustment time. In the short run demand will be inelastic while in the long run demand will be elastic.
- Habit forming products like beer and cigarettes will have inelastic demand Availability of substitutes: the greater the elasticity of demand.
- Proportion of income spent on commodity. If small proportion of income is spent on commodity then demand will be price inelastic like matchboxes & salt.

- Number of uses: the greater the number of uses to which a commodity can be put, the greater would be its elasticity of demand. This is because many units of the commodity are needed. For example, coat has several uses like heating.
- Cooking and lighting. When the price of electricity increases, the consumer can use coal for heating and cooking and lamps for lighting. People could also save on the usage of such goods.
- Level of price. Price elasticity of demand is different at different levels of price. At higher levels of price, demand is price elastic and at lower levels of price demand is price in elastic
- Nature of the commodity: generally the demand for luxuries will tend to be price elastic while that of necessities will tend to be price inelastic.
- Durability: the greater the durability of a product, the greater its elasticity of demand will tend to be, for example, if the price of salt increases it cannot be made to last longer so demand would be price inelastic. However, furniture can be made to last longer through careful use and so demand would be relatively elastic

QUESTION 32

May 2016 Question One D

How the concept of elasticity of demand guides economic decision making in the following areas

i. **Government tax policy on household consumption;**

The concept of elasticity of demand is helpful in determining who will bear the burden of taxes between producers and consumers in case of elastic demand, burden of tax will be borne by producers hereas for in elastic demand, burden of tax will be borne by customers

ii. Devaluation policy

Price elasticity of demand is relevant in a country considering a devaluation as a means of rectifying its balance of payment problems. Devaluation is the cheapening of the value of a currency in terms of a foreign currency in a fixed exchange rate system. This would reduce exports and increase import prices. Devaluation would only improve the balance, of payment position for both exports and imports if they are highly price elastic since the quantity demanded would respond significantly to changes in price. Incase they are in elastic, a country should not consider devaluation as a means of improving its balance of payment position.

iii) Priced discrimination by monopolist

Price discrimination entails charging difference prices for same products. This will only work if consumers differs in terms of price elasticity in that case the monopolistic will charge a high price in market with in elastic demand and a low price for market with elastic demand and a low price for market with elastic demand.

QUESTION 33

May 2016 Question Two C

i. The market demand and market supply functions of commodity x

Market Demand

(12-2Px)000

Qdx=12,000-2,000Px

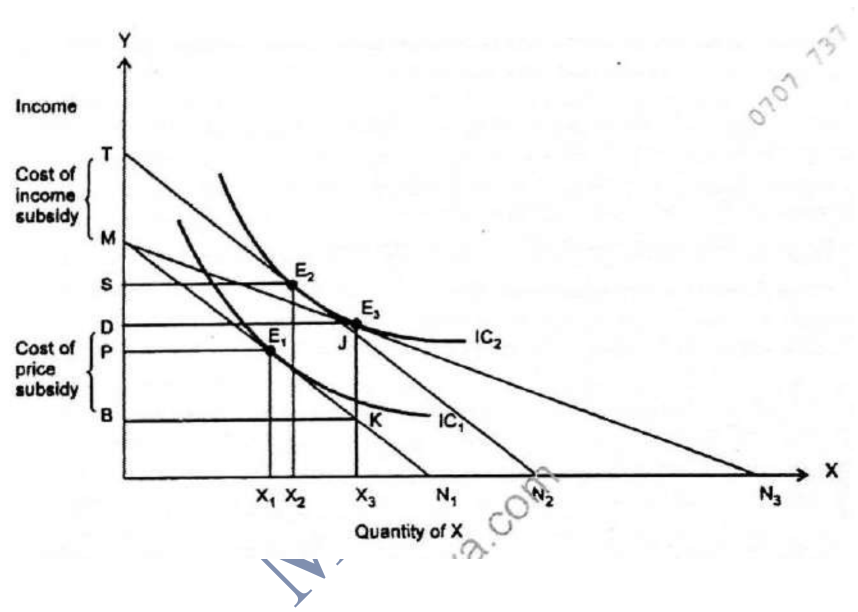
Market supply

QSx = 100 (20Px)

= 200Px

ii. **Using indifference curve analysis, illustrate the effect of a government subsidy on commodity x to low income earners.**

The Effects of Government subsidy on Price is as shown in the figure below.



The vertical axis measures income and horizontal axis measures the quantity of X on which subsidy is proposed. The consumer's budget line is shown by the line MN, which represents consumer's budgetary options in the absence of a price or income subsidy.

If the consumer is initially in equilibrium at point E1 on the indifference curve IC, and consumes OX1 of X for which he pays MP of his income and retains OP.

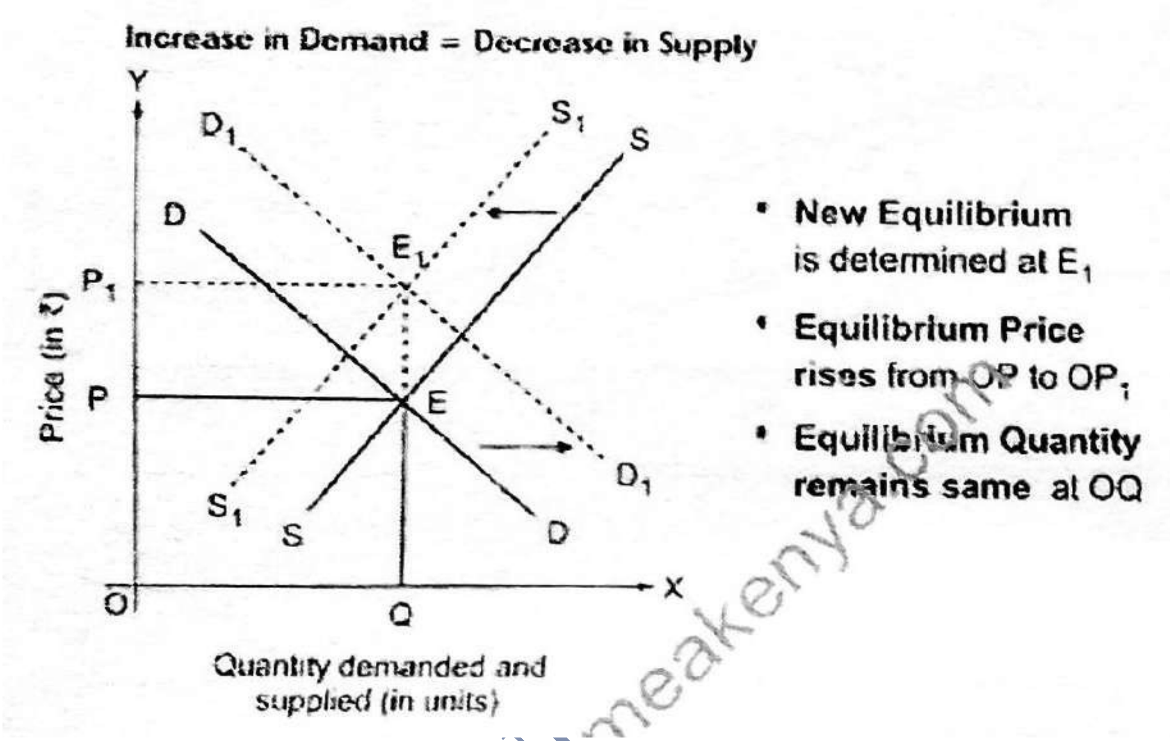
When the government subsidizes commodity X by 50 per cent of its price, that the budget line shifts from MN1 to MN and the consumer moves to the equilibrium point E3. At equilibrium point E3, he consumes OX3 of X for which he pays DM of his income at subsidised prices. Note that, in the absence of subsidy, he would have paid MB of his income for OX3 of X. Thus, MB – DM = BD is the cost of subsidy which the government would pay to the producers of X.

QUESTION 34

May 2016 Question Three B

The effect of simultaneous increase in demand and decrease in supply on equilibrium price and quantity of a commodity

When increase in demand is proportionately equal to decrease in supply, then rightward shift in demand curve from DD to DID1 is proportionately equal to leftward shift in supply curve from SS to SIS1. The new equilibrium is determined at E1. As the increase in demand is proportionately equal to the decrease in supply, equilibrium quantity remains the same at OQ, but equilibrium price rises from OP to OP1.



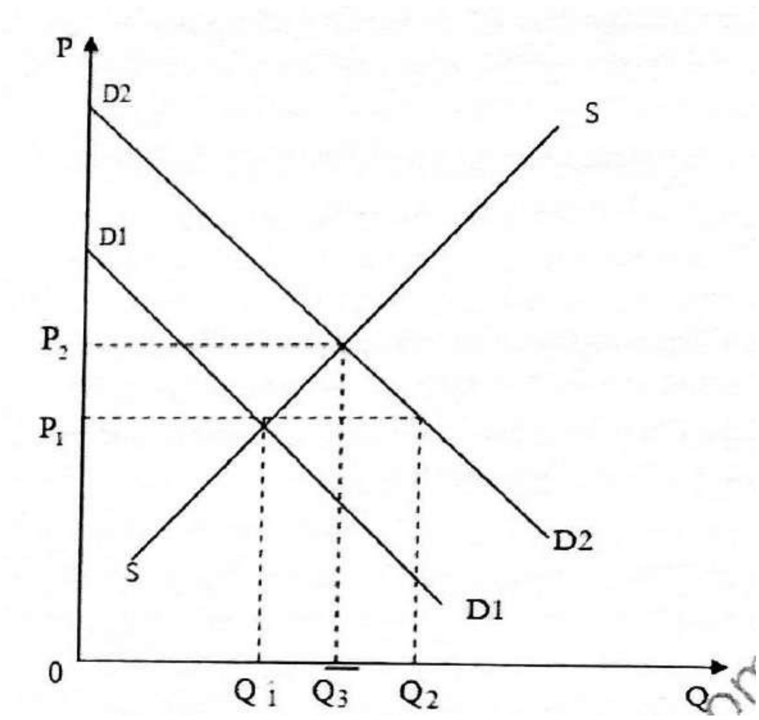
An increase in demand will shift demand curve to the right from dl to d2 whereas decrease in supply will shift supply curve from sl to s2. This will result I increase in price from pl to p2

QUESTION 35

November 2015 Question One A

Concept of unstable market equilibrium

Unstable market equilibrium refers to an equilibrium whereby divergence from equilibrium position generates forces that push further from equilibrium position, thus there is no restoration of original equilibrium position.



SS is the supply curve and DIDI the initial demand curve shifts to the right, to position D2D2. PI is the initial equilibrium price and Q1 the initial equilibrium quantity. When demand increases to D2D2, then at price P1 the quantity demanded increases from Q1 to Q3. But the quantity supplied at that price is still Q1. This leads to excess demand over supply (Q3 – Q1). This causes prices to rise to a new equilibrium level P2 and the quantity supplied to rise to a new equilibrium level, Q2.

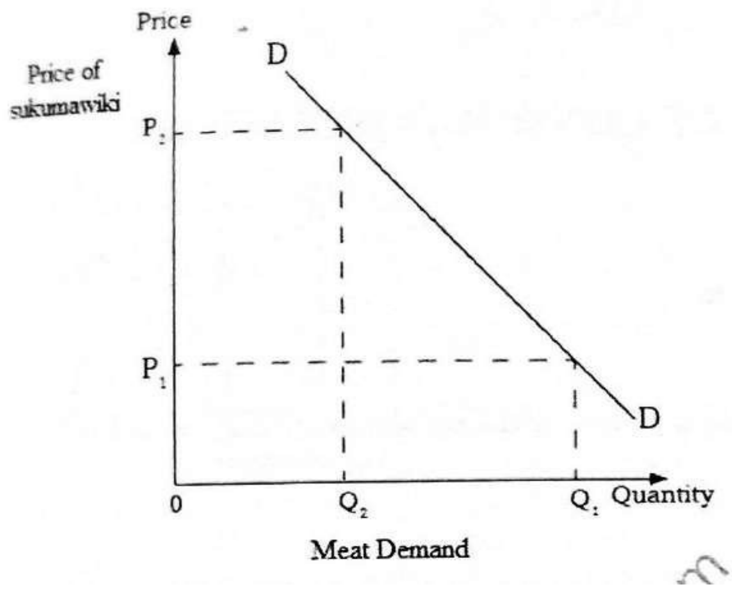
QUESTION 36

November 2015 Question One B

All giffen goods are inferior goods but not all inferior goods are giffen goods

Inferior goods are low value goods that a consumer is forced to consume because that is what they can afford. Thus when their income improves, the consumer ditches such low value goods and goes for other high value goods consequently, the demand curve is positive for inferior goods.

Giffen goods are a special category of inferior goods e.g. sukumawiki. In case the price of giffen goods declines, people don't buy more of giffen good, instead they use savings made to buy other goods like meat.



Originally people buy quantity of meat Q1when price of sukuma wiki is P1. When price reduces to P2, quantity demanded of meat increased to Q2 since people use savings made to buy more meat.

QUESTION 37

September2015QuestionFive

Concept of elasticity of demand in the economic management policy decision making

- Elasticity of demand refers to the responsiveness of demand to change in factors such as price, income among others. Application of elasticity of demand in economic decision making:-
- For purpose of regulating farm incomes and to predict consequences of bumper harvests of crops.
- From the point of view of wage bargaining among workers and employers and the government when fixing minimum wage legislation.
- It's crucial for business persons who need to know the effects that changes in price will have on the sales revenue for example, if they that demand for their product is relatively inelastic then increasing prices might help them to increase revenue. If on the other hand they are aware that source of their products have a high price.
- Elasticity of demand they will be more cautious when considering price increases for fear of losing revenue.
- Helps government to estimate the yield of a prospective tax…
- Devaluation policy that aims at improving the balance of payments. Can only succeed if imports and export demand is elastic. If that be the case, then devaluation will spur high demand for exports in foreign markets and lower local import demand.
- Competition and pricing: If a firm is in a competitive industry there would be a high cross elasticity between its products and those of other firms. For such a firm, it may be beneficial to lower prices in order to attract customers. From other firms. This is because the price elasticity of demand for its products is very elastic due to the availability of substitutes.

- Protection policy: The concept of cross elasticity of demand is useful to the government in predicting the effects of its protection policy, for example, if the government imposes a tariff on an imported product like clothes with the intention of protecting the local industry, then the local ana imported products must be close substitutes for the government to achieve its objectives
- Fluctuation of agricultural product prices: The more inelastic the demand for agricultural products are, the more widely prices will fluctuate with changes in output from period to period

QUESTION 38

September 2015 Question seven A

Factors that could affect the price elasticity of supply

- The availability of spare capacity: If fixed factors of production are being used to the fullest extent, however great the increase in price, the supply will be elastic. If however, a firm is operating below capacity and there are unemployed resources supply will be elastic.
- The availability of variable factors of production: if variable factors of production are not easily available then supply will be elastic even if the firm has spare capacity in its fixed factors of production. A firm should be able to employ variable factors of production easily and combine these with spare fixed factors that are available before the supply becomes elastic.
- The ease with which resources can be shifted from one industry to another: that is, factor mobility: In both the short and long run, in the absence of excess capacity and unsold stocks, an increase in supply necessitates the shifting of factors of production from one use to another. This may be costly because the price of factors may have to be raised to attract them to move and because of barriers to the mobility of labour.
- The level of unsold stocks: if suppliers are holding large stocks, supply will be elastic and an increase in demand can be met by running down stocks. If one the other hand stocks are depleted it may be difficult to increase output and supply them will be in elastic. It follows therefore that the higher the level of unsold stocks the more elastic will be the supply.
- The adjustment time: given that it takes time for firms to adjust the quantities they produce, the supply is likely to be more elastic the longer the period of time under consideration. In the momentary period, supply cannot be increased even if there is a substantial rise in price. In the short run, supply can be increased by employing more variable factors of production can be increased.
- The number of firms in the industry: The greater the number of firms, the more elastic the supply of the commodity.
- Length of production period: quick production responds to a price increase easier.
- Time period of training: where a firm invests in capital the supply is more elastic in its response to price increases.
- Reaction of costs: if costs increases slowly it will stimulate an increase in quantity supplied. If costs rise rapidly the stimulus to production will be choked off quickly

TOPIC 3

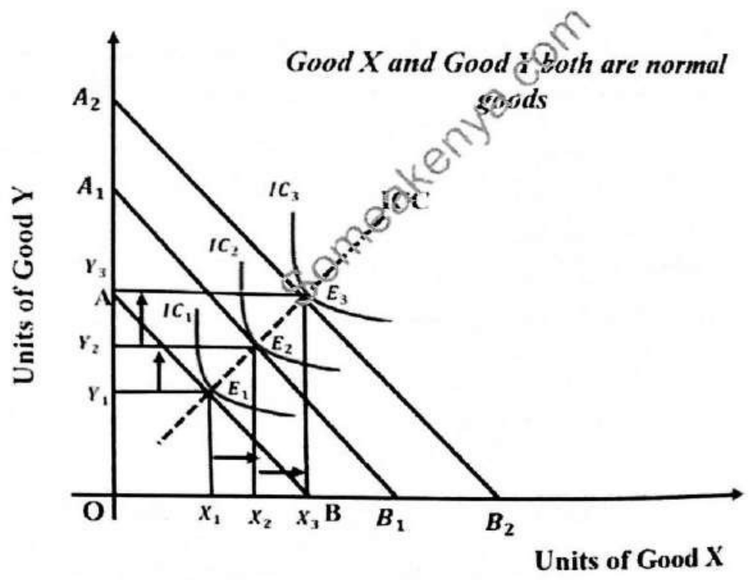
THE THEORY OF CONSUMER BEHAVIOUR

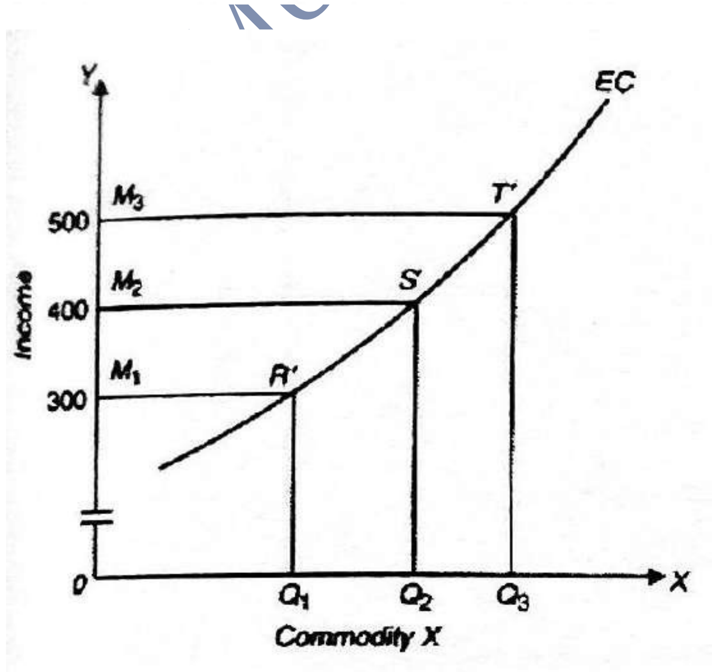
QUESTION 1

December 2021 Question Two B

Engel curve of a normal good.

The engel curve for a normal good is positive or upward sloping showing the positive income elasticity





RS is the initial budget line and the consumer is in equilibrium at point 1C1 on the indifference curve E1. At this consumer's equilibriun point, he has consumed X1 and X1 units of good X and Y respectively.

An increase in income will shift the budget line from AB to A 1B1 and from A [B] to A2|B2 This also changes the equilibrium points from El to E3.

When all equilibrium points are joined, we get an upward sloping income consumption curve (ICC)

In the lower portion of diagram, the demand for good X has measured along the X – axis. The demand quantity for good X has copied from the upper section of the figure X1 X2 and X3.

The increase in memory income has shown on the Y-axis as M, MI M2 . These combinations of income and demand for good X are based on equilibrium points derived in the upper part of the figure. Point E, helps to identify the combination A on the lower segment of the figure.

Following the same procure, we get combinations B and C as well.

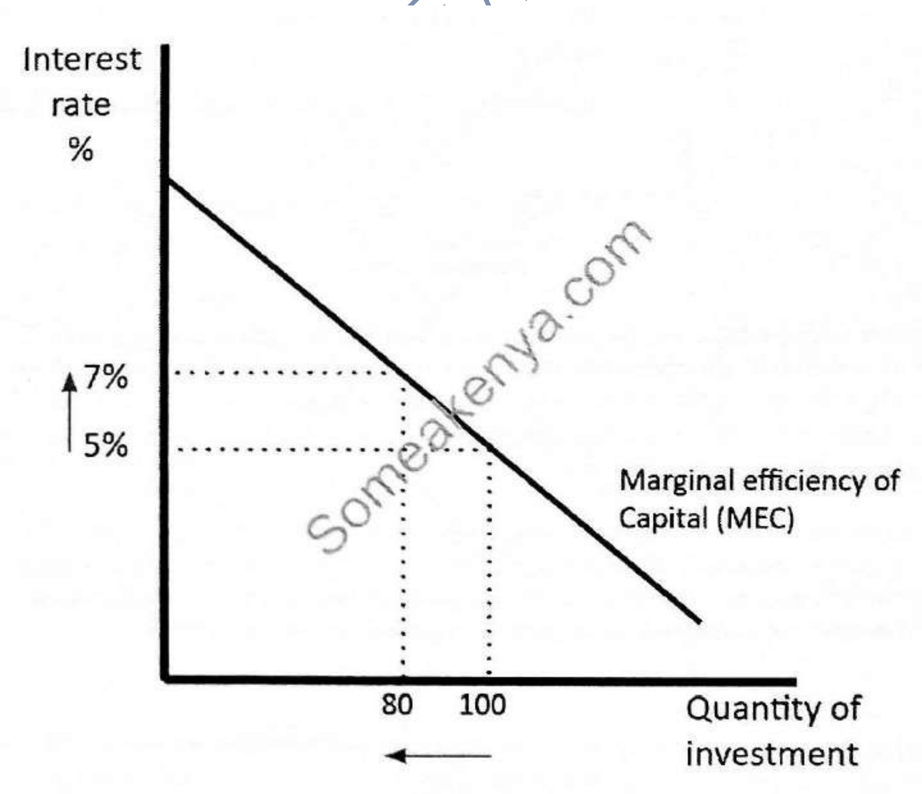
By joining these points, we get an upward sloping income demand curve or positive Engel curve.

QUESTION 2

August 2021 Question Four B

Explanation of marginal efficiency of capital.

The marginal efficiency of capital is equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital as set during its life just equal to its supply price



A cut in interest rate from 7% to 5% makes investment to increase from 80 to 100

MEC is influenced by factors like: cost of capital, technological change, supply of finance, demand for goods and rate of taxes.

QUESTION 3

May 2021 Question Three A

How an individual's equilibrium point is attained. (September 2015 Q5A)

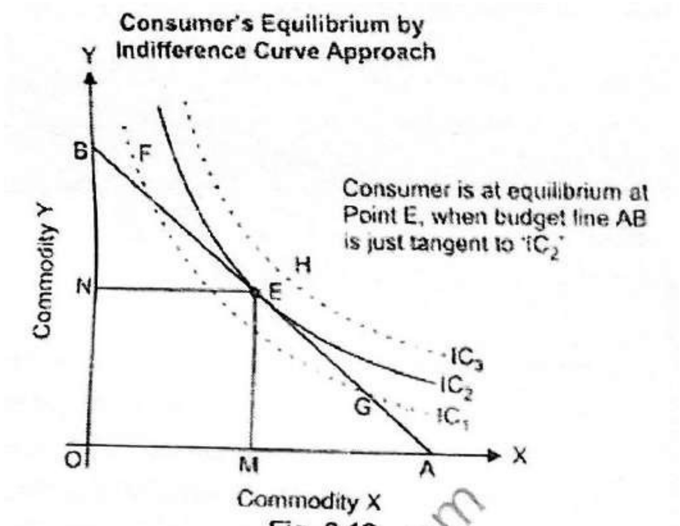


Fig. 2.12

IC1, IC2 and IC3 are the three indifference curves and AB is the budget line. With the constraint of budget line, the highest indifference curve, which a consumer can reach, is IC2. The budget line is tangent to indifference curve IC2 at point 'E'. This is the point of consumer equilibrium, where the consumer purchases OM quantity of commodity 'X' and ON quantity of commodity' Y

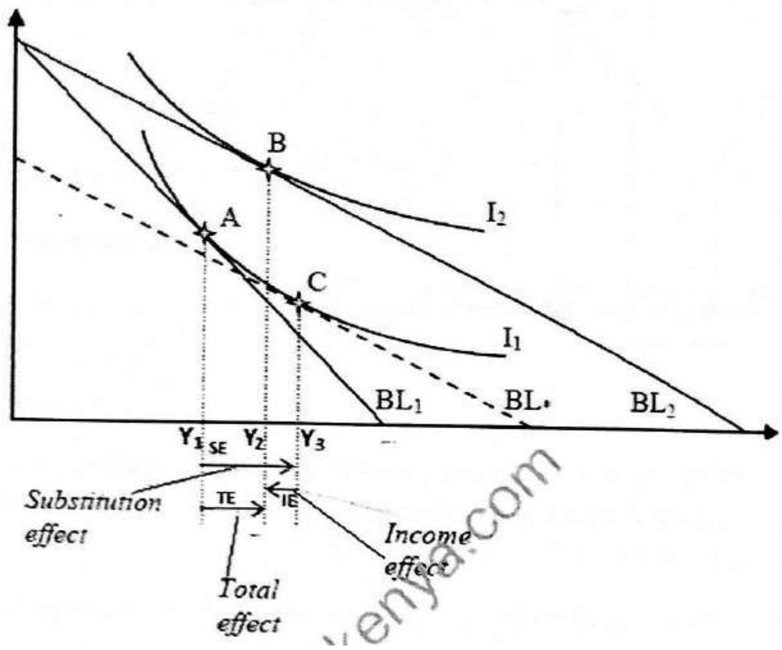
All other points on the budget line to the left or right of point 'E' will lie on lower indifference curves and thus indicate a lower level of satisfaction. As budget line can be tangent to one and only one indifference curve, consumer maximizes his satisfaction at point E, when both the conditions of consumer's equilibrium are satisfied:

QUESTION 4

May 2021 Question Three B

Substitution effect and income effect of an inferior good (September 2015 Question 5B (ii))

Inferior good Y



The above figure represents the substitution and income effects of an inferior good. The movement from Y1 to Y2 is the positive substitution effect. However the movement from Y2 to Y3 is the negative income effect.

QUESTION 5

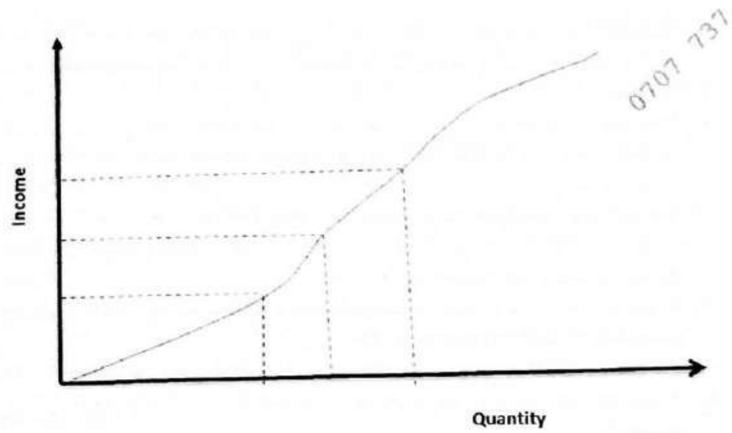
November 2020 Question Two A

Concept of an individual engel curve as applied in the theory of consumer behaviour.

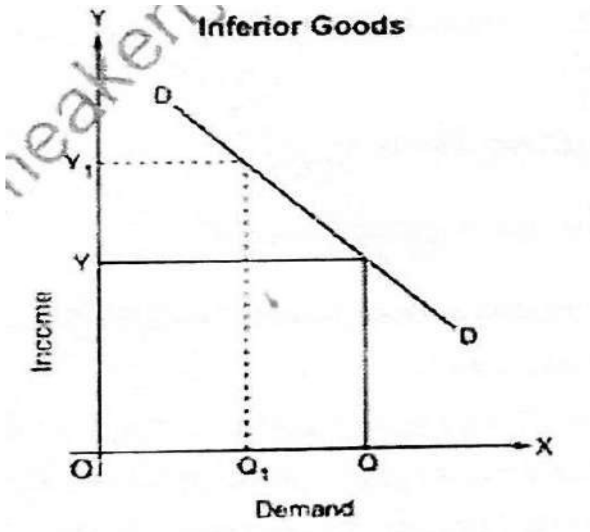
The engel curve for a good describes the relationship between income and the amount consumed holding everything else fixed (including prices and their consumer's preferences)

To graph an engel curve, we measure income on the vertical axis and the amount consumed on the horizontal axis.

For a normal good, an increase in income raises consumption, so the engel curve slopes upwards.



For an inferior good, an increase in income reduces consumption, so the engel curve slopes downwards



QUESTION 6

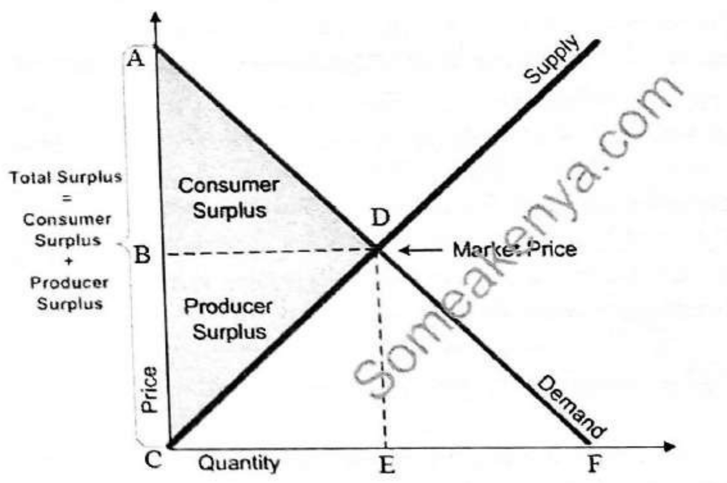
November 2019 Question One C

Concept of surplus as applied in the theory of market equilibrium.

Consumer surplus is an economic measurement of consumer benefit. Consumer surplus happens when the price that a consumer pays for a product or service is less than the price they are willing to pay. It is a measure of the additional benefit that consumers receive because they are paying less for something than what they were willing to pay.

Consumer surplus is based on the economic theory of marginal utility, which is additional satisfaction a consumer gains from one more unit of a good or service. The utility a good or service provides varies from individual to individual based on their personal preference. Typically the more of a good or service that consumers have, the less they are willing to spend for more of it, due to the diminishing marginal utility or additional benefit they receive

Diagram showing consumer surplus and producer surplus



- The consumer willingness to pay is shown by the straight line demand curve AF. The curve AF also indicates the utility derived from each successive unit of a commodity. The market price which consumer pays is given by BC. At price BC, the consumer buys CE units. The total utility derived by the consumer from OC units is shown by the area CADC for which the consumer pays BCDE thus total consumer surplus ABD which is the shaded area.

- Producer surplus is difference between the amount producer is willing to supply goods for and the actual amount received by him when he makes the trade.
- Producer surplus is a measure of producer welfare.
- Producer surplus is represented by region BCD above.

QUESTION 7

November 2019 Question Three A

Assumptions of consumer rationality

The consumer theory assumes that the consumer is rational. This implies that his preferences satisfy the following properties.

1. They are continuous: there are no big jumps in the ranking of alternatives
2. They are reflexive: it means that any bundle is at least as good as itself
3. They are transitive: meaning that if bundle A is preferred to a bundle B and this bundle B is preferable to a third bundle C then it is implied that the first bundle A will be preferred to the bundle.
4. They are complete: that is, given any set of possible bundles of goods, the consumer is always capable of deciding which one is preferable to the others and then ranking them in terms of preference.
5. Preferences are monotonic, or "more is preferred to less", this implies that, given any set of two bundles, if one of them contains at least as much of all goods and more of one good than the other, then the first bundle will be preferred to the second.
6. Preferences are convex: that is, any combination of two equally preferable bundles will be more desirable than these bundles.

QUESTION 8

May 2019 Question Three A

i. **Difference between "cardinal approach and "ordinal approach"**

Utility refers to the satisfaction derived from the consumption of some product

Cardinal approach assumes that utility measurable in terms of units called utils

Ordinal approach takes the view that utility cannot be measured quantitively such as other psychological phenomenon like sadness, happiness and joy. Though this can be the case we can be able to rank utility derived from consumption of a bundle of goods.

ii. Limitations of cardinal approach to measuring utility

- Assumes that there is constant marginal utility of money. This is idealistic as utility of money. This is idealistic as utility of cash will differ from person to person.
- Makes unrealistic assumption that we can measure utility objectively whereas in reality utility is a psychological phenomenon which can only be measured subjectively.
- The cardinal approach considers the effect of price changes on the demand curve is exclusively price effect. This assumption is unrealistic because price effect may include income and substitution effect.
- It assumes there is a single commodity that homogeneous that is consumed by a consumer which may not be realistic.
- Assumes consumers are rational beings. This might not be the case for all of them. Actual measurement of utility requires controlled experiments which is impossible.

- The axiom of diminishing marginal utility has been established from introspection.

  It is a psychological law which cannot be taken seriously

QUESTION 9

November 2018 Question Three B

Application of indifference carve analysis

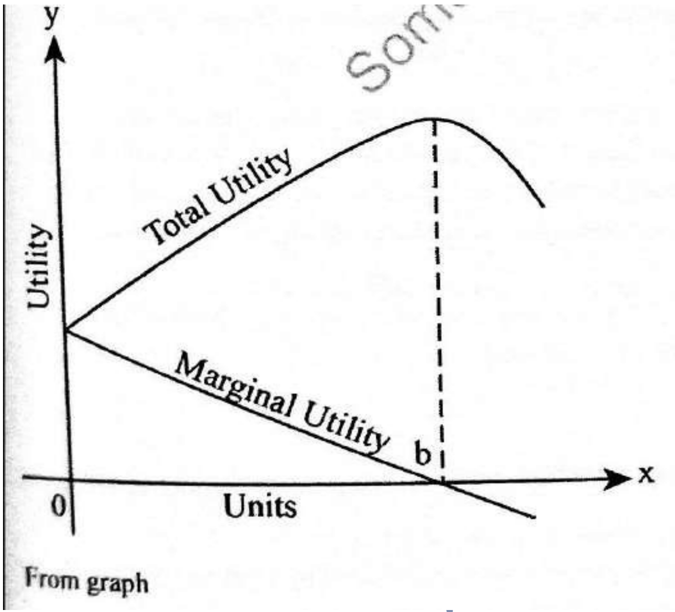
- Used in international economics to evaluate the welfare effects of free trade, tariff imposition among others
- Indifference curve analysis of cost of living indifference – curve analysis and the theory of revealed preference can be used to establish whether, over a period of time during which both money incomes and prices have been changing, the consumer is better or worse off. The assumption underlying the discussion is that the consumer spends all his money income in all time periods, that is he chooses a point on his budget line in any particular period.
- Indifference curve analysis is used to analyse and compare the effects of excise and income subsidies as policy measures.
- Indifference- curve analysis and the theory of exchange: indifference – curve analysis may be used to explain why exchange of commodities among individuals or groups of individuals, countries and so on, take place. Under certain conditions, exchange of commodities leads to an increase in the welfare of at least one
- Individual without any reduction in the welfare of the other so that overall welfare which can be enjoyed from a given bundle of commodities is increased.
- Indifference curve analysis is useful when measuring welfare effect of income and excise taxes.
- Indifference curve analysis is used to derive the labour supply curve since it analysis a labour's choice between work and leisure.
- Indifference curve analysis is used to indicate conditions under which rationing of goods can be effective to ensure fair distribution of essential consumer goods in short supply.

QUESTION 10

May 2018 Question Four A

Law of diminishing marginal utility

The law of diminishing marginal utility explains that as a person consumes an item of product, the satisfaction or utility that they derive from the product wanes as they product. In other words as the amount consumed of a good increase, the marginal utility of the goods tends to decrease.



The first units consumed gives a high level of utility but additional units create diminishing utility

When marginal utility (MU) becomes zero, total utility (TU) is at maximum

Exceptions to law diminishing marginal utility

- Consumption of beer and other addictive products
- The law is not fully applicable money. The marginal utility of money declines with richness but never reduces to zero.
- Participation in sports or hoppy which does not experience diminishing utility The law does not hold well in the rare collections. For example, collection of ancient coins, stamps etc

Assumptions of Law of Diminishing Marginal Utility

The law is said to hold true under certain conditions, and these conditions are referred to as the assumptions of the law of diminishing marginal utility. These are:

1. It is assumed that the unit of the consumer good is a standard one, i.e. the rational quantity of the commodity is consumed. Such as, a cup of tea, a pair of shoes, bottle of cold drink, glass of water, etc.
2. It is assumed that the utility is measurable, and the satisfaction of the consumers can be expressed in the quantitative terms.
3. The consumer's tastes and preferences remain same during the period of the consumption.
4. There must be continuity in the consumption. If a break is necessary, then the time interval between the consumption of two units should be appropriately short.

5. It is assumed that the quality of the commodity remains uniform during the period of consumption.
6. All the commodities consumed by the consumer are said to be independent of each other, such as the marginal utility of one commodity has no relation with the marginal utility of another commodity.
7. It is assumed that the income of the consumer and the price of goods and services remain unchanged during the period of consumption.
8. The marginal utility of money remains constant for the consumer.
9. The mental condition of the consumer should remain normal during the consumption period. For example, if a person drinks any alcoholic drink, then he will derive more pleasure with each additional glass of drink, this is because of a change in his mental status due to intoxication.

QUESTION 11

May 2018 Question Four B

Properties of indifference curves

- Convex to the origin i.e. bowed inwards
- Indifference curves are downward sloping or slope negatively.
- Indifference curves cannot interest
- Higher indifference curves are preferred to lower ones. Every indifference curve to the right represents higher level of satisfaction than that of the proceeding one and others
- Indifference curves are not necessarily parallel to each other. Although they are falling and negatively inclined to the right.
- An indifference curve cannot touch either axis
- In reality indifference curves like bangles

QUESTION 12

May 2018 Question Five D

Why isoquants are negatively sloped

An isoquant is a combination of factors of production that produce same level of output graphically an isoquant is also called an equal product curve

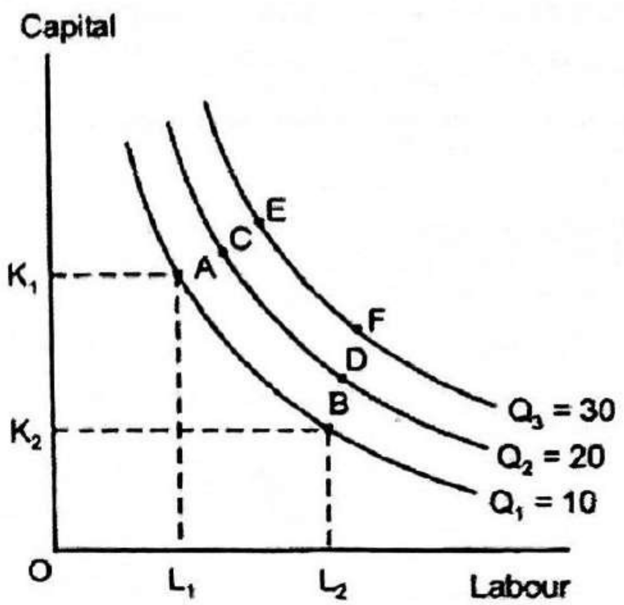


Fig. 6.3 : Isoquant Curve/Isoquant Map

An isoquant is negatively sloped since at the same level of output of one factor we have to reduce the units of another input factor. Com

Point A represents just one possible combination of K and L which can be used to produce Q1 units of output. There are, in fact, an infinite number of other points on the Isoquant Q1 all of which represent different of K and L, which can be used to produce Q1 units.

Output Q2 and Q3 can be produced using any of the combinations of K and L representedby points along the isoquants.

Moreover, an isoquant is bowed inward because of the marginal rate of technical substitution effect. This indicates that factors of production may be substation effect. This indicates that factors of production may be substituted with one another. The increase in one factor, must still be used in conjunction with the decrease of another input factor.

QUESTION 13

November 2017 Question one B

Exceptions to the law of diminishing marginal utility

- Consumption of beer and other addictive products
- The law is not fully applicable to money. The marginal utility of money declines with richness but never declines to zero.

Participation in sports or hobby which does not experience diminishing marginal utility

The law coins, does not hold well in the rare collections. For example, collection of ancient coins, stamps etc.

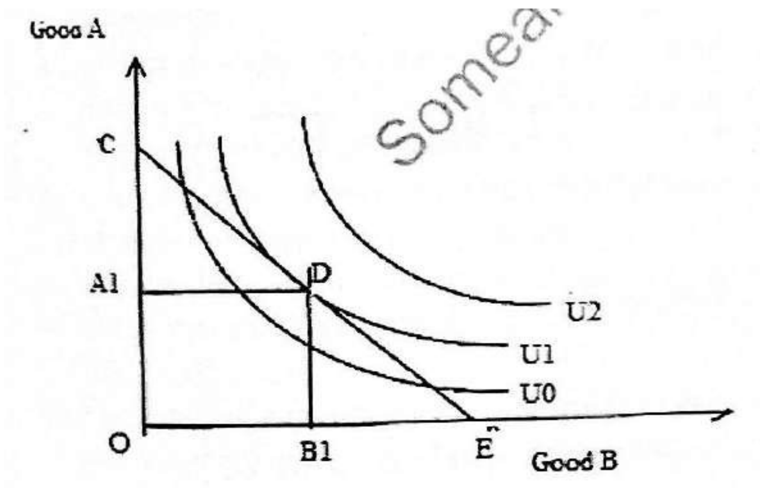
QUESTION 14

November 2017 Question Four B

Consumer equilibrium under the ordinalistic approach.

Indifference curves are a locus of points representing combinations of two commodities that yield the same utility to the consumer so that he is indifferent as to part combination he consumes.

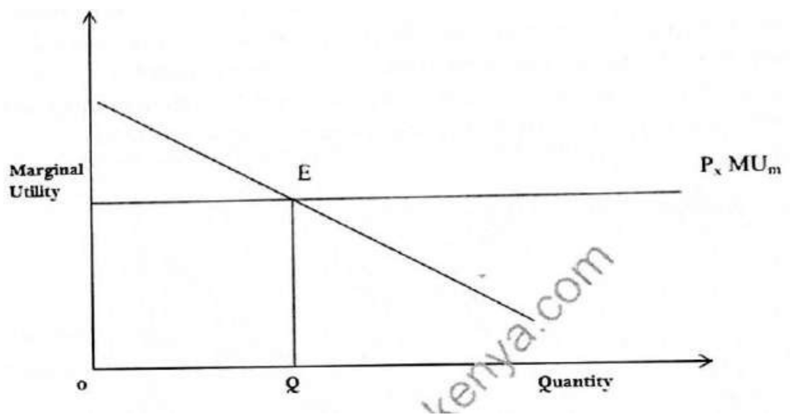
Under the ordinalistic approach, the point of consumer equilibrium refers to the combination of two commodities that yield maximum utility to the consumer given the budget line. Assuming a consumer has a choice of two commodities And B on which to spend his income.



Assuming all consumers D for units income of A and is spent units on B. A This and is B, the they point will where be choose reached. The combination budget is CD is represented by tangent to an indifference curve, which is the highest that can . Point line D is called the point of consumers equilibrium. At this point, the consumer will have maximized utility subject to the budget constraint.

Consumer equilibrium under cardianalistic approach

Under cardinalistic approach a consumer reaches equilibrium position when he maximizes his total utility given his income and prices of commodities he consumes.



Consumers equilibrium in a scenario of one commodity is a as illustrated above.

The horizontal line Px(MUm) shows the constant utility of money weighted by Px, the price of commodity x and MUM curve represents the diminishing marginal utility of commodity X

The Px(MUM) line and MUM curve intersect at point E, where Mux = Px(MUM). Therefore consumer is equilibrium at point E.

At any point below E, Mux < Px (MUM) the consumer can therefore increase his satisfaction by reducing his purchase.

At any point above E, Mux > Px (MUM). Therefore, if consumer exchanges his money income from commodity x, he increases his satisfaction per unit of the commodity.

QUESTION 15

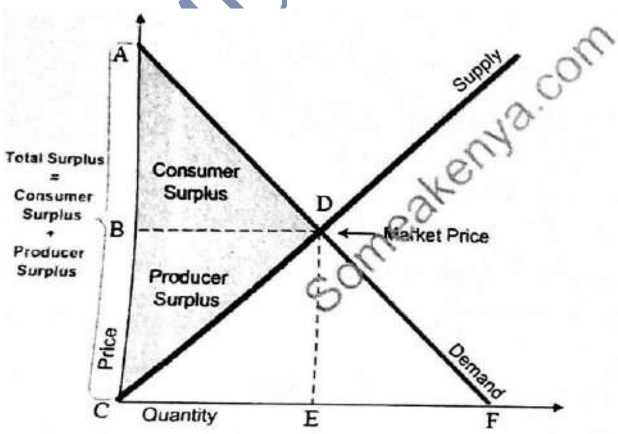
November 2017 Question Six A

Surplus as applied in the theory of market equilibrium

Consumer surplus is an economic measurement of consumer benefit. Consumer surplus happens when the price that a consumer pays for a product or service is less than the price they are willing to pay. It is a measure of the additional benefit that consumers receive because they are paying less for something than what they were willing to pay.

Consumer surplus is based on the economic theory of marginal utility, which is additional satisfaction a consumer gains from one more unit of a good or service. The utility a good or service provides varies from individual to individual based on their personal preference. Typically the more of a good or service that consumers have, the less they are willing to spend for more of it, due to the diminishing marginal utility or additional benefit they receive.

Diagram showing consumer surplus and producer surplus



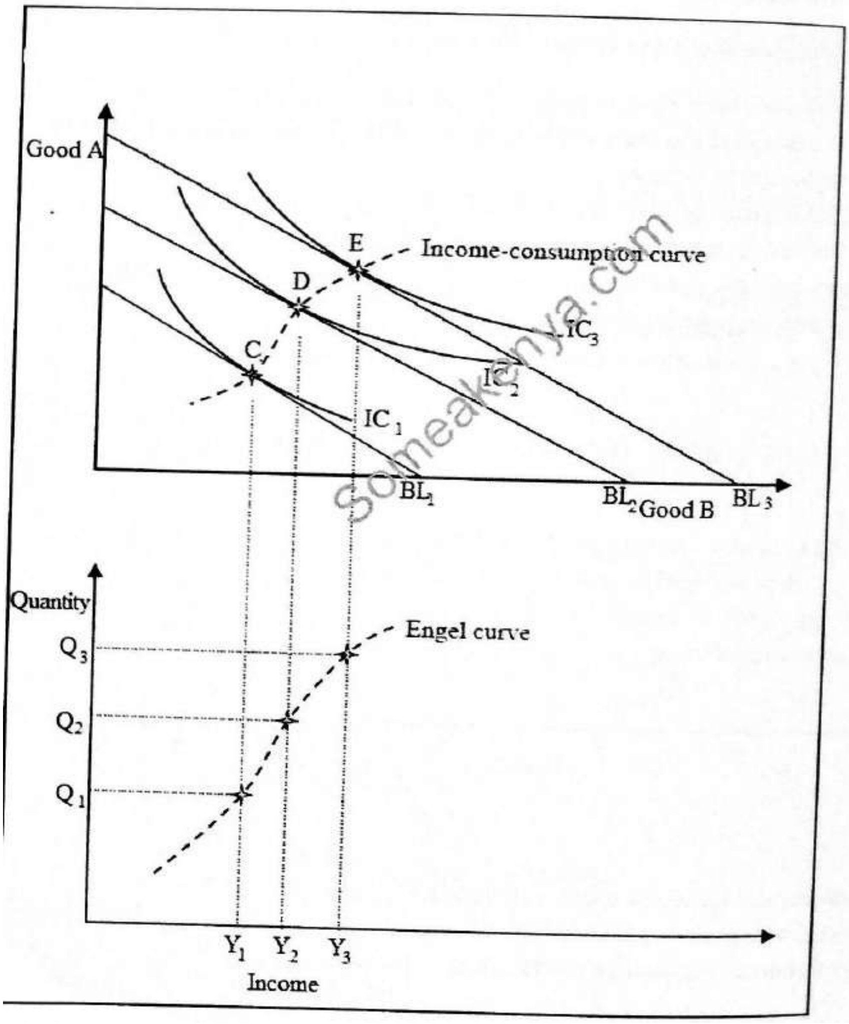
- The consumer willingness to pay is shown by the straight line demand curve AF. The curve AF also indicates the utility derived from each successive unit of a commodity.
- Producer surplus is difference between amount produce is willing to supply goods for and for the actual amount received by him when he makes the trade.

- Producer surplus is a measure of producer welfare
- Producer surplus is represented by region BCD above.

QUESTION 16

May 2017 Question One C

Using indifference curve analysis to derive the engel's curve of a normal good



Where: C,D and E – consumer's equilibrium position

IC1, IC2 and IC3 = Indifference curves 737 BL1, BL2 and BL3 are budget lines

Where good B is a normal good, as the income increases, the budget line styles outwards. This causes the equilibrium position to shift from point C to D to E. joining the consumer's equilibrium position gives the income consumption curve. The resulting engel's curve is upward sloping.

QUESTION 17

May 2017 Question Three B

Limitations of the cardinal approach to the theory of consumer behaviour

1. Assumes that there is constant marginal utility of money. This is idealistic as utility of money. This is idealistic as utility of cash will differ from person to person.

2. Makes unrealistic assumption that we can measure utility objectively whereas in reality cardinal utility approach can is a psychological phenomenon which can only be measured subjectively.
3. It assumes there is a single commodity that homogeneous that is consumed by a consumer which may not be realistic.
4. Assumes consumers are rational beings. This might not be the case for all of them.
5. Actual measurement of utility requires controlled experiments which is impossible.
6. The axiom of diminishing marginal utility has been established from introspection. It is a psychological law which cannot be taken seriously.

QUESTION 18

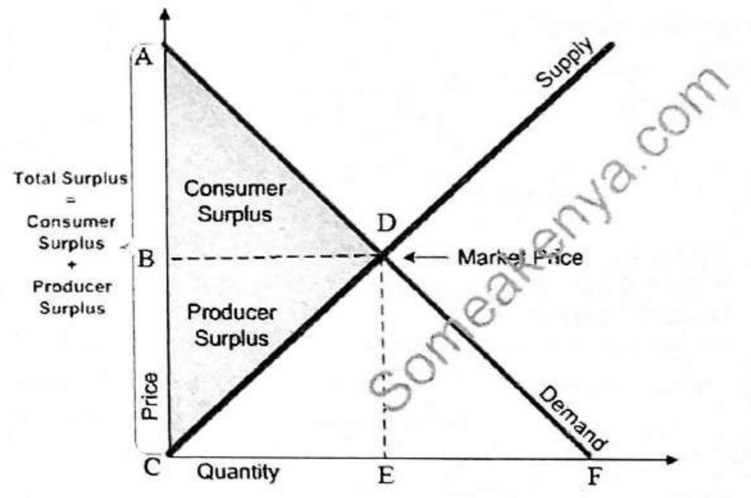
November 2016 Question One C

Concept of consumer surplus

Consumer surplus is an economic measurement of consumer benefit. Consumer surplus37 happens when the price that a consumer pays for a product or service is less tan the price they are willing to pay. It is a measure of the additional benefit that consumers receive because they are paying less for something than what they were willing to pay.

Consumer surplus is based on the economic theory of marginal utility, which is additional satisfaction a consumer gains from one more unit of a good or service. The utility a good or service provides varies from individual to individual based on their personal preference. Typically the more of a good or service that consumers have, the less they are willing to spend for more of it, due to the diminishing marginal utility or additional benefit they receive

Diagram showing consumer surplus and producer surplus



- The consumer willingness to pay is shown by the straight line demand curve AF. The curve AF also indicates the utility derived from each successive unit of a commodity. The market price which consumer pays is given by BC. At price BC, the consumer buys CE units. The total utility derived by the consumer from OC units is shown by the area CADC for which the consumer pays BCDE thus total consumer surplus ABD which is the shaded area.
- Producer surplus is difference between the amount producer is willing to supply goods for and the actual amount received by him when he makes the trade.
- Producer surplus is a measure of producer welfare.

- Producer surplus is represented by region BCD above.

QUESTION 19

May 2016 Question One A

Assumptions underlying consumer equilibrium

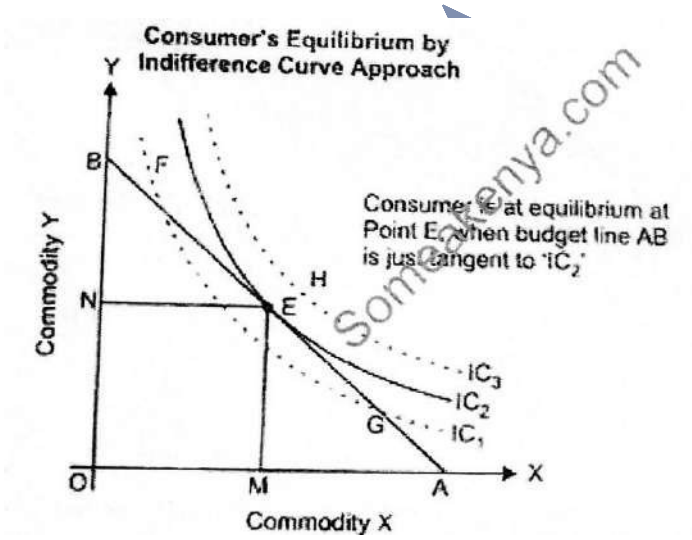
- Utility can quantified in monetary terms
- Constant prices of commodities

- Consumers income is given
- Utility is cardinally measurable i.e. it can be expressed in exact unit

QUESTION 20

September 2015 Question Five A

How the consumers' equilibrium is obtained



IC1, IC2 and IC3 are the three indifference curves and AB is the budget line. With the constraint of budget line, the highest indifference curve, which a consumer can reach, is IC2. The budget line is tangent to indifference curve IC2 at point 'E'. This is the point of consumer equilibrium, where the consumer purchases OM quantity of commodity 'X' and ON quantity of commodity 'Y.

All other points on the budget line to the left or right of point 'E' will lie on lower indifference curves and thus indicate a lower level of satisfaction. As budget line can be ECONOMICS REVISION KIT

Tangent to one and only one indifference curve, point E, when both the conditions of consumer's equilibrium are satisfied:

QUESTION 21

September 2015 Question Five B

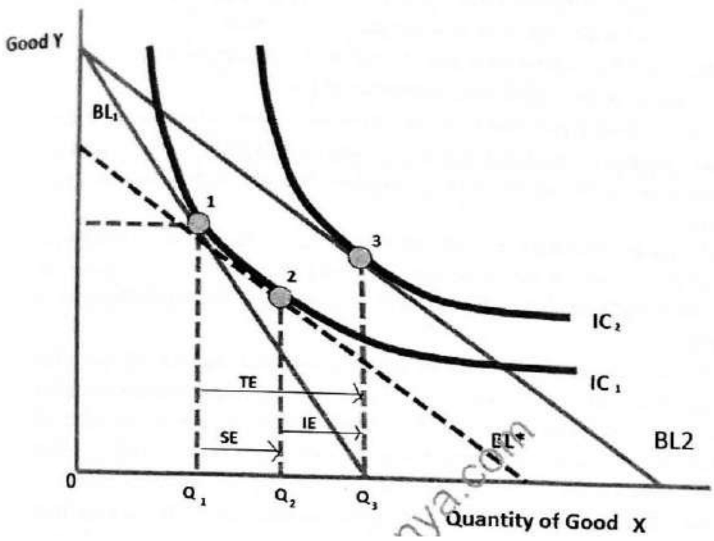
Substitution and income effect

Substitution effect refers to a change in the quantity demanded of a given commodity which results from a change in the relative price when the level of real income is held constant.

The income effect on the other hand, refers to a change in the quantity demanded from a

The substitution effect always acts in a way in which a fall in the relative price of a commodity gives rise to more of the commodity being purchased.

Substitution effect and income effect of a normal good.



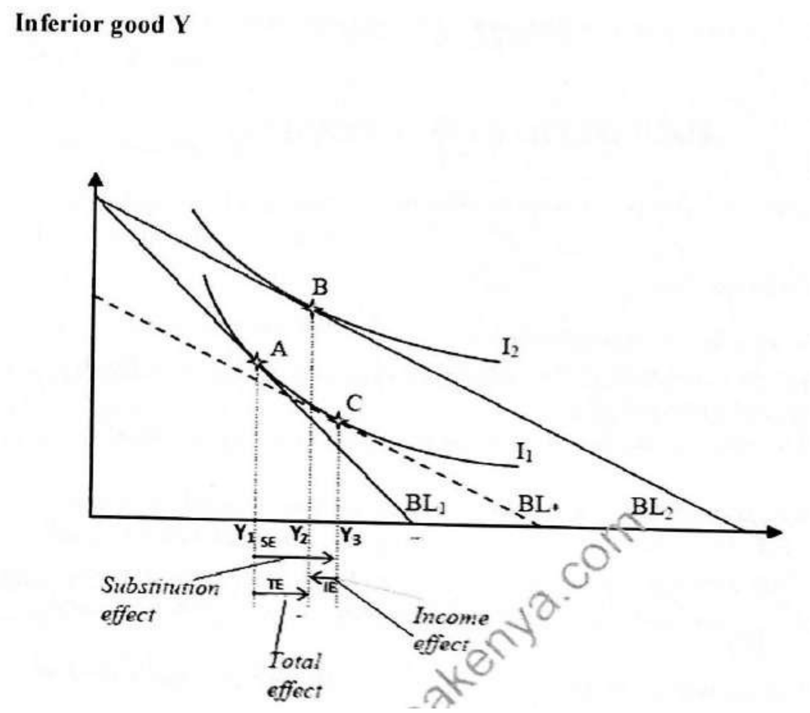
Initially the consumer is in equilibrium at point 1 on the budget line BL1 where the indifference curve IC1, is tangent to it at point 1 in. If the price of good X fall. As a result, his budget line rotates outward to Bis2, where the consumer is in equilibrium at point 3 on the higher indifference curve IC

The movement from 1 to 3 or 2 to E on the horizontal axis is the price effect of the fall in the price of X. With the fall in the price of X, the consumer's real income increases

The movement from the 1 to 2 on the IC, curve is the substitution effect whereby the consumer increases his purchases of X from Q1 to Q2 on the horizontal axis by substituting X for Y because it is cheaper.

When there is a fall (or rise) in the price of good X, the substitution effect always leads to an increase (or decrease) in its quantity demanded. Thus the relation between price and quantity demanded being inverse, the substitution effect of a price change is always negative, real income being held constant.

Substitution effect and income effect of an inferior good.



The above figure represents the substitution and income effects of an inferior good. The movement from Y1 to Y2 is the positive substitution effect. However the movement from Y2 to Y3 is the negative income effect.

TOPIC 4

THE THEORY OF A FIRM

QUESTION 1

December 2021 Question Two A

Features of capital as a factor of production.

- Capital is a passive factor of production. This is so because capital is ineffective without the cooperation of labour
- Capital is man-made. Its production and supply are controlled by the efforts of man
- Capital is not indispensable. It is not an indispensable factor of production like labour and land. This means that production can be possible even without capital
- Capital has high mobility: Among all the factors of production, capital has the highest mobility. The land is immobile and labour has both "place mobility" and "occupational mobility"
- Capital is recalled as past savings: capital goods become savings when production exceeds consumption
- Capital is prospective: Capital considered much prospective as the accumulation of capital yields an income. The more we invest in the accumulation of capital, the greater is the possibility of it providing aid to the business when needed.
- Capital is temporary in nature: It cannot last forever therefore capital needs to be reproduced and replenished from time to time. This makes capital a short term asset.
- Capital is productive: Capital helps in increasing production. When labour is given adequate capital, it effectively increases production. More capital leads to better efficiency and increased productivity. Capital depreciates over time Capital is elastic

QUESTION 2

December 2021 Question Three C

Technical economies of scale.

- Research: A large firm will be in a better financial position to devote funds to research and improvement of its product than a small firm.
- Specialization: Specialization of labour and machinery can lead to the production of better quality output and higher volume of output
- Economies of linked processes: Technical economies are also sometime gained by linking processes together e.g in the iron and steel industry, where iron and steel production is carried out in the same plant, thus saving both transport and fuel costs.
- Indivisibilities: These may occur when a large firm is able to take advantage of an industrial process which cannot be reproduced on a small scale, for example, a blast furnace which cannot be reproduced on a small scale while retaining its efficiency.

- Increase dimensions: These occur when it is possible to increase the size of the firm's equipment and hence realize a higher volume of output without necessarily increasing the costs at the same rate. For example. A matatu and a bus each require one driver and conductor. The output from the bus is much higher than that from the matatu in any given period of the time, and although the bus driver and conductor will earn more than their matatu counterparts, they will not earn by as many times as the bus output exceeds the matatu output, i.e if the bus output is 3 times that of the matatu counterparts

QUESTION 3

December 2021 Question Four C

i. **The total cost function.**

$$\int MC = 6Q + 4$$

$$TC = \tfrac{1}{2}\times 6Q^2 + 4Q + C$$

$$= 3Q^2 + 4Q + C$$

ii. **The average fixed cost function.**

$$AFC = TFC \div Q$$

$$= C \div Q$$

$$= \frac{C}{Q}$$

iii. **The average variable cost function.**

$$AVC = TVC + Q$$

$$\frac{3Q^2}{Q} + \frac{4Q}{Q}$$

$$= 3Q + 4$$

iv. **The level of output that would minimise the average variable cost.**

$$\frac{dAVC}{dQ} = 3$$

Units minimizing average variable cost are three units

v. **The level of output that would minimise the average total cost.**

$$TC = 3Q^2 + 4Q + C$$

$$ATC = 3Q + 4 + C/Q$$

$$\frac{dAVC}{dQ} = 3 - CQ^{-2}$$

$$3 - CQ^{-2} = 0$$

$$\sqrt{Q^2}=\sqrt{1/3C}$$

$$Q=\sqrt{1/3C}$$

QUESTION 4

August 2021 Question One B

Explanation of the terms in relation to labour as a factor of production:

i. **Participation rate.**

Labour force participation is defined as the section of working population in the age groupof18 -60 in the economy currently employed or seeking employment. People who are still undergoing studies, housewives and persons above the age of 60 are not reckoned in the labour force

ii. **Real wages.**

Are wages adjusted for inflation or equivalently wages in terms of the amount of goods and services that can be bought.

iii. **Labour productivity.**

It is also knows as workers productivity. It measures output per labour hour. Growth in labour productivity depends on three main factors: saving and investment in human capital, new technology and physical capital.

iv. **Derived demand.**

The demand for labour is an economics principle derived from the demand for a firm's output. That is, if demand for a firm's output increase, the firm will demand more labour, thus hiring more staff.

QUESTION 5

August 2021 Question Two A

Term "marginal factor cost".

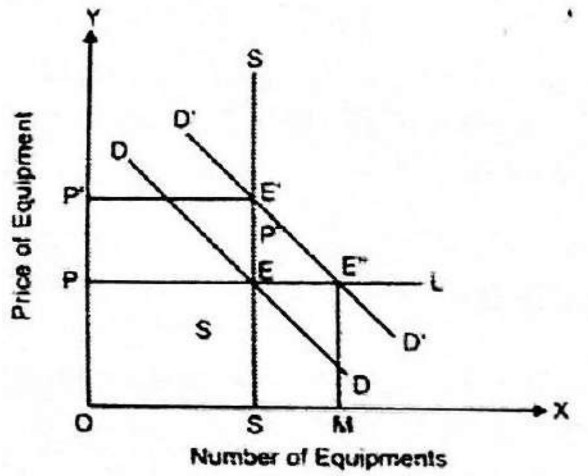
Refers to the additional created by adding a single unit of output. Comparison of marginal cost with marginal cost with marginal revenue helps businesses to determine profit maximizing output

QUESTION 6

August 2021 Question Two D

Distinction between "economic rent" and "quasi rent".

Quasi rent refers to surplus earnings generated by factors of production except land It is for temporary period and can be fixed in the long run.

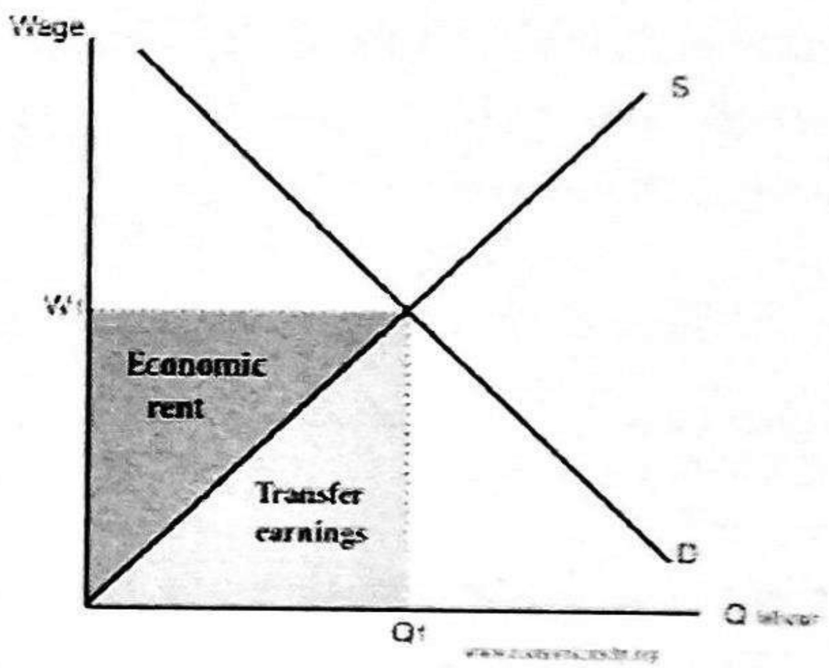


In figure above SS represents the inelastic supply curve. The demand curve (DD) and supply (SS) curve intersects at point E. at point E, the price is equal to OP and quantity of equipment is OS. In the short run, the increased demand (D1D1) reaches to the price level of OP1 with constant supply OS

As the number of equipment is constant in the short run, therefore, the transfer earnings are zero and quasi rent is equal to total earnings from the equipment. However, in the long-run, the supply of equipment is perfectly elastic. Therefore, any number of equipment can be supplied at (P Now, the supply reaches to OM and the prices falls to E'M. the quasi rent could disappear because the price gets equal to the transfer earnings (OP)

Economic rent

In economics, rent refers to producer's surplus. It should be distinguished from transfer earnings which is the minimum sum that has to be paid to a source to prevent it from transferring its service to another sector or activity. An excess of actual return over this amount is treated as surplus income or economic rent.



For labour transfer earnings are the minimum income a worker needs in order to supply their labour.

Economic rent is the extra income a worker receives above the minimum level they need in order to work.

QUESTION 7

May 2021 Question Five A

The total cost and demand functions of a firm

i. **Fixed cost function)**

$$F.C = 850$$

ii. **Variable cost function.**

$$VC = - 8Q + 10Q^2$$

iii. **Average cost function.**

$$A.C = TC – Q$$

$$= (850 -8Q + 10Q^2) – Q$$

$$= \frac{850}{Q} \text{-8+10Q}$$

iv. Marginal cost function.

MC=-8+20Q

v. Marginal revenue function.

TR = PQ

= Q (200) = 200Q

Therefore MR = 200

vi. **The level of output at which the firm breaks-even**.

Firms break even at a point where total cost equals to total revenue

200Q = 850 – 8Q+ 10Q^2

0 = 10Q^2 – 8Q – 200Q + 850

0 =10Q^2-20Q+850

Using quadratic formula

a=10

b = -208

c = 850

$$Q = \frac{-b \pm \sqrt{b^2 - 4ac}}{2a}$$

$$Q = \frac{-208 \pm \sqrt{-208^2 - (4 \times 10 \times 850)}}{2 \times 10}$$

$$Q = \frac{-208 \pm \sqrt{43264 - 34000}}{20}$$

$$Q = \frac{208 + 96.25}{20} \text{ or } \frac{208 - 96.25}{20}$$

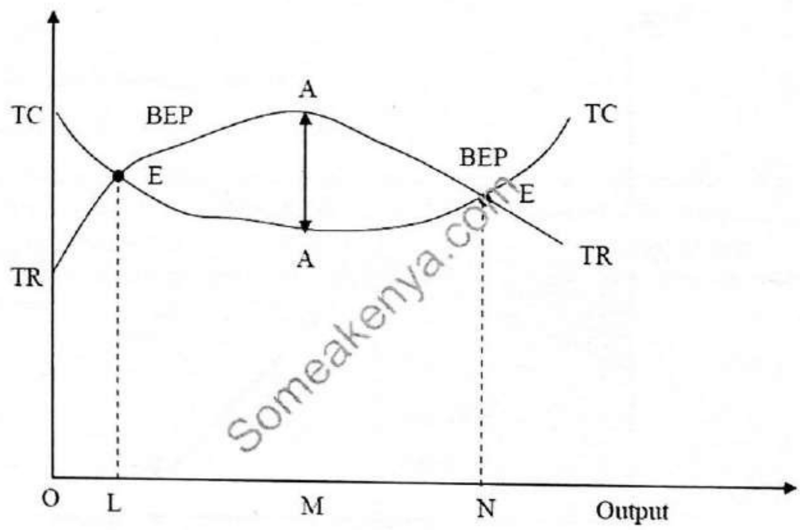
Q= 15.21 or 5.59 units

QUESTION 8

May 2021 Question Six C

Illustration of the optimal point of a firm

This is the level of output at which total profit is at maximum. It is the best or the most efficient size of a firm when the long run average cost of a firm is at minimum. At this point there will be no motive for further expansion since at any other size large or smaller the firm will be less efficient. This is also attained when the firm cost of production is at its minimum level as illustrated in figure below



Below OL total cost exceeds total revenue and hence the firm is making loss. At the point EL neither profit nor loss are being made and hence its break-even point (BEP) when total revenue is equal to the total cost. The same case applies to the point EN. Maximum profit lies where revenue and total cost difference total in the greater i.e. the point where the vertical distance between the total revenue and the total cost is greatest. In figure above, the maximum profit is at point M where AA is the largest vertical distance.

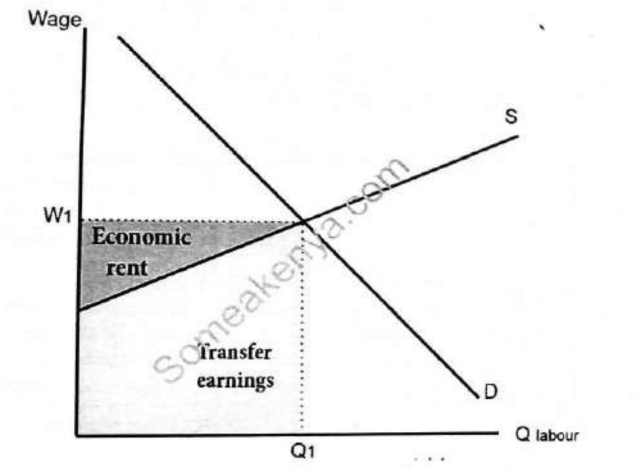
QUESTION 9

May 2021 Question Seven B

Illustration of the concept of economic rent.

- Refers to the income earned by the owners of factors of production in excess of what he expected to earn or what he should reasonably earn as per the market forces.
- It represents a surplus over and above the market price of the factor.

Economic rent = agreed price – free market price



Any payment of wages above market price W1 is the economic rent.

How economic rent might be used as a good base for taxation.

The tax base is the difference between the receipts from the sale ofngoods and services and the current and capital expenditures of the enterprise over a given period.

Economic rents have long been identified as an efficient tax base. In addition, the recent literature documents that rent income is highly concentrated and that rents are quickly increasing. Rent taxation thus seems attractive for reasons of both efficiency and equity. Nevertheless, rent taxation remains a marginal topic in research and policy making. In a systematic review of the neoclassical literature on different rent types, we find that some types of rents reflect inefficiencies and should thus be minimized, while others reward investments and should be supported in line with social welfare. What remains for taxation are land rents, one of the few true scarcity rents. Land rents have significant potential to improve the efficiency of the tax system. We then begin to develop a comprehensive theory of land rent taxation by identifying relevant efficiency and equity effects. The interaction of many of these effects remains unexplored, which might explain policymakers' hesitation in using land taxes to date.

QUESTION 10

November 2020 Question five C

Factors that might lead to an inward shift in the optimal point of a firm

An optimum firm is one which operates at the lowest point of the long run average cost curve. Production at minimum point is considered optimum because society's resources are efficiently deployed at that point. Factors responsible for an inward shift in the optimal firm points include:

- Decrease in firm size
- Poor deterioration of technology used by firm
- Economic performance worsening
- Elimination of subsidies and increase of taxation by government
- Inefficiency of entrepreneur
- Decrease in quantity of factors of production like land and labour.

QUESTION 11

November 2019 Question Two B

Factors that lead to external economies of scale in an economy

- Supportive legislation: in the political arena, if an industry grows and becomes important to become important to a region, it may gain greater political bargaining power and local politicians will seek to gain favourable terms for their local industry – in the form of subsidies/ tarrifs.
- Transport links: if mining concentrates in a certain areas, then there will develop better transport links for shipping the goods to the market. Therefore, as a new firm enter or existing firms expand then they can take advantage of the existing737 infrastructure to get lower average costs.
- Cluster effect. If firms locate in a similar area, then this makes more efficient for suppliers to meet a large base of purchasers, for example, if you set up a chemical firm in the Ruhr valley, Germany, there will be already suppliers and transport links to a deal with related aspects of the industry.
- Skilled labor: if similar firms locate up in a particular region it will encourage skilled labor to seek work in this area .for example silicon valley outside San Francisco has become a hotspot for IT related industries.

This attracts skilled workers. Thus firms have to spend less on recruiting the skilled labor

- Development of subsidiary industries catering for special needs of a major industry or the provision of ancillary services. Examples would be firms specializing in waste collection and processing from local industries
- Co-operation between firms can take the forma of joint research centers and the formation of trade societies which is easier in the case of localized industry.
- External economies of scale may arise through the provision of commercial facilities by some industries in the area that develop a special knowledge of the needs of the industry.
- The creation of a labour force skilled in various techniques used in the industry special training courses may be offered by local colleges geared to particular needs.

QUESTION 12

November 2019 Question Two C

Assumptions of law of variable proportions

Law of variable proportions states that "In a given state of technology, when the units of variable factor of production are increased within the units of other fixed factors, the marginal productivity increases at increasing rate up to a point, after this point it will become less and less"

The assumptions of law of variable proportions are:

1. It is assumed that labor is a single variable factor
2. The various factors are not to be used in rigidly fixed proportions but the law is based upon the possibility of varying proportions. It is also called the law of proportionality
3. It operates in the short run because in the long run, fixed inputs become variable.
4. It is assumed that all units of variable factors of production are homogenous in amount and quality

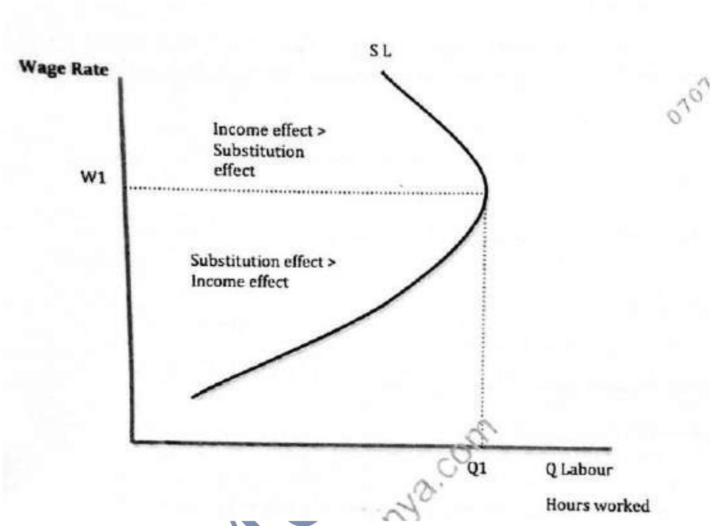
5. Some inputs must be kept constant
6. It is assumed that the technique of production

QUESTION 13

November 2019 Question Three B

Backward bending supply curve of labour

A typical supply curve shows an increase in supply as wages rise. It slopes from left to right. However, in labour markets, we can often witness a backward bending supply curve. This means after a certain point, higher wages can lead to a decline in labour supply. This occurs when higher wages encourage workers to work less and enjoy more leisure time.



There are two effects related to determining supply of labour.

1. The substitution effect states that a higher wages makes work more attractive than leisure, therefore, in response to a higher wages, supply increases because work gives more remuneration.
2. The income effect states that higher wage means workers can achieve a target income by working fewer hours. Therefore, if wages increase, it becomes easier to get enough income through working fewer hours.

QUESTION 14

May 2019 Question One C

Factors that might lead to a rightward shift in a firm's optimal point

- An optimum firm is one which operates at the lowest point of the long run average cost curve. Production at minimum point is considered optimum because society's resources are efficiently deployed at that point
- An increase in firm size.
- Modern technology adoption by the firm
- Economic performance improvement
- Giving of subsidies and reduction of taxation by the government
- The efficiency of entrepreneur

- Increase in quantity of factors of productions like land and labour.
- Government control over externalities e.g. Pollution

QUESTION 15

May 2019 Question Two C

Total cost function

$$TC = ACQ$$

$$=(100/Q - 16 + 2Q)\ Q$$

$$= 100\text{-}16Q$$

Variable cost function

$$=-16Q+20Q\text{\^{}}2$$

Total profit function

$$TR = (50 - Q)Q$$

$$= 50Q - Q\text{\^{}}2$$

Total profit π = TR – TC

$$= 50Q - Q\text{\^{}}2 - (100 - 16Q + 2Q\text{\^{}}2)$$

$$50Q + 16Q - Q\text{\^{}}2 - 2Q\text{\^{}}2 - 100$$

$$= 66Q\text{\^{}} - 3Q\text{\^{}}2 - 100$$

Profit when output Q=10 units

π= 340Q–3Q^2– 100

= (66×10) – (3×10^2) – 100

= 660 – 300 – 100

= Shs. 260 x 1000

= Shs. 260,000

QUESTION 16

May 2019 Question Three B

Determinants of effectiveness of trade unions in society

A trade union is an association of workers/employees whose principals' purpose is to regulate relations between employees and employers, including employers' organization.

Factors that determine effectiveness of a trade union include:

- One industry, one union: one industry should have a single recognized union to ensure issues facing workers are addressed adequately.
- Sufficient finances: trade unions rely on contributions made by workers failure to contribute or reductions in contributions made ends up impairing the activities of the trade union. Ake
- Education and training of workers: ignorance and illiteracy of workers is a key impediment to the development of trade unions. This can only be overcome by training of workers about their interests and extend their cooperation which will bring new awakening of the industry as well.
- Internal leadership: union leaders should be selected internally. On top of this, there is need to train and educate them on labour welfare activities and union leadership techniques
- Co-operation from the members: co-operative members strengthen a trade union whereas un co-operative members weaken it.
- Away from political influence: trade unions should keep off from politics though members should be at liberty to join politics, they should not let politics distract them from their core objective.
- Attitude of the government towards the worker: if the government views trade union positively, then they will be stronger unlike a scenario where government views workers negatively.
- Organization of trade union: well organized trade unions are able to bargain for higher wages as compared to disorganized trade unions.
- Power of the employer: in a perfectly competitive market most of trade unions are stronger than in a monopolistic market for labour.

QUESTION 17

May 2019 Question Four C

Measures that could be adopted by a government to enhance mobility of labour

1. Improve education and training: The mobility of labour depends on the extent to which labour is educated and trained. The more a person is educated and skilled, the greater are his chances of moving from one occupation or place to another. Geographical and vertical mobility depend on education and training.
2. Improve transport network: Well developed means of transport and communications encourage mobility of labour. The worker knows that in case of emergency at home, he can easily communicate with his family on phone or travel back by train within the country or by aero plane if he is abroad.
3. Agricultural Developments: With agricultural Development, labour moves from high population to low population areas during busy seasons.

4. Industrialisation: When the state starts industrial centres, and estates, employment exchanges, dams, public works, etc ., they encourage mobility of labour. The mobility of labour is determined by industrial development. Workers move from different occupations and places to work in factories. Industrialisation also leads to urbanisation and workers move from rural and semi-urban areas to industrial centres and big cities.
5. Support trade: The development of business and trade leads to the spread of their offices and institutions related to them in different parts of the country. As a result, workers move from one place and occupation to another to work in trade and business offices, banks, insurance companies, etc.
6. Maintain Peace and Security: The mobility of labour depends to a large extent on law and order in the country. If the life and property of the people are not safe, they will not move from their present places and occupations to others.

QUESTION 18

May 2019 Question Four D

Average variable cost when the units produced are 2, 6 and 10 respectively

Output	Total cost	Fixed cost	Variable cost
0	77	77	0
2	216	77	139
4	235	77	158
6	319	77	242
8	348	77	271
10	382	77	305

Average variable cost (AVC)= $\frac{Total\ variable\ cost(TVC)}{Output(Q)}$

AVC 2 units=139000÷2=sh.69000

AVC 6 units= 242000÷6=sh.403333.33

AVC 10 Units=305000 ÷10=sh.30500

Marginal costs of production for the 4th and 8th units respectively

Output	Total cost	Fixed cost	Variable cost	Marginal cost
0	77000	77000	0	0
2	216000	77000	139000	139000
4	235000	77000	158000	19000
6	319000	77000	242000	84000
8	348000	77000	271000	29000
10	382000	77000	305000	34000

Marginal cost refers to the increase in total cost as a result of unit increase in output

Marginal cost for producing 4 units is sh. 19,000 while marginal cost for producing 8 units is sh 29,000.

QUESTION 19

May 2019 Question Seven B

Relationship between the short run average cost curve and the long run average cost curve

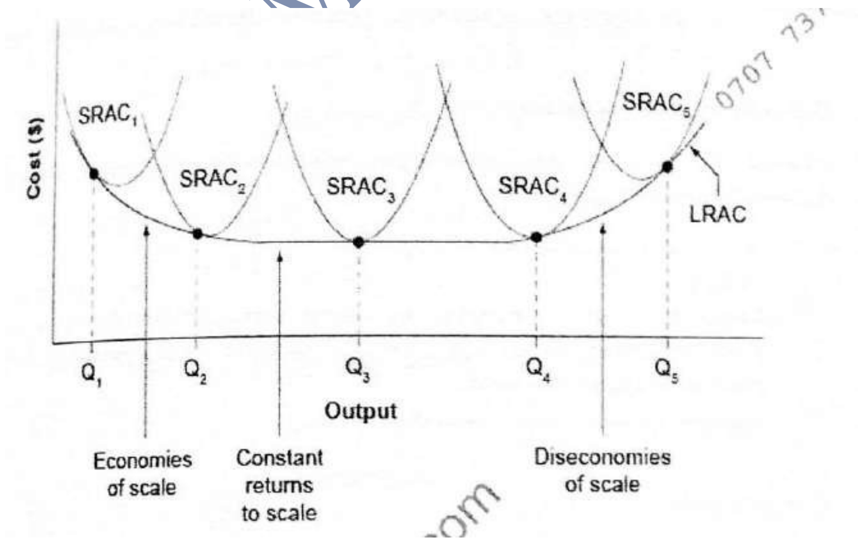
Production is the creation of utilities to supply human needs and wants short run average cost curve.

Short run average cost curve

In the short run, the shape of the average total cost curve (ATC) is u-shaped. The SATC falls in the beginning reaches a minimum and begins to rise as its demonstrated in the SRAC1 to SRAC5 in the diagram below. The reasons for the average total cost to fall in the beginning of production is that the fixed factors of a firm remain the same. The change only takes place in the variable factors such as raw material and labor. As the fixed cost gets distributed over the output as production is expanded, the average cost, therefore, begins to fall. When a firm fully utilizes its scale of operation (plant size), the average cost is then at its minimum. The firm is then operating to its optimum capacity. If a firm increases its level of output with the same fixed plant, the economies of scale of production change into diseconomies and the average cost then begins to rise sharply.

Long run average cost curve:

This is the sum total of short run average cost. In the long run, all costs of the firm are variable. The factors of production can be used in varying proportions to deal with an increased output. The firm having time period long enough can build larger scale or type of plant to produce the anticipated output. The shape of the long run average cost curve Is also u shaped but is flatter than the short run curve.



The five different short-run average cost (SRAC) curves each represents a different level of fixed costs, from the low level of fixed costs at SRACI to the high level of fixed costs atSRAC5.OtherSRACcurves, not shown in the diagram, lie between the ones that are shown here. The long-run average cost (LRAC) curve shows the lowest cost for producing each quantity of output when fixed costs can vary, and so it is formed by the bottom edge of the family of SRAC curves. If a firm wished to produce quantity Q3, it would choose the fixed costs associated with SRAC3.

QUESTION 20

November 2018 Question One D

Barriers to occupational mobility of the labour

Occupational mobility refers to the ease at which one can change from job to another. Factors that limit this include:

- Personal talents
- Cost and length of training
- Availability of training
- Availability of capital
- Regulation e.g. professional occupational licensing
- Social class
- International barriers: countries do not allow for inflow of labour by adopting protectionism policy.
- Family/social ties: some people are so connected to their family that they fear changing jobs as it will disrupt their family life.

QUESTION 21

November 2018 Question Three A

Characteristics of capital as a factor of production

- Reward for capital is interest
- Capital is a mobile production factor
- Capital is subject to wear and tears e.g. machines
- Improved technology can lead to an increase in capital productivity
- Capital is an artificial factor of production"
- Interest on capital can be calculated in terms of time

QUESTION 22

November 2018 Question Three C

Arguments used by trade unions justify increase in wages.

- Profit argument: profit increases in firms can be attributable to workers efforts.
- Thus workers should share in the fruits of their labor in terms of wage increases. Differential argument: applies where similar companies are making similar profits amounts and workers? Efficiency is same, thus a claim for similar wages is justifiable.
- Cost of living argument: trade unions hereby demand for arise in wages to support workers current living standards.
- Productivity argument: productivity refers to output per worker. If it increases, trade unions can use that to advocate for higher wages.

QUESTION 23

May 2018 Question Seven C

i. **The marginal cost function**

$$\text{Marginal cost (MC)} = \frac{\Delta TC}{Q}$$

$$=16Q$$

ii. **The average fixed cost function**

$$\text{Average fixed cost} = \frac{Total\ cost}{Output}$$

$$= \frac{50}{Q}$$

iii. **The marginal revenue function**

TR=PQ

=100Q

$$\text{Marginal Revenue MR} = \frac{\Delta TR}{Q} = 100$$

iv. **The profit maximising level of output.**

Profit maximising output is at the point where MR=MC

16Q/16=100/16

Q=6.25

QUESTION 24

November 17 Question Three A

Determinants of labour supply in an economy

- Size of working population in any country refers to people above 15 years who are willing and able to work. The higher, the high the labour supply.
- Wage rate: high wages can influence people to concentrate on particular industry

Difficulty in getting qualifications

Incase it's difficult to get qualification supply will be inelastic. For example training doctors takes a lot of years.

- Wage rate/ remuneration
- Mobility
- Length of the working week (working days per week)
- Extent of barriers to entry into a particular profession or occupation e.g. ICPAK

- Political and economic stability
- Opportunity cost-leisure and work

QUESTION 25

November 17 Question Five A

Total cost of production

C= 5000 + 500Q + 150Q^2 + 5Q^3

= 5000 + (50 × 10) + (150 x 10) + 5 ×103

= 3000 + 5000 + 15000 + 5000

= Sh. 30,000 x 1000

= Sh. 30,000,000

Average variable cost of production

Average variable cost of production

=TVC/Q

AVC=(500Q+150Q^2+5Q^3)/Q

=500+150Q+5Q^2

=500+(150×10)+(5×102)

=sh.2500000

Marginal cost of production

$$\text{Mc} = \frac{\Delta TC}{\Delta Q} = 500 + 300Q + 15Q\text{\^{}}2$$

when output is 10 units then marginal cost = 500 + (300 x 10) + (15 x102)

= 500 + 3000 + 1500

= 5000 x1000

= Sh. 5000,000

QUESTION 26 nya.com

November 17 Question Six B

Factors that influence the cost behavior of a firm

- Technology: technological change often leads to a fall in average cost but raises the productivity of existing resources.
- Lot size production cost per unit goes down with 10t size, but storage and risk cost per unit goes up. Usually, in large scale production, cost of production tends to fall initially with increase in lot size.

- Volatility of output rate also affects cost behavior. Stability and plan ability of output lead to cost saving. Additional cost savings occur due to learning effect and technological progress.
- Variability of product mix prices of inputs (material and labour)
- Plant size
- Rate of output marginal cost rise continuously as output rate increases above some given level. The resulting average cost curve has a u shaped relation to output.
- Time period: business considerations dictate that many costs cannot be avoided in the shortrun

QUESTION 27 737

May 2017 Question Two B

i. **Factors that could lead to increasing returns to scale**.
- Managerial economies: this is where a company has a competent and qualified manager who enhances high production levels.
- Automation: application of modern technology ensures production of quality output and also enhances the speed of production process.
- Existence of excess capacity in machines and labour can be utilized for more production of goods.
- Adequate stock that enhances the continuity of production process in the firm. Selling and marketing economies their efficacy is improved through sales promotion and advertising ensuring placing of more orders for production.
- Specialization and division of labour: this leads to increased output.
- Storage facilities and transport facilities: adequate warehouses and transportation vehicles ease the production process.

ii. Factors that could lead to decreasing returns to scale
- Use of obsolete technology which lowers output produced.
- Lack of specialization, which drags down the production process.
- Due to long bureaucratic procedures that lead to time wastage and thus low production
- Monotony due to repeated performance of same type of work which contributes to an individual losing interest in work and consequent decline in productivity.
- Due to poor co-ordination of production activities by inexperienced and unqualified supervisors, this may lead to defeats and low output.

QUESTION 28

May 2017 Question Three A

Difference between "real" and "pecuniary" economies of scale of a firm

Pecuniary economies are economies realized from paying lower prices for the factors used in the production and distribution of the product, due to bulk buying by the firm as its size increases. Such strictly monetary economies do not imply an actual decrease in quantity of inputs used but accrue to the firm from lower prices paid for raw materials, bought at a discount due to large volume of the purchase) lower interest charges or lower wages & salaries as firm increases in size.

Real economies are those associated with a reduction in the physical quantity of raw materials, inputs, various types of labour and capital

QUESTION 29

November 2016 Question Two B

Assumptions of marginal productivity theory of wage determination

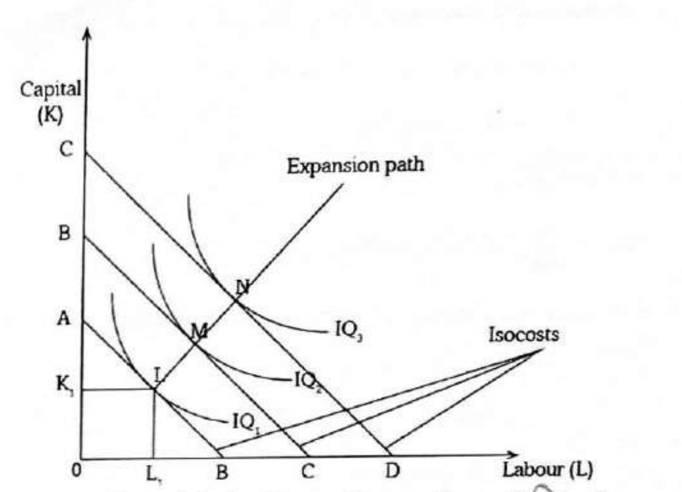
- It assumes labour supply is fixed
- The productivity of labour does not depend entirely on its own effort and efficiency but largely on the quality of other factors of production employed. The theory is based on weak assumptions since it assumes that all units of each worker are homogeneous.
- The theory is only applicable under perfect o competition which is idealistic.
- According to this theory, the higher the wage, the smaller the amount of labour that entrepreneurs will employ. Ake
- The employment of or more units of labour may completely offset the method of production in use for sometime.

QUESTION 30

November 2016 Question Four B

Expansion curve of a firm as applied in the theory of production.

The firm's expansion curve, refers to a curve showing the least combination of resources for all possible output levels of a firm. For example assume that firm only uses labour (1) and capital (k), in the production process, the firms expansion curve can be shown below:



Cost minimisation and expansion path of a firm

If all points of tangency like L, M and N are joined by a line, that 'joining' line is known as the expansion path or the output factor curve. It shows how the proportions of the two factors used might be changed as the firm expands.

QUESTION 31

November 2016 Question Five B

The average cost of producing each level of output cost

Total cost = fixed cost + total variable cost

Average cost = total cost -output

Maximum attainable profit is Shs. 2,470,000

QUESTION32

May 2016 Question Three C

Five causes of the u shaped long run average cost curves of a firm.

- In the long run all factors are variable and it is possible to change the quantity of all factors according to circumstances during long run total fixed cost can be varied to a considerable extent. In the short run, a reduction in output raises average cost because fixed cost remains the same, in the long run fixed cost can be reduced so average fixed cost may be lower in the long run than in the short run.
- Another reason of the flatter long run average cost curve is that factors of production can be divided in smaller parts. If all factors of production can be used in varying proportions, it means the scale of operation of the firm can be changed.
- Economics of scale whereby long run average cost declines as the output produced increases. Economies of scale arise due specialization of management plant and equipment and labor
- Constant returns to scale whereby long run average cost stays the same as quantity produced increases.
- Diseconomies of scale whereby long run average total cost rises as the output produced increases
- Diseconomies of scale arise due to problems of managerial control and coordination

QUESTION 33

May 2016 Question Four A

Barriers to occupational mobility of labour

Occupational mobility refers to the ease at which one can change from job to another. Factors that limit this include:

- Personal talents
- Cost and length of training
- Availability of training
- Availability of capital
- Regulation e.g. professional occupational licensing Social class
- International barriers: countries do not allow for inflow of labour by adopting protectionism policy.
- Family/social ties: some people are so connected to their family that they fear changing jobs as it will disrupt their family life.

QUESTION 34

November 2015 Question One C

Case for and against specialization as a production method

Argument for specialization

- Less fatigue: The worker habituated to the repetition of simple tasks, become less fatigued by his work.
- Greater skill of the workers: The constant repetition of a task makes it performance almost automatic
- Saving time: a worker concentrates only on a single operation and waste less time between operations moreover less time, too, is required to learn how to perform a single operation than to learn a complete trade
- Employment of specialists: The carrying out of ten needing its own particular skill. Specialization therefore makes possible for each workman to specialize in the work for which he has the greatest aptitude.
- It makes possible the use of machinery: Specialization permits the use of some tools specific to a particular task, which can make the life of a worker easier.

Argument against of specialization

- Monotony: boredom for the worker as they do some job daily.
- Greater risk of unemployment : workers suffers risk of jobless if demand for product he is specializing declines or skills needed become non-marketable. Decline of craftsmanship: workers skills may suffer as they are doing any one job.
- Workers may eventually be replaced by machinery.
- Greater cost of training workers
- Quantity may suffer as they are doing any one job.
- Workers may eventually be replaced by machinery.
- Greater cost of training workers
- Quantity may suffer if workers become bored by the lack of variety in their job
- More expensive workers

QUESTION 35 0707

November 2015 Question Two A

Arguments upon which trade unions base their demand for increase in wages for unionisable employees

- Profit argument: profit increases in firms can be attributable to workers efforts.
- Thus workers should share in the fruits of their labor in terms of wage increases.
- Differential argument: applies where similar companies are making similar profits amounts and workers? Efficiency is same, thus a claim for similar wages is justifiable.

- Cost of living argument: trade unions hereby demand for arise in wages to support workers current living standards. On

- Productivity argument: productivity refers to output per worker. If it increases, November trade unions can use that to advocate for higher wages.

QUESTION 36

Effects of price decontrols to an economy

Price decontrol entails removal of maximum price controls or minimum price controls and then leaving prices to be determined by forces of demand and supply.

Effects of price decontrol

- It encourages competition which will lead to lower consumer prices.
- In the long run many firms enter decontrol lines of production which will lead to increased government revenue since producers will produce more.
- It's likely to lead to more efficient long run allocation of resources because of absence of shortages and surpluses.
- It may encourage greater investment since producers can charge more profitable prices.
- In case of price floors price will reduce towards equilibrium.
- In case of a price ceiling the prices will increase towards equilibrium. There may be increase in employment when minimum wages are eliminated.
- Consumers will end up paying more in case of removal of price ceiling.
- It will reduce producers' income in case of removal of minimum prices.

QUESTION 37

November 2015 Question Two C

Uses of elasticity of demand in decision making

Elasticity of demand refers to the responsiveness of demand to change in factors such as price, income among others. Application of elasticity of demand in economic decision making:-

- For purpose of regulating farm incomes and to predict consequences of bumper harvests of crops
- From the point of view of wage bargaining among workers and employers and the government when fixing minimum wage legislation.
- It's crucial for business persons who need to know the effects that changes in price will have on the sales revenue fer example, if they that demand for their product is relatively inelastic then increasing prices might help them to increase revenue. If on the other hand they are aware that source of their products have a high price elasticity of demand they will be more cautious when considering price increases for fear of losing revenue.
- Helps government to estimate the yield of a prospective tax
- Critical for devaluation policy that aims at improving the balance of payments. Can only succeed if imports and export demand is elastic. If that be the case then devaluation will spur high demand for exports in foreign markets and lower local import demand. Competition and pricing
- If a firm is in a competitive industry there would be a high cross elasticity between its products and those of other firms. For such a firm, it may be beneficial to lower prices in order to attract customers. From other firms. This is because the price elasticity of demand for its products is very elastic due to the availability of substitutes.

- Protection policy

The concept of cross elasticity of demand is useful to the government in predicting the effects of its protection policy, for example, if the government imposes a tariff on an imported product like clothes with the intention of protecting the local industry, then the local and imported products must be close substitutes for the government to achieve its objectives

- Fluctuation of agricultural product prices

The more inelastic the demand for agricultural products are, the more widely prices will fluctuate with changes in output from period to period

QUESTION 38

November 2015 Question Two D

Price elasticity of supply when price decreases from Sh.10 per unit to Sh.5 per unit

Elasticity of supply (ES)

$$\frac{\Delta Q}{\Delta P} \times \frac{P}{Q}$$

(6000-11000)/(5-10)x10/11000

=0.9091

QUESTION 39

November 2015 Question Three A

Explanation of Optimal size of firm

This is the most efficient size of the firm, at which cost of production per unit of output will be at a minimum, so that it has no motive either to expand or reduce it scale of production. Thus, as a firm expands towards the optimum size it will enjoy economies of scale, but if it goes beyond the optimum point diseconomies will set in.

QUESTION 40 0707

November 2015 Question Three C

Barriers to geographical mobility of labour as a factor of production

- International barriers: countries do not allow cross border movement in search of Jobs
- Family/ social ties: some people are connected to their family so that moving to another region for work becomes difficult
- Cost of moving may be prohibitive: geographical mobility may restricted by high cost of moving and settling down. Cultural differences between people
- May create cultural barriers to labour mobility.
- Ignorance's some people are ignorant about job opportunities in other parts of the world so they cannot move
- Lack of education facilities which reduces the mobility of labor because insome places people do not have adequate facilities for training.

Measures that could be adopted SU by a government to enhance mobility of labour

- Improve education and training: The mobility of labour depends on the extent to which labour is educated and trained. The more a person is educated and skilled, the greater are his chances of moving from one occupation or place to another. Geographical and vertical mobility depend on education and training.
- Improve transport network: Well developed means of transport and communications encourage mobility of labour. The worker knows that in case of emergency at home, he can easily communicate with his family on phone or travel back by train within the country or by aero plane if he is abroad.
- Agricultural Developments: With agricultural development, labour moves from high population to low population areas during busy seasons.
- Industrialisation: When the state starts industrial centres, and estates, employment exchanges, dams, public works, etc ., they encourage mobility of labour. The mobility of labour is determined by industrial development. Workers move from different occupations and places to work in factories. Industrialisation Also leads to urbanisation and workers move from rural and semi-urban areas to industrial centres and big cities.
- Support trade: The development of business and trade leads to the spread of their offices and institutions related to them in different parts of the country. As a result workers move from one place and occupation to another to work in trade and business offices, banks, insurance companies, etc.
- Maintain Peace and Security: The mobility of labour depends to a large extent on law and order in the country. If the life and property of the people are not safe. They will not move from their present places and occupations to others.

QUESTION 41

September 2015 Question Three A

Distinction between “fixed costs” and “variable costs”

Fixed costs are those that remain the same regardless the change in output e.g.

Depreciation of building and salary of management Variable costs are those that change with change in output like direct material cost and direct labour cost.

QUESTION 42

September2015QuestionThreeB

Firm’s total cost, average total cost, average variable cost, average fixed cost and marginal cost giving your solution in columnar form/tabular form

$$Total\ Cost = Fixed\ cost\ total + Total\ variable\ cost$$

$$Average\ total\ cost = Total\ cost - output$$

$$Average\ variable\ cost = Total\ variable\ cost - output$$

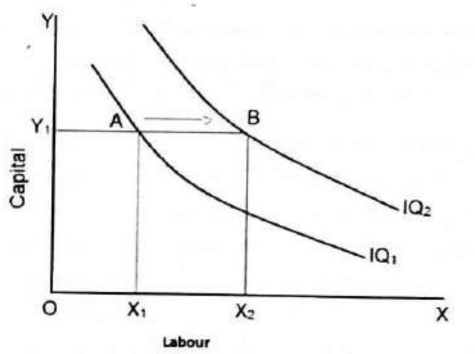
$$Average\ fixed\ cost = Total\ fixed\ cost - output\ total$$

QUESTION 43

September 2015 Question Three C

Properties of isoquants

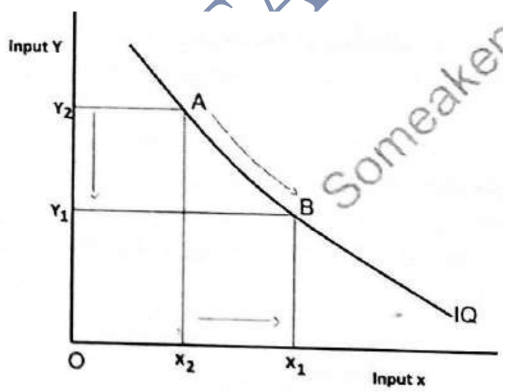
An isoquant lying above and to the right of another isoquant represent a higher level output



Combination of input lying in 1Q2 will be preferred to y producer to the combination of that use on IQ1.

Isoquants are negatively sloped an isoquant slopes from left to right.

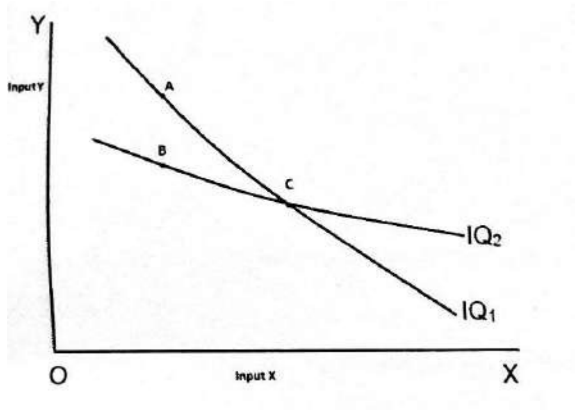
The logic behind this is the principle of diminishing marginal rate of technical substitution. In order to maintain a given output, a reduction in the use of one input must be offset by an increase in the use of another input



For output to remain unchanged, as unit of input y are given out, additional unit of input x must be used as shown by the movement from point A to B where producer reduces unit of y from Y2 to Y1

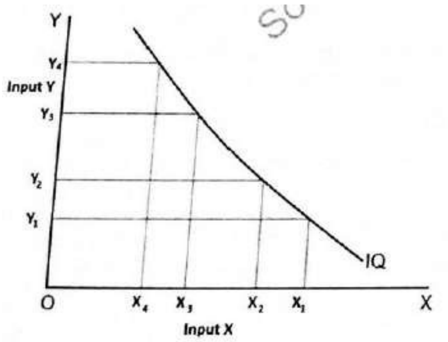
Two isoquants cannot cut each other

Just as two indifference curves cannot cut each other, so two isoquants also cannot cut each other, if they intersect there would be a contradiction and this will lead to inconsistent results.



An individual is indifference between combination A and C and between combination B and C and should therefore be indifferent between combination A and B. However A contains more units of input Y but the same units of input X thus irrational

Isoquants are convex to the origin.



This is because as more of the and operation more units of the of law Y are of given diminishing ups successively marginal rate bigger of technical quantities of X must be obtained to compensate producer for loss. Thus the marginal rate of technical substitution of X for Y diminishes along the isoquant

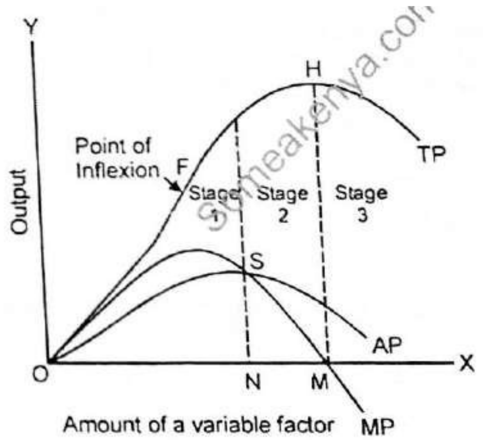
QUESTION 44

September 2015 Question Seven B

Law of diminishing marginal returns

Law of diminishing marginal returns or production of a commodity is increased by adding units of a variable input are held constant, the increase in total production becomes, after some point, smaller and smaller.

Stages of production according to law of diminishing marginal returns



Where: Tp->Total product

MP->Marginal product

AP->Average product

Stage 1: law of increasing return

In this stage, total product increases at an increasing rate upto point F, marginal product also rises and becomes maximum at the point which corresponds to point F. Average, ,the total product increases but at diminishing rate. This will lead to a fall in marginal product but remains positive. The stage1ends where the AP curve reaches its highest point. The reasons for increasing returns to scale stage 1

Stage 2: Diminishing returns

Decreasing returns: if increases in variable factor is continued, the marginal product starts falling i.e. law of decreasing returns sets in causes for decreasing returns. Stage ends when marginal becomes zero.

Stage 3: Negative returns

When a business experiences decreasing returns and the quantity of variable returns become negative. Comeakenya.com

QUESTION 45

September 2015 Question Seven C

Functions of trade unions

- To protect laborers agams, victimization and injustice.
- To raise the status of workers as part of industry.
- To achieve higher wages and better working conditions To protect women workers against discrimination
- To provide opportunities for growth and promotion.
- To encourage sincerity and discipline among workers
- To take up welfare measures for improving the morale of workers.

Note:

Factors that could lead to increasing returns to scale

- Managerial economies: this is where a company has a competent and qualified manager who enhances high production levels.
- Automation: application of modern technology ensures production of quality output and also enhances the speed of production process.
- Existence of excess capacity in machines and labour can be utilized for more production of goods.
- Adequate stock that enhances the continuity of production process in the firm. Selling and marketing economies their efficacy is improved through sales promotion and advertising ensuring placing of more orders for production.
- Specialization and division of labour: this leads to increased output.
- Storage facilities and transport facilities: adequate warehouses and transportation vehicles ease the production process.

Factors that could lead to decreasing returns to scale

- Use of obsolete technology which lowers on put produced.
- Lack of specialization, which drags down the production process.
- Due to long bureaucratic procedures that lead to time wastage and thus low production
- Monotony due to repeated performance of same type of work which contributes to an individual losing interest in work and consequent decline in productivity.
- Due to poor co-ordination of production activities by inexperienced and unqualified supervisors, this may lead to defeats and low output.

TOPIC 5

MARKET STRUCTURES

QUESTION 1

December 2021 Question Two C

Conditions that are necessary for effective price discrimination by a monopolist.

- Distance of two markets: Price discrimination is possible when two markets are separated by large distance or tariff barriers, so that it is not possible to transfer goods from a cheaper market to nearer markets
- Ignorance of the consumers: Price discrimination is possible when the consumers are ignorant about price discrimination, they are not aware that in one part of the market, prices are lower than in the other part.
- Government regulation: Price discrimination is only possible if government rules and regulations permit
- Geographical discrimination: Hereby, monopolistic charges a higher prices to foreigners as compared to local buyers
- Difference in elasticity of demand: High price is charged for a product with inelastic demand and low prices are charged for a product with elastic demand
- Artificial difference between goods e.g through branding
- Nature of commodity

QUESTION 2

December 2021 Question Six A

Differences between monopoly and monopolistic market structures.

- High barriers to entry for monopoly. Low barriers to entry can monopolize market
- Structure
- No competition exists for monopoly whereas very high competition exists under monopolistic market structure
- Due to steep demands and only one seller, the price is controlled by the seller under monopoly. Some level of price control is exercised by buyers as many sellers and available in the monopolistic market.
- As single player in the monopoly market. More than one but a small number in the monopolistic market
- Variants in a particular product may or may not exist depending upon seller monopoly market. Variants do exist which are produced by the different players in the monopolistic market.
- Competition is highly predictable under monopoly since there is only one seller.
- Monopolistic competition is very unpredictable

QUESTION 3

August 2021 Question Five A and B

Explanation of the term “collusion”.

It occurs when entities or individuals work together to influence a market or pricing for their own advantage e.g OPEC Act of collusion include price fixing, synchronized advertising and sharing insider information.

Antitrust and whistle blower laws help to deter collusion

Benefits that might accrue to consumers as a result of price wars by firms.

A price war is when two or more rival companies lower prices of comparable products or services with goal of stealing customers from their competitors or gaining market share

It benefits consumers in some of the following ways

1. Provides better deals to consumers: the consumers get access to cheaply price goods which they were buying at expensive prices before price war.
2. Price fall for consumers which leads to an increase in their real incomes (their disposable incomes stretch further each month) and an increase in consumer price.
3. Price wars can help bring down the annual rate of consumer price inflation
4. Price wars on stable / essential products might have bigger impact on larger and relatively low income families. In this case, aggressive price wars can have a progressive effect on the distribution of real income and consumption.

QUESTION 4

August 2021 Question Six A

Explanation of the term “price discrimination”.

Price discrimination is a selling strategy that charges customers different prices for the same product or service based on what the seller thinks they can get the customer to agree to

Types of price discrimination.

1. First degree price discrimination: Hereby, the monopoly seller of a good or service charges the maximum price each consumer is willing to pay
2. Second degree price discrimination: The price of a good or service varies according to quantity demanded. Those who make bulk purchases will enjoy discounts which will reduce their purchase cost
3. Third degree price discrimination: The price changes in line with consumer attributes such as age, gender, economic status and location.

QUESTION 5

November 2020 Question Three A

Sources of monopoly power

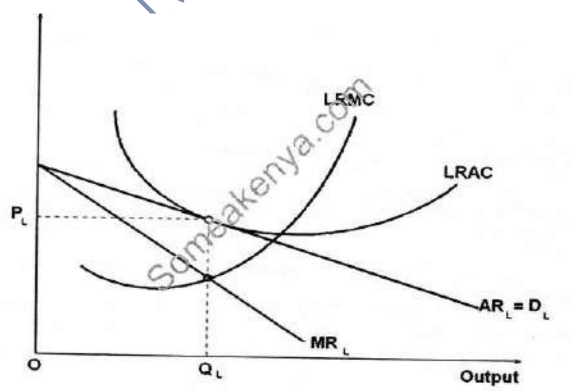
- Exclusive ownership and control of factors inputs
- Market franchise: Refers to exclusive right by law to supply the product or commodity e.g. Kenya bus service before the coming of the matatu business in Nairobi
- Patent rights e.g. beer brands like Tusker, soft drinks like Coca-Cola
- Natural monopoly which results from a minimum average cost of production.
- The Firm could produce the least cost possible and supply the markets
- Sunk costs: The greater the cost of establishing a new business in an industry the more difficult it is to enter that industry. That cost will, in turn, be greater if the outlays required to start are business unlikely to be recovered if the business should fail. The potential for high sunk cost will contribute to the monopoly power of an existing firm by making entry by other firms more difficult.
- Location: Sometimes monopoly power is the result of location. For example, sellers in markets isolated by distance from their nearest rivals have a degree of monopoly power. The local movie theatre in a small town has Monopoly in showing first-run movies. Doctors, dentist and mechanics in isolated towns may also be monopolists.

QUESTION 6

November 2020 Question Three B

Equilibrium level of a firm operating under monopolistic market structure in the long run

Monopolistic competition is a type of imperfect competition such that many producers sell products that are differentiated from one another.



In the long run, a firm under a monopolistic competitive market will produce the amount of ,goods where the long-run marginal cost (LMRC) curve intersects marginal revenue ((MRL). The price (PL) will be set where the quantity produced (Qz) falls on the average revenue curve (AR). The result in the long run the firm will break even.

QUESTION 7

November 2019 Question Three C

The revenue function of product "R"

Linear revenue function

Q = a – bq

20 = a – 600q … … ….. (i)

70 = a – 500q … … ….. (ii)

100Q/100=50/100

20 = a – (600 x 0.5)

20 =3-300

Therefore,Price function P = a – bq

320- 0.5q

Total revenue = PQ

= Q (320 – 0.5q)

= 3200 – $0.5Q^2$

The profit earned at equilibrium

Equilibrium will occur at a point where marginal revenue equals to marginal cost

$$\text{Marginal revenue (MR)} = \frac{\Delta TC}{\Delta Q} = 320 - Q$$

$$\text{Marginal cost (MC)} = \frac{\Delta TC}{\Delta Q} = 320 - Q = 1.8Q - +30$$

$$320 - Q = 1.8Q + 30$$

$$1.8Q + a = 320 - 30$$

$$2.8Q/2.8=290/2.8$$

$$a = 103.57 \text{ units}$$

$$\text{Profit function} = TR - TC$$

$$: 3200 - 0.5Q^2 - (0.9Q^2 + 30Q + 1000)$$

$$= 320Q - 30Q - 0.5Q - 0.9Q^2 - 1000$$

$$= 290Q - 1.4Q^2 - 1000$$

Profit made at equilibrium point

(290 × 103.57) – 1.4 ×103.572) – 1000 i

The equilibrium price

$$P=320-0.5Q$$

$$=320\ (0.5x103.57)$$

$$=320-51.785$$

$$=\text{Sh.}268.215$$

QUESTION 8

May 2019 Question One B

Distinction "perfect oligopoly" and "imperfect oligopoly"

A perfect oligopoly is also known as pure oligopoly. It is a form of oligopoly whereby firms produce an homogenous product e.g. diesel. The level of inter-dependence is high. Imperfect oligopoly is a form of oligopoly in which firms produce differentiated products like car manufacturers. The level of interdependence is low.

Methods used in fixing prices under the oligopoly market structure

1. Priceleadershipmodel:in many industries there is a dominant firm and the other, firms, often copy the dominant firm price changes. Hereby dominant firm acts like a price leader
2. Cartel model: hereby firms form a card by agreeing to fix prices or to divide ,the market among themselves or to restrict competition in some other way. Thus firms collude to fix prices or restrict competition so that they can earn monopoly profits
3. Contestable market model: is an oligopolistic model based on barriers to entry and barriers to exit that determine the firm's price and output. If the barriers are high, then the oligopolist will set higher prices. On the other hand, if the barriers are low, then the oligopolist will set low prices to prevent new firms from entering the industry or to promote the exit of its competitors.
4. Non- price competition: Oligopolies try to outwit competitors by non-price competitive like improved products and advertising companies. The reason for non-reluctance to use price is because rivals can easily and quickly match any firms' price reduction. Thus, research and development is critical for oligopolistic firms

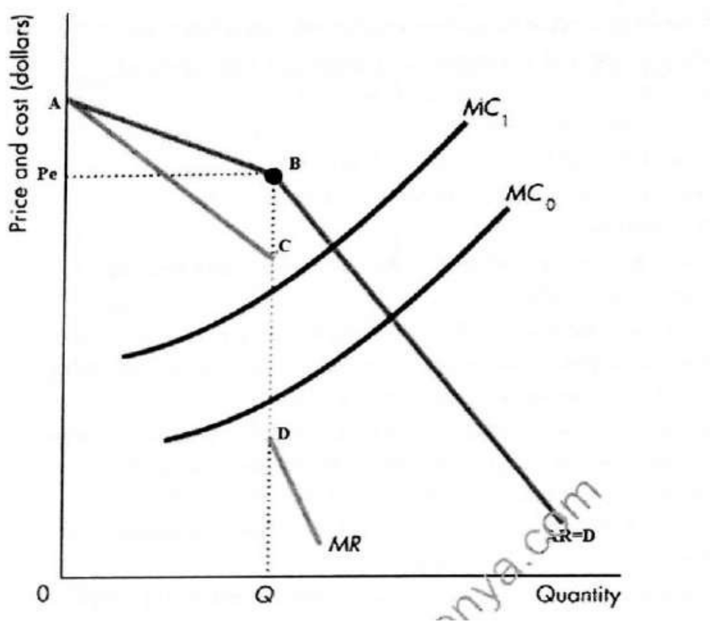
QUESTION 9

May 2019 Question Four A

Equilibrium level of a firm operating under an oligopolistic market structure

An oligopoly is a market structure with few sellers dealing with a differentiated or homogenous product.

Equilibrium position for oligopolistic firm:



An oligopolistic firm maximizes profit at Point where marginal revenue (MR) equal to marginal cost (MC)

The marginal revenue curve is A CD with a discontinuity between D & C.

The demand curve is ABD which is also the average revenue curve. The equilibrium point is point B where there is kink. Above point B, affirm faces elastic demand and if it raises prices then firm will lose customers to other firms. If a firm reduces price past B, then other firms will follow suit to protect market share

QUESTION 10

November 2018 Question Four B

Advantages and disadvantages of a monopoly market structure in an economy

Monopoly is a scenario whereby we have a single seller of a commodity in the market.

Advantages of monopoly:

- No wastage of resources: as there is no competition from other firms, the monopolistic firm does not waste resources in product differentiation and advertising in an effort to capture consumers from rival firms.
- Price maker: since the monopolist is a price maker, prices under a monopoly tend to be more stable than in competition where they are bound to change due to changes in supply and demand beyond the control of the individual firm.
- Research and development
- A monopolistic firm is in better position to carry out research and improve its products than a competitive firm.

- Economies of scale: increased output. Will lead to a decrease in average costs of production. These can be passed on to consumers in the important for industries with high fixed costs, such as tap water and steel production,

- International competitiveness: a domestic firm may have monopoly power in the domestic country but face effective competition in global markets e.g. british steel has a domestic monopoly but faces competition globally. With markets increasingly globalized, it may be necessary for a firm to have a domestic monopoly in order to be competitive internationally.
- Monopoly mostly uses modern technology which enhances production efficiency. Monopoly arising out of amalgamation benefits the shareholders since they are able to enjoy high dividends from the operations.

Disadvantages of monopoly

- Exploitation: exploitation of the consumer is the most notorious practice for which monopolists are known for done with intent to maximize profits and price discrimination lack of innovation: although the firm is in a better financial position, to carry out research and improve its product than a firm in a competitive market, it may not actually do so because of the absence of competition.
- Inefficiency: since there is no competition the firm can be inefficient as it has no fear of losing customers to rival firms
- Diseconomies of scale: while the monopolistic firm can grow to large size and exploit economies of scale, there is danger that it eventually suffers from diseconomies of scale. This will raise its long run average cost and also raise its price.
- Reducing consumer sovereignty
- Restricting choice for consumers.
- Reducing consumer surplus and economic welfare
- Restricting output into the market
- Less employment in the economy as higher prices lead to lower output and less07 need to employ labour
- Less competitive economy in the global market place
- The economy is also likely to suffer from inefficiency, which is the loss of management efficiency associated with markets where competition is limited or absent.

QUESTION 11

November 2018 Question Four D

The maximum level of profit of the firm

Total revenue TR =PQ=

Q(140-2Q)=140Q-2Q^

Profit (TI) = TR-TC

Q = 10

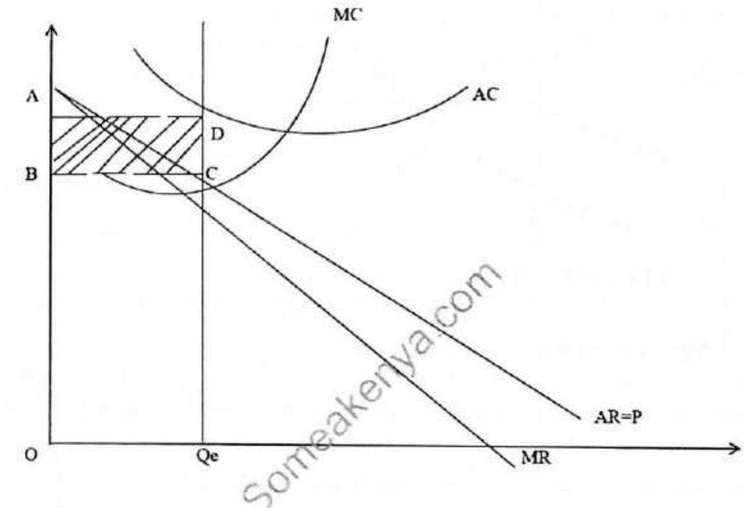
Profit function = 140Q – 7Q^2 – 10

= (140 x 10) – (7 x 102) – 10

= 1400 – 700 – 10

The loss making level of output.

This happens when monopolist firm sells product at a price below its average cost0707



Shaded region ABCD represents the loss made by monopolist firm.

The price charges is OB which is less than the average cost (AC)

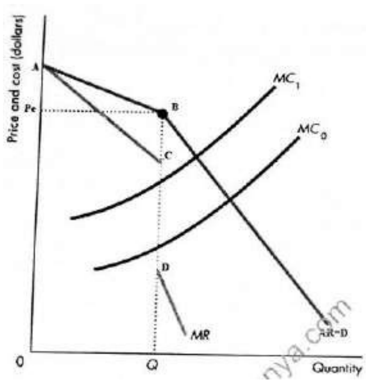
QUESTION 13

May 2018 Question Three C

Normal profit making firm under oligopoly in the short-run

An oligopoly is a market structure with few sellers dealing with a differentiated or homogenous product.

Equilibrium position for oligopolistic firm:



An oligopolisticfirmmaximizesprofitat?Pointwheremarginalrevenue (MR) 15 equal to marginal cost (MC) mea

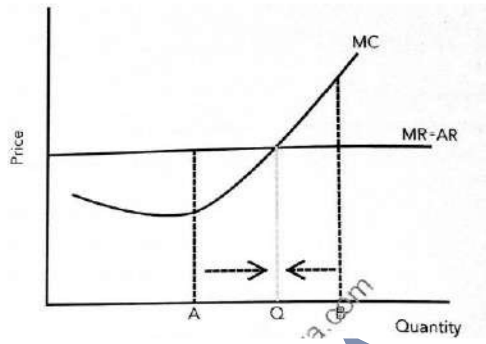
The marginal revenue curve is ACD with a discontinuity between D & C.

The demand curve is ABD which is also the average revenue curve. The equilibrium point is point B where there is kink. Above point B, affirm faces elastic demand and if it raises prices then firm will lose customers to other firms. If a firm reduces price past B, then other firms will follow suit to protect market share

QUESTION 14

May 2018 Question Five C

Why condition marginal revenue equal to marginal cost is only a necessary but not a sufficient condition for profit maximization



- At A, marginal cost is less than marginal revenue, then for each additional unit produced, revenue will be higher than the cost so that you will generate more so keep producing more
- At B, marginal cost is greater than marginal revenue, then for each extra unit produced, the cost will be higher so reduce production.
- At Q, the quantity produced is optimal and that is the point where MC= MR.

QUESTION 15

November 2017 Question A

Explanation of the following types of development plans:

i. Short term plans: These are development plans that will cover a period of one year or less
ii. Medium term plan: Development plans that will cover a period of over one year but a maximum 5 years
iii. Long term plans: Plans that will cover a period of more than 5 years e.g. vision 2030

QUESTION 16

November 2017 Question Four A

Advantages and disadvantages of perfect competition

i. The model of perfect competition describes a market situation in which there are.

ii. Many buyers and sellers ii. The product sold is homogeneous so that a consumer is indifferent as to whom to buy from.
iii. There is free entry and exit out of the industry
iv. Each firm aims at maximizing profit
v. there is free mobility of resources vi. There is perfect knowledge about the market
vi. There is no government regulation and only the invisible hand of the price allocates the resources.
vii. There are no transport costs or if there are, they are the same for all the producers

Advantages of perfect competition

i. Perfect competition achieves an automatic allocation of resources in response to changes in demand.
ii. Perfectly competitive firms are technically efficient in the long run, in that they produce that level of output, which minimizes their average costs, given their small capacity.
iii. It achieves, subject to certain conditions, an allocation of resources which is socially optimal", or "pare to efficient".
iv. The consumer is not exploited. The price of goods, in the long run will be as possible. Producers can only earn a normal profit, which are the minimum levels of profit necessary to retain firms in the industry, due to the existence of free entry into the markets.
v. There is maximum possible consumer surplus and economic welfare
vi. No monopoly power as there are no barriers to entry so existing firms cannot derive any monopoly power

Disadvantages of a perfectly competitive market structure

i. With perfect knowledge there is no incentive to develop new technology because of the ability to share information.
ii. Lack of supernormal profits may mean the investment of research and development is unlikely. This critical for industries like pharmaceuticals.
iii. No scope for economies of scale because of the high number of firms there
iv. There is great deal of duplication of production and distribution facilities amongst firms and consequent waste.

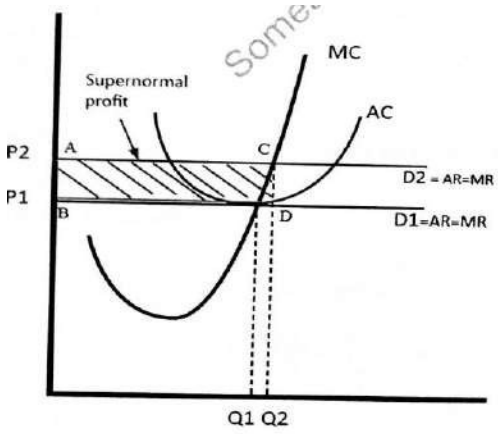
v. Perfectly competitive industries produce undifferentiated products and this lack of variety may be seen as disadvantage to the consumer.

QUESTION 17

May 2017 Question Three E

Condition under which a firm operating under perfect competition market structure would make supernormal profits in the short-run

Supernormal profits can only be made where average cost (AC)is less than average revenue (AR) and marginal revenue (MR) and this only happens in the short term. In the long-term firms will make normal profit.



Since the market price is constant for each unit sold, the AR curve also becomes the marginal737 revenue curve (MR) for a firm in perfect competition

Suppose there is a rise in demand Q1 to Q2, price rises to P2 and a firm makes 0707 supernormal profit in the short-term presented by the shaded region above ABCD.

Other firms will be aware of this fact. Because there are no barriers to entry, firms will be encouraged to enter the market until price falls back down to Pl and normal profits are made.

QUESTION 18

May 2017 Question Four A

Salient features of monopolistic competition

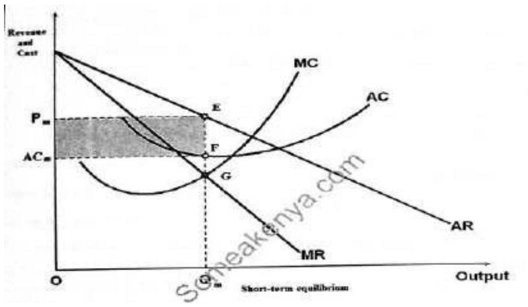
- Large number of buyers and sellers
- More elastic demand
- Free entry and exit of firms Product differentiation.
- Selling cost
- Lack of perfect knowledgeSomeakenya.com
- Less mobility

QUESTION 20

November 2016 Question Three A

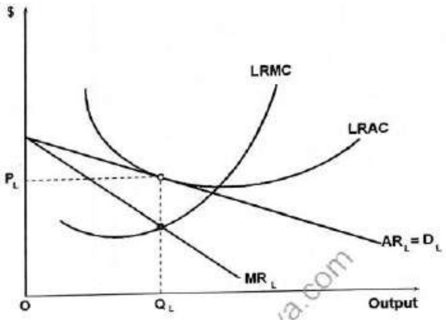
Short run and long run equilibrium positions of a firm operating under monopolistic competition

The profit maximizing level of output occurs at a point where marginal revenue is equal to marginal cost



In diagram above, equilibrium quantity Qm is established at point where Marginal cost is equal to Maginal revenue (MC=MR). The firm is able to collect a price based on the average revenue(AR) curve.That is at Point G. This is the point where profits are maximized too. Price Pm is the price charged for the product which exceeds the average cost (AC). The region shaded above represents the supernormal profits made by monopolist firm.

Long run equilibrium position of a monopolistic firm



Long-run equilibrium of the firm under monopolistic competition. The firm still produces where marginal cost and marginal revenue are equal; however, the demand curve (MR and AR) has shifted as other firms entered the market and increased competition. The firm no longer sells its goods above average cost and can no longer claim an economic

QUESTION 22

May 2016 Question Two B

Disadvantages of the monopoly market structure

- Exploitation: Exploitation of the consumer is the most notorious practice for whichmonopolists are knownfor done withintent to maximize profits andprice discrimination lack of innovation: although the firm is in a better financial position, to carry out researchand improve its product thanafirminacompetitive market, it may not actually do so because of the absence of competition.
- Inefficiency: since there is no competition the firm can be inefficient as it has no fear of losing customers to rival firms.
- Diseconomies exploit economies of scale: of scale, while there the is monopolistic danger that it firm eventually can grow suffersto large fromsize and diseconomies of scale. This will raise its long run average cost and alsoraise its price

- Reducing consumer sovereignty
- Restricting choice for consumers.
- Reducing consumer surplus and economic welfare
- Restricting output into the market
- Less employment in the economy as higher prices lead to lower output and less needtoemploy labour
- Less competitive economy in the global market place
- The economy is also likely to suffer from inefficiency, which is the loss of managementefficiency associated with markets where competition is limited or absent.

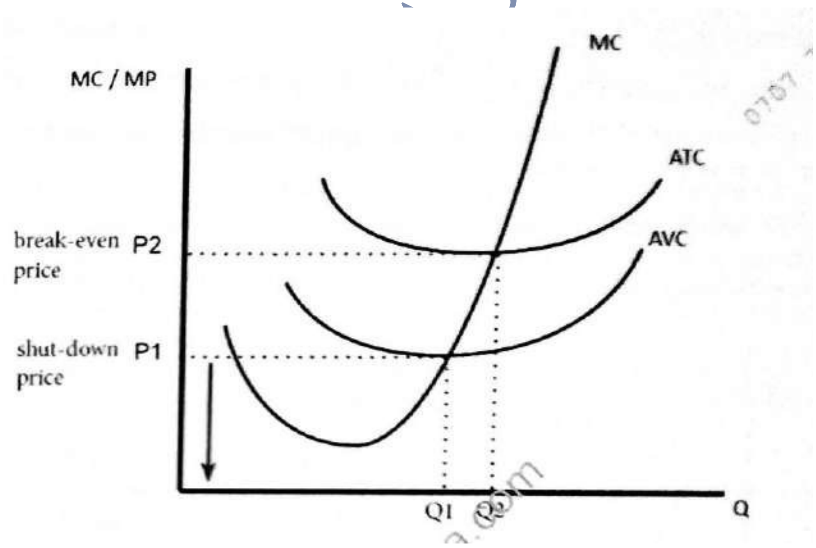
QUESTION 23

May 2016 Question Four B

Close down price of a firm operating unaer perfect competition

The Close down price is also referred to as hut down price and are the conditions and price where a firm will decide to stop producing. It occurs where AR <AVC

- The close down price is said to occur, where price (average revenue AR) is less than average variable costs (AVC).
- At this price (AR<AVC), the firm is making an operating loss. The total revenue is less than operating (variable) costs.

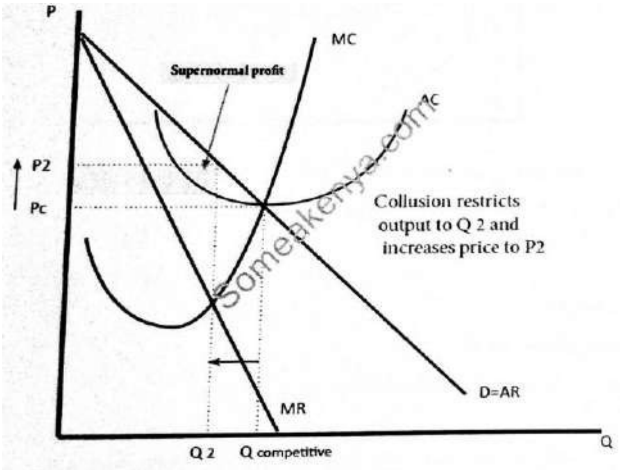


QUESTION 25 737

November 2015 Question Three B

Condition under which a firm operating under oligopoly market structure would make super normal profits in the short-run

For a firm operating under oligopoly market structure to make super normal profits in the short-run if for them to make a collusion. In this case the firms collude on price and set profit maximising levels of output.



In the above example, the industry was initially competitive (Qc and Pc). However, if firms collude, they can agree to restrict industry supply to Q2, and increase the price to P2. This enables the industry to become more profitable. At Qc, firms made normal profit. But, if they can stick to their quotas and keep the price at P2, they make supernormal profit. Collusion is illegal, but tacit collusion may be hard to spot. For collusion to be effective, there need to be barriers to entry. A cartel is a formal collusive agreement.

QUESTION 26

September 2015 Question Two A

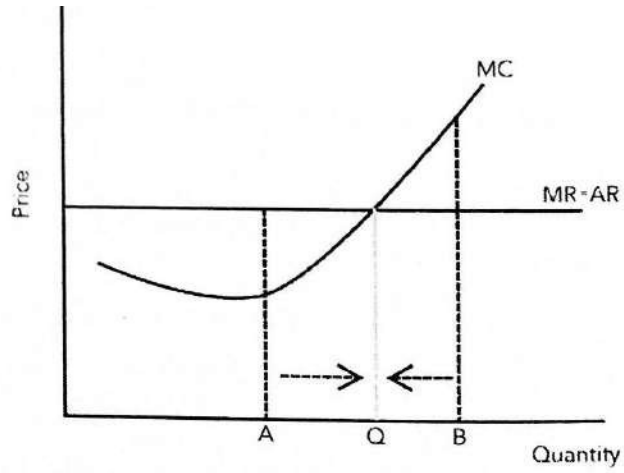
Features of a firm under perfect competition

1. The model of perfect competition describes a market situation in which there are.
2. Many buyers and sellers ii. The product sold is homogeneous so that a consumer is indifferent as to whom to buy from.
3. There is free entry and exit out of the industry
4. Each firm aims at maximizing profit V. there is free mobility of resources
5. There is perfect knowledge about the market
6. There is no government regulation and only the invisible hand of the price allocates the resources.
7. There are no transport costs or if there are, they are the same for all the producers

QUESTION 27

September 2015 Question Two B

MC=MR is just a necessary hut rot sufficient condition for profit maximisation



At A, marginal cost is less than marginal revenue, then for each additional unit produced,revenue will be higher than the costs that you will generate more so keep producing more

At B, marginal cost is greater thanmarginalrevenue,thenforeachextraunit produced, the cost will be higher so reduce production.

At Q, the quantity produced is optimal and that is the point where MC= MR.

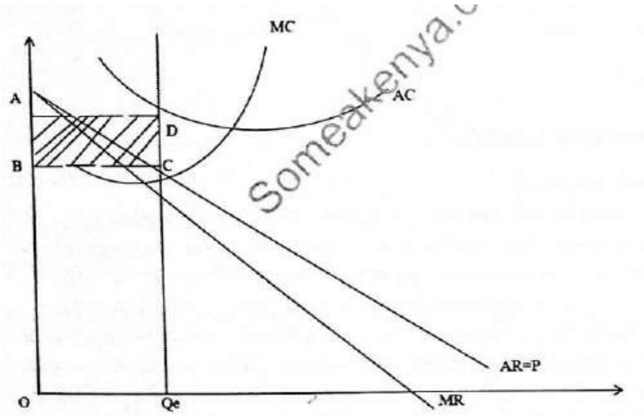
QUESTION 28

September 2015 Question Two A, B, C and D

Conditions for the loss minimisation of a monopolist

This happens when monopolist firm sells product at a price below its average cost

(AR<AC)



Shaded region ABCD represents the loss made by monopolist firm.

The price charges is OB which is less than the average cost (AC)

QUESTION 29 737

September 2015 Question Two A, B, C and D

Types of product differentiation in monopolistic competitive market

1. Differentiation through distribution, including distribution via mail order or through internet shopping, such as Amazon.com, which differentiates itself from traditional bookstores by selling online.
2. Marketing differentiation, where firms try to differentiate their product by distinctive packaging and other promotional techniques for example, breakfast can easily be differentiated through packaging.
3. Human capital differentiation, where the firm creates differences through the skill of its employees, the level of training received, distinctive uniforms, and so on.
4. Physical product differentiation, where firms use size, design, colour, shape performance and features to make their products different. For example, consumer electronics caneasilybephysicallydifferentiated. Kenya

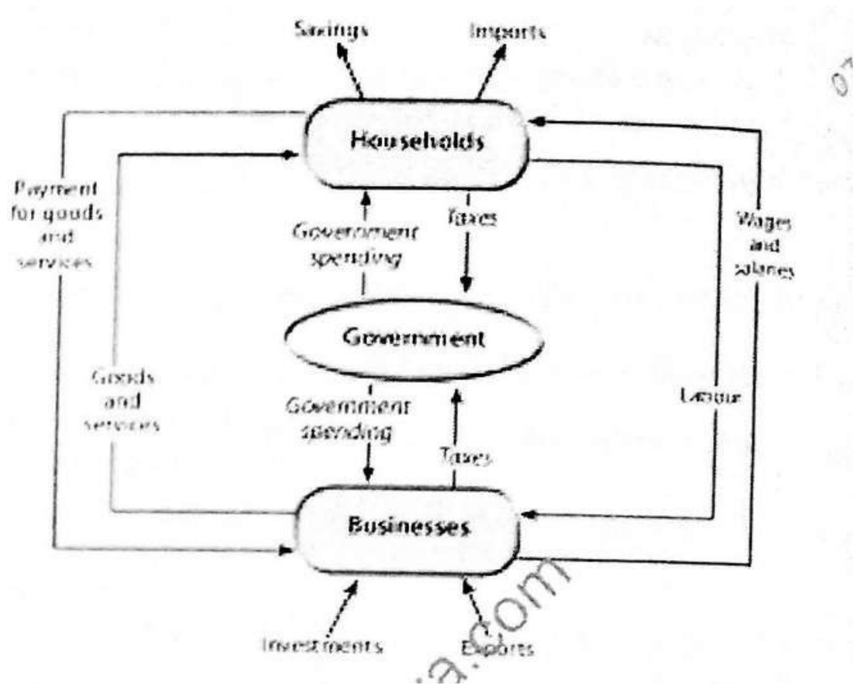
TOPIC 6
NATIONAL INCOME

QUESTION 2

August 2021 Question Three B

Description of the circular flow of income for a closed economy with the existence of the government.

Is an economic model illustrating the flow of payments and receipts between domestic firms and domestic households. The households supply factor services to The firms.Inreturn,they get factor incomes which they use to buy goods and service from the firms. 73



QUESTION 3

August 2021 QuestionFourAand

Uses of consumer surplus,

1. Measuring gains from international trade: consumer's surplus from international transactions enables us to measure gains from international trade.
2. Comparison of living standards: consumer's surplus enjoyed by different people at different places and at different times enables us to compare their living standards. Larger consumer's surplus indicates a higher living standard.
3. Monopoly pricing: while practicing discrimination, a monopolist may charge different prices for the same commodity from the different buyers (i.e higher prices from the affluent buyers and lower prices from others) in such a way that none gets any consumer's surplus.
4. Importance in welfare economics: the concept of consumer's surplus has a great importance in modern welfare economics, for consumer's surplus measures individual welfare is likely to be.

Resolving the paradox of value. The concept of consumer's surplus can also help to resolve the paradox of value. In fact, the concept makes one thing clear At least there is no paradox in a good with high total utility having a lowprice andmarginal utility as long as it is abundant

Implicationsofadeflationary gap in an economy.

1. Rising unemployment: we will get demand deficient employment and possibly high structural unemployment
2. Low / negative rate of economic growth
3. Negative impact on government's budget: with low economic growth, the governmentwillreceive lower tax revenue and lower government spending,
4. Low rates of inflation: possibly, deflation with a deflationary gap, firms have excess capacity, this tends to put downward pressure on prices and wages.
5. Households become more pessimistic on their future job and income prospects. As a result, they spend less on goods and services.
6. In financial markets, investors will usually reduce investment in cyclical companies and commodity based companies. They begintorelocate investment more stable performance duurag an economic slowdown

QUESTION 4

August 2021Question FiveC

Value of each of the following:

Gross national product at factor cost.

GNP at FC = GNP at market price + price subsidies – indirect taxes

= 400 + 10 – 60

= 410 – 60

=$ 350 million

Net national product at factor cost.

NNP at FC = GNP at FC – Depreciation

$ 350 - $ 24

= $ 336 326 million

QUESTION 5

August 2021 Question Seven B

The equilibrium level of:

National income.

Yd =y-T= Y – 10 – 0.2Y = 0.8Y – 10

Y = C + I + G + (X-M)

Y = 100 + 0.6 (0.8Y – 10) + 40 + 50 + 30

Y = 100 + 0.48Y-6+120.

Y -0.48Y=100+120 -6

0.52Y/0.52=214/0.52

Ksh411.54trillion

Consumption.

C = 100 + 0.6Y^d

Y^d = 0.8Y – 10

= (0.8 x 411.54) – 10

= 329.23 – 10

= 319. 23 trillion

C = 100 + (0.6 x 319.23)

= 100 + 197.54

= Ksh 297.54 trillion

Taxes

T = 10 + 0.2Y 0707

= 10 + 0.2 ? 411.54

= 10 + 82.31

Ksh 92.31 trillion

QUESTION 6

November 2020 Question Five B

Relationship between the multiplier and the accelerator.

- Multiplier is the numerical coefficient showing how large an increase in income willresult from each increase in investment. It is the ratio of change in income to the change in investment.

$$\text{Multiplier} = \frac{\textit{Change in income}}{\textit{Change in investment}}$$

- The accelerator shows the reaction (effect) of changes in consumption of an investment. The idea underlying the accelerator is a functional relationship between the demand for consumption of goods and the demand for machines which make them. The accoreration coefficient is the ratio between induced investments to a given net change in consumption expenditures.

Differences between accelerator and multiplier.

Multiplier shows the effect of a change in investment on income and employment whereas accelerator shows the effect of a change in consumption on investment.

Multiplier depends upon the propensity to consume (psychological factors) and accelerator depends upon durability of machines (technological factors)

Multiplier works rigorously in the reduction of income as it does in its increase. But, the working of the accelerator is restricted in the downward direction to the rate of replacement of capital because businessmen can at most disinvest to the extent of not replacing the wearing out capital.

Benefits that might accrue to an economy as a result of accelerator effect. The accelerator principle indicates how changes in the level of current income will have an accelerated impact on the level of investment and is therefore one explanation of economic instability and the upward and downward swings of the trade cycle.

QUESTION 7

November 2019 Question Four A

Reasons that might have residents to fee that despite an increase in per capita income, their living standards were deteriorating

- National income may grow but this says nothing about the distribution of that income. A small group may be much better off. Other groups may have a static standard of living or be worse off.
- Any increase in per capital income may be accompanied by a decline in the general quality of life. Working conditions may have deteriorated. The environment may have suffered from forms of pollution. These non-monetary aspects are not taken into account in the estimates of gross national product. The composition of output may change e.g. more defence related goods may be producedand less spent on social services, more producer goods may be made and less consumer goods and there may be a surplus of exports over imports representing investment overseas. Standard of living depends on the quantity of consumergoodsenjoyed.
- Over time prices will charge. The index of retail prices may be used to express gross national product in real terms but there are well known problems in the use of such methods.
- National income increases when people pay for services which they previously carried out themselves if a housewife takes an office job and pays someone to do her housework, national income will increase to the extent of both persons' wages. Similarly a reduction in national income could occur if a man painted his house rather than paying a professional painter to do the same changes of the above type means that changes in per capita income will only imperfectly reflect changes in the standard of living

- Regional variations in income and spending: national data can hide regional variations in output, employment and income per head of the population.
- Changes in life expectancy:improvementinlifeexpectancydoesn'talwaysshow through GDP accounts a monetary value on the benefits of increased longevity is difficult.

QUESTION 8

November 2019 QuestionFour B

Methods that could be used to measure the national income of a country

- Income method: this method measures national income at the phase of distribution and appears as income paid and / or received by individualsof the country. Thus, under this method, national income is obtained by summing up of the incomes of all individuals in a country. Individuals earnincomesby contributing their own services and the services of their property such as land and capital to the national production.
- Value added approach. This is also called the output method. This involves adding up the total contributions made by the various sectors of the economy.
- Expenditure approach: the approach centres on components of final demand whichgenerateproduction. It thus measures gross domestic product. As the total sum of expenditure on final goods and services produced in an economy.

QUESTION 9

November 2019 Question Four C

Aggregate spending at equilibrium level

$$Y = C + I + G + X - M$$

Where:

C=consumption

I=Investment expenditure

G=Government expenditure

X-M =Net exports

Therefore, Aggregate spending at equilibrium level

$$Y = 200 + 0.8Y + 400$$

$$Y = 600 + 0.8Y$$

$$Y - 0.8Y = 600$$

$$0.2Y = 600$$

$$Y = \text{Sh } 3000 \text{ billion}$$

QUESTION 10 737

May 2019 Question Five D

Investment function

Marginal Propensity to consume MPC =Change in C/Change in Y= 0.6

$Y = C + S$

$S = Y – C$ But $C = 300 + 0.6Y$

Therefore, $= Y – (300 + 0.6Y)$

$S = Y – 300 – 0.6Y$

$S = 0.4Y – 300$

Determinants of consumption in an economy com

1. Rate of interest: Derived from classical economists argument that consumer saves more and spends less when interest rates are high
2. Relative prices: This will affect consumption behavior because people will shift from the highly expensive goods to jess expensive goods.
3. Capital gains: Keynes suggested there is possibility of wind fall gains orlosses influencing consumption. He argued that consumption of the wealthowninggroup might be susceptible to unforeseen changes in the money value of the wealth. This is true where stock exchange market is composed of speculators.
4. Wealth: Greater wealth increases ability to consume because the larger the stock ofwealth, the lower the desire to add to future wealth by curtailing current consumption. The more saving an individual has, the weaker will be the desire to accumulate savings in future.
5. Money stock/liquid assets the possession of liquid assets influences the amount of saving and consumption. This is because liquid assets are easily converted to cash and used for purchase of goods and services.
6. The availability of consumer credit. Availability of credit at low cost leads to consumers more likely to borrow and thereby in aggregate save less at all levels of aggregate disposable income therefore, more borrowing increases consumption holding other factors constant.
7. Attitudes and expectation of consumers: Expectations of income and price changes in future will affect consumer behavior in consumption. For example expectation of future pricerise,may make the consumers to spend more and save less.

QUESTION 11

May 2019 Question Seven A

Why national income statistics should not be used to compare living standards between countries

- Different currencies conversion of these currencies may be tedious
- Different goods and services. The type of goods and services that are used in computing national income may differ from country to country.

- Disparity in distribution of income Although income per capital may be similar in both countries, standard of living may differ significantly because of disparity in income distribution.
- Different needs and tastes. Due to different needs and tastes of people living in different countries, national income statistics may not give a true and fair picture of the standards of living.
- Different sizes of territorial boundaries makes it hard to use national income to gauge standards of living between countries.
- Different price structures between countries is a limitation for comparison hence an apparently higher living standards.
- Existence of different climatic conditions between income levels that become meaningless for comparison.
- Different degrees of accuracy. Which may vary from one country to another, depending on the problems of computing national income figures.
- Different forms of published national income figures. For meaningful comparison both sets of national income figures should be in the same form and units or in money terms, or in real terms but this is not the case for countries.

QUESTION 12

November 2018 Question Four C

The change in the equilibrium level of national income, if the levelofinvestments for the economy increases by Sh.300 million

In this case;

Change in equilibrium level of national income = Investment increase/MarginalPropensity to Save

=300- 0.25

= sh. 1200 million

QUESTION 13

November 2018 Question Six B

Determinants of the level of national income of a country

National income is the total income received by the owners of the factors of production in a given country over a given period of time casually one year, determinants of national income include:

- Foreign investment: increased foreign investments may increase the production of goods and services thereby raising the level of a country's national income. On the other hand, reduced foreign investment may lower the production of goods and services thereby lowering the level of a country's national income.
- Size of the subsistence sector: in a country where the subsistence sector is large, the true level of national income may not be known. National income in such a country may be low especially where the out put is underestimated. This may be the case as it may be difficult to accurately increase the unmarked output.

- Attitude of citizens towards work: a country whose labour force has negative attitude towards work may register low level of national income compared to another country where citizens are hardworking.

- Political of national stability: income of political a country. Stability The is government a crucial factor tat maintains that determines a conducive the size
- Political atmosphere may attract both local and foreign investors, who in turn maycontribute to increasing the size of the national income.
- Level of technology: the technology: the techniques used in the production of goods andservices determine not only the quantity but also the quality of goodsand services produced. The higher the level of technology used in the production process, the higher is the output and hence the higher the national income. For technology to have any meaningful impact on the size of the national income, it must be appropriate.
- Land: land as a factor of production includes all natural resources such as forests, water, minerals, mountains, beaches and climate. The size of national income of a country depends on the natural resource endowment of that country. Therefore, a country with abundant resources is likely to have a high national income relative to a country without the quality of the natural resources will also affect a country's national output.
- Entrepreneurship: the availability of entrepreneurs who have the ability to organize the other factors of production will have a bearing on the country's national income. Where factors are organized in the correct proportions, output is likely to increase thereby increasing the national income.
- Capital: the size of the national income may depend on the amount and quality of the available capital Capital varies from simple tools to modern equipment. A country that uses miodern equipment such as tractors in ploughing, would be able to produce more than a country using simple tools like jembes. Capital is seriously locking in most developing countries and this explains why the size of their national income is less than that of developed countries.
- Labour supply: labour supply refers to the quantity and quality of the work force in a country. A country with more people would be expected to produce more than a country with less people .a country with a more highly skilled labour force would be expected to produce more and higher quality goods and services than a country with less skilled labour force.

QUESTION14

November2018QuestionSeven C

The Gross National Product using the value added approach

Sector	Total output	Intermediate purchases(billions)	Value added(billions)
Agriculture	55000	24000	31000
Manufacturing	96000	63000	33000
Service	71000	42000	29000
Gross national product			93000

Therefore GNP is sh. 93,000 billion

Net domestic product at market price

NDP = GNP – Depreciation

= 93,000 – 26,000

= sh. 67,000billion

Net domestic product at factor cost

NDP at factor cost = GNP – Depreciation – Indirect tax

=93,000-5,000-22,000

=145,000billion

QUESTION 15

May 2018 Question Six B

consumption function

Marginal propensity to consume (PMC)

= 1 -MPS

= 1 – 0.25 = 0.75

Therefore consumption function C = 800 + 0.75

Therefore consumption function C = 800 + 0.75Y

Change in equilibrium national income if the level of investment increased by Sh.1,000 million, determine the

Multiplier =1/MPS= 1/0.25= 4

Change in equilibrium national income

= increase in investment x multiplier

= 1000 x4 = Sh. 4000 million

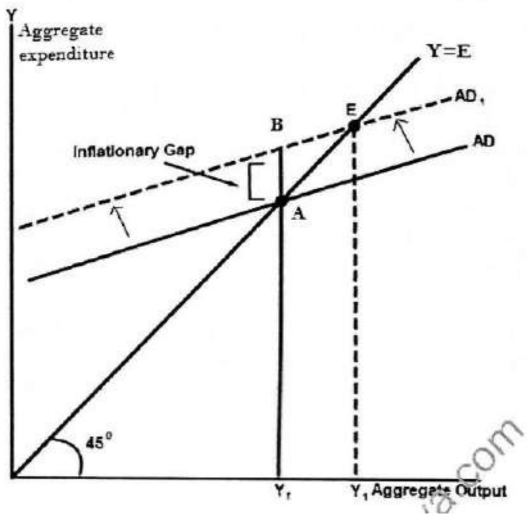
QUESTION 16

November 2017 Question Six C

Distinction between "inflationary gaps"and" deflationary gaps" represented diagrammatically

Inflationary gap

Fulfill Usually It's when this occurs the increased aggregate at a situation demand, demand of the full exceeds average employment the price productive levels due to in the potential theinability economyof the of increases,the economy resulting to in inflation.



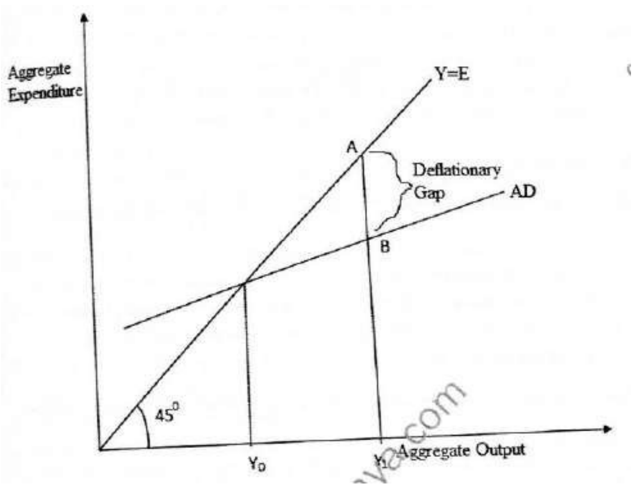
Inflationary gap occurs when aggregate expenditure exceeds aggregate output at the full employment level. This leads to an increase in prices to be able to ration the few goods available in the economy. Thus, equilibrium income increases from Y, ToY1

Measures that can be put in place to reduce inflationary gaps include:-

- Reduce government expenditure
- Increase taxes to reduce disposable income
- Reduce exports

Deflationary gap

This is the difference between the full employment output level and the actual an output. For example in a recession the deflationary gap may be quite substantial indicative of the high rates of unemployment and underused resources. A deflationary gap is also known as a negative output gap.



As indicated above the distance (AB) between the 45 ? line and the aggregate demand line (AD) at the full employment situation is referred to as the deflationary gap. In such a case priceshaveto be reduced to pull demand up to from y to Yf.

Some of the measures to achieve this include:

- Increasing exports
- Reducing taxes
- Increasing government expenditure

QUESTION 17

November 2017 Question Seven C

(NNP) Net National Product at market price

(NNP) net national product= Gross national product- Depreciation allowance

… NNP = 3992 – 570

= sh. 3422 million

Net national product at factor cost

NNP at factor= NNP at market priceless indirect Taxes less subsidies

= 3422 – 524

= sh. 2898 million

Personal Income (PI)

PI= National income + Transfer payment from government – Retained profits Corporate taxes – Employment taxes

= 3992 + 693 – 230 – 214 = sh. 4241 million

Disposal income

Disposal income = PI – Personal taxes

= 4241 -763

= sh.3478million

QUESTION 18

November 2017 Question Seven D

Challenges encountered by economic planners when using the income approach to estimate the level of national income in developing countries.

i. Transfer payments pose a problem since it is difficult to impute the proportion of income constituted by those transfers.

ii. The problem of in accurate data for example i.e. companies do not tell the truth about their income in order to evade tax.
iii. Due to price fluctuation, it is very difficult to calculate the national income accurately.
iv. The problem of handling illegal and unrecorded economic activities which yield income to the recipients such as incomes received by drug traffickers and commercial sex workers.
v. Large informal sector in some countries: many sub-Saharan countries have economies dominated by the subsistence sector where no records are kept,
vi. Double counting: This is brought about by the inability to distinguish between final goods and intermediate goods. The implication is national income be higher than need be.

QUESTION 19

May 2017 Question Three D

The gross national product implicit price deflator for the years 2011 and 2016

GNP price deflator = Nominal GNP/Real GNP x100%

2011 deflator =1.085/1.085x100%=100%

2016 deflator =1.085/1.275x 100%=145.10%

Interpretation:

Inflation was high in2016ascomparedto2011

Using year 2011 as the base year, determine the inflation rate for the economy.

Growth in real GNP 2011 to 2016

= 1.275 – 1.085 = 0.190

% change in rear GNP =1.085x100% = 17.51%

Growth in nominal GNP (2011 to 2016) = 1.85 – 1.085 = 0.765

% Growth in nominal GNP =1.085 x 100% = 70.51%

Inflation rate =(% growth in Number Nominal of GNP years – % growth in rear GNP)/Number of years 2011 to 2016

(70.51 - 17.51)/6

= 8.83%

QUESTION 20

May 2017 Question Five D

Distinction between "multiplier" and "accelerator" as used in national income statistics

Accelerator is the factor by which the increase in income resulting from an initial autonomous increase in investment multiplied by the induced investment whereas the multiplier is a coefficient relating a change in GDP to the change in autonomous expenditure that brought it about

Factors that could limit the application of the multiplier in developing countries

- In less developed countries exports rather than investment are the key injections of autonomous spending
- The size of exports multiplier itself would be affected by the economies dependence on two or three export commodities.
- In poor but open economies the savings leakage is likely to be very much smaller and the import leakage much greater than developed countries
- The difference and fundamental one, in less developed countries in the impact of themultiplieron real output, employment and prices as a result of inelastic supply. Long adjustment period may mean multiplier benefits may not be felt immediately.
- In case of full employment, an increase in demand would be inflationary and hence multiplier effect will be limited.
- The predictability of measures to influence the national income depends on the volatility of the consumption function.

QUESTION 21

November 2016 Question Four C

Limitations of using national income statistics to compare the standards of living between different countries

1. Different goods computing national income may differ from country to country.
2. Disparity in distribution of income. Although income per capital may be similar in both countries, standard of living may differ significantly because of disparity in income distribution.
3. Different needs and tastes. Due to different needs and tastes of people living in different countries, national income statistics may not give a true and fair picture of the standards of living.
4. Different sizes of territorial boundaries makes it hard to use national income to gauge standards of living between countries.
5. Differentprice structures between countries is a limitation for comparison hence an apparently higher living standards.
6. Existence of different climatic conditions between income levels that become meaningless for comparison.
7. Different degrees of accuracy. Which may vary from one country to another, depending on the problems of computing natural income figures
8. Different forms of published national income figures. For meaningful comparison both sets of national income figures should be in the same form and units or in money terms, or in real terms but this is not the case for countries.
9. Regional variations in income and spending: National data can hide regional variations in output, employment and income per head of the population
10. Leisure and working hours and working conditions: An increase in real GDP might have been achieved at the expense of leisure time if workers are working longer hours or if working conditions have deteriorated
11. Imbalances between consumption and investment: High levels of investment as a share of GDP might be superb for creating extra capacity to produce but at the expense of consumer goods and services for the current generation
12. Changes in life expectancy: Improvements in life expectancy don't always show through in GDP accounts. Putting a monetary value on the benefits of increased longevity is difficult

13. The value of non-marketed out put: Much useful and valuable work is in charities, markets self-help at market groups prices. and The of value housework of the might output reasonably of people working be added to national income statistics been available to the richest person on earth less than fiftyyearsago.Abouthalfof what we spend our money on now was not invented in 1870. Examples include air travel, cars, computers, antibiotics, hip replacements, insulin and many other lifeenhancing and life- saving drugs
14. Defensive expenditures: Much spending is to protect against an economic or social bad examples crime, or spending to clean up the effects of pollution and waste.

QUESTION 22

November 2016 Question seven D

Gross national product (GNP)

GNP = (76,000,000 - 37,000,000) + (55,000,000 - 23,000,000) + (111,000,000 - 69,000,000)

= sh 113,000,000

Net Domestic Product at Market Price

NDP = GNP-depreciation

= 113,000,000 - 22,000,000

Sh.91,000,000

Net domestic product at factor cost

NDP at factor cost = NDP at market price - indirect taxes

= Sh 91,000,000 - Sh. 21,000,000

= Sh 70,000,000

QUESTION 23

May 2016 Question Five A

Factors that determine the macroeconomic level of consumption in an economy

1. Rate of interest: Derived from classical economists argument that consumer saves more and spends less when interest rates are high
2. Relative prices: This will affect consumption behavior because people will shift from the highly expensive goods to less expensive goods.
3. Capital gains: Keynes suggested there is possibility of wind fall gains or losses influencing consumption. He argued that consumption of the wealth owning group might be susceptible to unforeseen changes in the money value of the wealth. This is true where stock exchange market is composed of speculators.

4. Wealth: Greater wealth increases ability to consume because the larger the stock of wealth, the lower the desire to add to future wealth by curtailing current consumption. The more saving an individual has, the weaker will be the desire to accumulate savings in future.
5. Money stock/liquid assets the possession of liquid assets influences the amount of saving and consumption. This is because liquid assets are easily converted to cash and used for purchase of goods and services.
6. The availability of consumer credit. Availability of credit at low cost leads to consumers more likely to borrow and thereby in aggregate save less at all levels of aggregate disposable income therefore, more borrowing increases consumption holding other factors constant. en
7. Attitudes and expectation of consamers: Expectations of income and price changes in future will affect consumer behavior in consumption. For example expectation of futureprice(jusris maymaketheconsumerstospendmore and save less.
8. Distribution of income: A change in income distribution affects aggregate consumption if the consumers do not have same average propensity to consume and marginal propensity to consume.
9. Composition of population: The composition of the population in terms of sex, age and classes will determine consumption. For example where there are many children consumption of children related commodities will be high.

QUESTION 24

May 2016 Question Five B

Equilibrium level of interest rate

Equilibrium in the commodity market for closed economy

IS function

$$Y=E$$

$$E=C+I$$

$$Y = 204 + 0.7Y + 300 - 100r$$

$$Y - 0.77Y = 504 - 100r$$

$$0.3Y/0.3=504/0.3-100r/0.3$$

$$Y = 1680 - 333.333r \text{ ..... IS function}$$

Equilibrium at money market for closed economy

LM function

$$MD=MD_T+MD_S$$

$$0.25Y + 248 - 200r$$

At equilibrium money Sosupply (M_S) Equals money demand (M_D)

$$Ms = Ms$$

$$: 0.25Y + 248 - 200r = 600$$

$$0.25Y = 600 - 248 + 200r$$

$$0.25Y/0.25=352/0.25+200r/0.25$$

Y = 1408 + 800r ………….. LM function

Equilibrium interest rate

IS function = LM function

168-333.333r = 1408 + 800r

800r + 333.333r = 1680 - 1408

1133.333r/1133.333=272/1133.333= 0.24 or 24%

Equilibrium level of national income

$$Y = 1408 + 800r$$

$$= 1408 + (800 \times 0.24)$$

$$= 1408 + 192$$

= Sh1600Million

QUESTION 25

November 2015 Question Four A

Problems associated with the expenditure approach of measuring national income

- No accurate records of expenditure are kept especially in the private sector.
- Expenditure for the subsistence sector can only be mere approximates due to lack of records in this sector.
- Differentiating between final expenditure and intermediate expenditure and intermediate expenditure may be difficult.
- It suffers from the problem of double counting
- Fluctuating exchange rates may pose challenges especially in valuation of exports and imports.

QUESTION26

November2015Question Four C

The consumption function

Saving function S = 500 + 0.36Y

MPS =Change in S/Change in Y =0.36

MPC = 1 - MPS = 1 - 0.36 = 0.64

Therefore consumption function C = 500 + 0.64Y

Equilibrium level of national income

$$Y = C + I + G + (X - M)$$

$$Y = 500 + 0.64Y + 8000$$

$$Y = 8500 + 0.64$$

$$Y - 0.064Y = 8500$$

Y= Shs.23,611.11 Million

The Multiplier

Multiplier =1/MPS=1/0.36

= 2.778

QUESTION 27

November 2015 Question Seven C

Net National Income at factor cost (NNI_{FC})

NNIFC = GNP_{MP}- Indirect taxes + Subsidies - Depreciation

= 620.4 + 0 - 36.5 - 42.3

= Sh 541.6 Million

Net national product at market price (NNP_{MP})

NNP_{MP} = NNP_{FC} + Indirect taxes- Subsidies

= 541.6 + 36.5

= Sh 578.1 trillion

Personal income (PI)

=NI + Transfer payments from government -Corporate retained profit-Corporate income tax - employment taxes.

= 620.4+78.6-18.2=Sh. 680 trillion

Disposable income for country "X"

Disposal income=Pl-Personal taxes

= sh 624.7 trillion

QUESTION 28

September 2015 Question one A

Distinction between" Gross Domestic Product and "Gross National Product"

Gross Domestic Product refers to the money value of all goods and services produced within a country in one year including net factor income from abroad. Gross National Product is a measure of all output of citizens of a country working within the country or outside the country less income earned by foreigners in the country.

Reasons for the lower value of the gross national productinthelessdeveloping countries

This is becausemost businesses are owned by foreign nationals

QUESTION 29

September 2015 Question one B

Gross national product

GNP = G + I + C + X - M + (P - Q)

Where:

G = Government spending

I = Investment spending

C = Consumer expenditure

X = Exports

M = Imports

P - Q = Net factor income from abroad

: GNP = 6,750 + 18/500 + 5,750 + 250 + 8,750 - 9,250

=Sh.30,750million

Net national product

NNP + GNP - Depreciation

= 30750 - 3500

= Sh. 27,250 million

National Income (NI)

NI = NNP - Indirect business taxes

= 27,250 - 0

= Sh. 27,250 million

Personal income (PI)

PI= NI + transfer payments from government - corporate tax - employment taxed social security contribution

= 27250 + 675 - 2500 - 500 - 750

= Sh 24,175 Million

Disposable personal income (DPI)

DPI = PI - Personal income taxes

TOPIC 7

ECONOMIC GROWTH, ECONOMIC DEVELOPMENT AND ECONOMIC PLANNING

QUESTION 1

December 2021 Question Four B

Factors that determine the economic development of a country.

- Human resources
- Physical output
- Quantity and availability of natural resources
- Improvement in technology
- Political freedom
- Corruption
- Conditions in the foreign Someakenya.comtrade
- Social organization
- Economic system

QUESTION 2

August 2021 Question Six B

Effects of Covid-19 pandemic on the world economy.

- School closures
- Reduction in government tax revenue due to reduction in economic growth
- Income losses
- Business closures
- Reduced productivity
- Loss of life
- Trade disruption
- Decimation of tourism industry

QUESTION 3

May 2021 Question Three C

Factors that might hinder Kenya from realising the objective.

- Project mismanagement - most of cash borrowed ends up in pockets of a few due to corruption. Consequently, this leads to incomplete projects with high over run and time delays. If such projects were well done, then they could have generated revenues which could have helped in financing debt payments.
- Decline inflow of concessional assistance and a result greater reliance costly borrowing.

- Persistent inflationary pressures

- Aggravation of balance of payment deficit by oil crisis.
- Limited productive use of resources
- Low export earnings
- Lack of political will - lack of commitment and political will by politicians since they have higher level of decision making.
- Limited range and effectiveness of policy instruments.
- Unanticipated economic disturbances e.g. covid 19
- Over ambitious plan that do not take inte account the realities on ground. E.g. tax revenue collection. Someake
- Foreign dominion
- Inflation
- Natural calamities Insecurities
- Poor planning in its self
- Non-coordination of various policy making organs
- Lack of public participation and ownership by the public.

Measures that might be put in place in order to overcome the impediments in (c) (i) above or solutions

- Population growth control through family planning education programs.
- Moving towards greater investment in research and development which will lead to greater use of natural resources.
- By the formation of regional trading blocs in order to expand markets hence export earnings.
- Preparation of realistic development plans.
- War on corruption to ensure funds are used for the intended purpose
- Political instability should be addressedbyforminganinclusivegovernment

QUESTION 4

May 2021 Question six A

Term "economic integration".

Refers to the merging to various degrees of the economies and economic policiesoftwo or more countries in a given region

Factors that limit successful economic integration in developing countries.

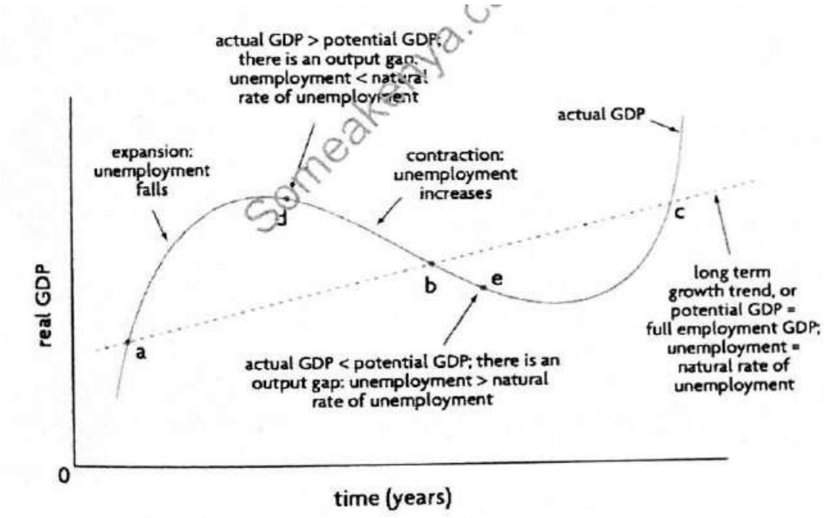
- Indispensable high capital import content - most developing countries are not in a position to sufficiently produce capital goods and other input forthe production of goods hence continued vulnerability to foreign influence and dominance. This is traced to wide spread poverty and minimal technical progress.
- Product similarity duplication - because of product similarity especially primary products regional number countries have not lived to substantial benefit as would be required. What one country produces is equally produced by others so that the overall relative market share remains distinctively small.
- Unequal distribution of trade benefits / gain - Although all countries gain to a certain extent one member country may benefit more than the others. This often rises due to high subsidization of production so that one country may succeed in attracting a more than

proportionate share of new industrial development. In particular income and employment opportunities will increase more than proportionately due to the multiplier effect.

- Government loss of tax revenue - removal of traffic (import duties) leads to reduced tax revenue to the government with free trade , in countries where import duties constituted a high proportion of tax revenue, the government spending programme will be distorted.
- Neo colonialism and dependence mentality - the psychological influence arising from massive and persuasive advertising by the developed world has largely role - modeled the consumption pattern (taste and preferences) of people in developing countries. Preferences has been given to products which do not originate from the region. This then forcesregionalmembercountriesto import such products in order to meet domestic demand.
- Trade diversion
- Wide spread conflictsand general politicalinstabilities.

QUESTION 5

May 2021 Question Seven C



QUESTION6

November2020Question Four C

Explanationofthe term "economic planning"

As per H.D Dikinson, economic planningisthemakingofmajoreconomicdecisionsbyn, the conscious decision of a determinate authority, on the basis of a comprehensive survey of a country's existing and potential resources and a careful study of the needs of the people on the basis of the available resources and the needs of the people, development plans for a definitive period are prepared beforehand by the central planning authority and then the economic activities of the country are directed towards the implementation of the plans.

QUESTION 7

November 2020 Question Four D

Characteristics of a good economic plan

Definite objective:

The most significant characteristic of economic planning is that it should possess definite objectives. Planning means conscious and deliberate undertaking for a definite objective. For instance, economic planning has the objective to accelerate the rate ofgrowth,elimination of trade cyclesbringing the stability and attain full employment in the economy.

Central planning authority:

The existence of a central planning authority is another feature of economic planning. This central planning authority is responsible to prepare different schemes of development and coordinating the various activities. The central planning authority takes all decisions relating to production and consumption in an economy.

Democratic character:

Another pioneer feature is its democratic nature. No doubt, various plans are prepared by experts but at the same time, adequate opportunities are provided to the people to actively participate at various levels. Being federal structure of Indian Constitution, the Union Government only uses its fiscal, monetary and physical controls to guide and give direction in consequence with the five year plans.

Only an advisory role of planning commission:

In the decentralized set up of planning. Planning Commission is the apex body. It provides the necessary perspective, guidance and coordination. Furthermore, it serves as a close link between different agencies so that functioning may besmooth. In this regard, planning commission is an advisory character.

Comprehensiveness:

Another important characteristic of planning is its comprehensiveness in scope. As central planning authority takes all decisions regarding production, consumption and distribution, thus, it must cover the entire economy which must be comprehensive in scope. In other words, planning must be effective so that the planning of one sector may not be nullified by the absence of planning in other sectors.

Planning for consumption:

In a centrally planned economy, it should not be confined to production alone but at the same time, it must cover the distribution and consumption also. In other words, the planning authority should not decide what and how to produce but it must keep in mind and decide accordingly among whom it is to be distributed.

Rational allocation of resources:

Generally, in under-developed countries, available resources are scarce and these resources are allocated in such a manner as to get maximum social welfare. It needs to fix up priorities relating to economic development, thus, allocation of resources in accordance to these fixed priorities.

These scarce resources are also allocated to eliminate wastages for maximizing social welfare, coordinating inter sector and international plans into a single unified unit which, in turn, promotes economic development in an economy.

Feasible policies and targets:

A good planning is based on the initial resources of the country to achieve the feasible goals and policies. In this way, domestic resources are planned for attaining economic stability.

QUESTION 8

November 2019 Question Seven A

1. **Reasons of inequalities in the distribution of income and wealth in an economy**
2. Inequality can arise from differences in:-
3. Pension rights
4. Inheritance
5. Ownership of financial assets
6. Type of job
7. Unemployment
8. Experience/age
9. Skills and training
10. Education, school, college, degree

QUESTION 9

November 2019 Question Seven B

Benefits of development planning in an economy

- Development planning is defined as the utilization by the government of a coordinated group of policy instruments for the purpose of attaining desired goals within a specified time frame benefits of development planning include:
- Resource mobilization and allocation argument this implies that planning will assist in selecting and co-ordinating investment projects and investing in more viable ventures.
- Attitudinaler physiological argument? Development planning assists the government to determine the sectors in a national campaign to eliminate poverty, ignorance and disease amongst social groups, race, tribes and religious groups. Market failure argument market failure results to gross disparities between social and private valuations of alternative investment projects thus, with development planning there will be optimal resource allocation in a country.
- Foreign aid argument: existence of a detailed development plan will be used by the government to convince and persuade donors to give aid, because the donations will specify on how it will be used.
- Due to disorganized commodity and factor markets that may contribute to poor allocation of resources. But with development planning, all thesemisfitswillbe avoided.

QUESTION10

May2019QuestionFourB

Reasonsforfluctuationsinprices of agricultural products

- Perishable nature of products: most agricultural products are perishable and 737 cannot be stored for long and especially since storage facilities would be very expensive to establish and maintain.

- Inelasticity of demand- since agriculture products are used in small quatities as inputs (raw material) in manufacturing processes, they are purchased in small quantities, thus production may not always be sufficient to achieve the required periodic level of supply. Inelastic demand makes it difficult to sell excess without depressing prices significantly.
- Weather conditions: good weather can lead to unexpectedly large increase in supply which can lead to agreed on the market and falling prices. Also diseases and bests can affect the supply causing prices to rise.
- Processing: most of the farm products have te be processed before their consumption by the ultimate consumers. This processing function increases the price spread of agricultural commodities. Variation inequality of products: there is a large variation in the quality of agricultural products, which makes their grading and standardization somewhat difficult. There is no such problem in manufactured products since their quality is uniform.
- Bulkiness of products(The characteristic of bulkiness of most farm products makes their transportation difficult and expensive. This fact also restricts the location of production to somewhere near the place of consumption or processing , the price spread in bulky products is higher because of the higher costs of transportation and storage.
- Small size of holdings and scattered production: farm products are produced throughout the length and breadth of the country and most of the producers are of small size. This makes the estimation of supply difficult and creates problems in marketing.

QUESTION 11

May 2019 Question six C

Causes of high levels of external dept. in developing countries

- Low export earnings.
- Limited productive use of resources
- Aggravation of balance of payment deficit by oil crisis. 0707 Large scale lending by western banks in the wake of recessionary conditions within the developed countries. Persistent inflationary pressures
- Decline in flow of concessional assistance and as a result greater reliance on costly borrowing.
- Deterioration in the terms of trade for primary producing countries.
- High interest rates: interest charged is too high thus most of developing cash is spent on servicing dept payments rather than on development spending.
- Project mismanagement. Most of cash borrowed end up in pockets of few due to corruption. Consequently, this led to incomplete projects or projects with high overruns and time delays. If such projects were well done, then they could have generated revenues which could have helped in financing dept payments

- Devaluation of third world currencies this is duete balance of payment deficits and high inflation in developing. This has created dept countries servicing problems

QUESTION 12

November 2018 Question Seven B

Obstacles to industrial development in developing countries

- High input costs such as rising labour costs, unreliable and expensive energy and expensive and low quality raw materials.
- Poor infrastructure facilities e.g. roads, rails which hampers the accessibility and competitiveness of local manufacturer in local and regional markets.
- Low firm productivity: capital productivity is low) compared to regional and global productivity levels.
- Counterfeit products: the entry into the local markets has fairly reduced the market share of locally manufactured products. It has also reduced government revenue base, discouraged innovation efforts and some are health hazards to consumers. Lack of investment in an industrial knowledge base, innovation, research and development uptake in manufacturing limits the growth of modern methods of manufacturing in the country. The lack of knowledge, high cost and fear of change has led to low technology uptake.
- Lack of awareness on intellectual property right hinders the development 737 registration and protection of new innovationsinthemanufacturingsector.There are limited technical and managerial skills, there is generally poor linkage between the industry and training institutions.
- In adequate capacity of industries to meet product quality standards and ISO certification limits their efficiencies and product qualities. This also makes consumers reluctant to trust these firms and their products or services.

QUESTION 13

May 2018 Question Three D

Determinants of economic development

- Natural resources: availability of natural resources in an important factor in a country's economic development.
- Political stability: political instability can lead to civil war and complete economic breakdown. Political stability leads to growth when there is a political freedom citizen are likely to have a say in the development process. Countries that have political stability attract more foreign direct investment and foreign aid which helps in improving technology and innovations
- Education
- Infrastructure
- The use of appropriate technology

- Technical know-how: as the scientific and technological knowledge advances, man discovers more and more sophistical techniques of production which steadily raise the productivity levels Economic system

- Conditions in foreign trade
- Capital formation growth

QUESTION 14

November 2017 Question two B

Ways to tackle rising external debt in developing countries

- Reducing costing of projects: proper valuation of projects will assist in reduction 890 of debt unlike current scenario of inflated project costs.
- Elimination of low priority expenses wasteful spending e.g. huge amounts spent by public officials in benchmarking trips and foreign travel should be reduced Reduction in public wage bill: for case in Kenya around 60% of tax revenuesare spent in paying salaries and wages. This means the government has to borrow to finance development projects. A reduction in wage bill can meanreleaseoffunds for development in medium term and
- Establishing a public debt management office. This will be charged with formulating policies on public debt and implementing them to ensure the sustainability of public debt.
- Developing the financial markets: the government raises funds it needs from borrowing in financial markets. Thus, well functioning capital and money markets are critical to help meet financing needs of the government.
- Coordination of monetary and fiscal policies to minimize or ensure no conflict exists between them. This avoids destabilizatien of financial markets since a wellcoordinated monetary and fiscal policy may lead to a lower public debt burden. Identification of alternative methods to fund large infrastructure projects like public private partnerships which will reduce public debt burden. War on corruption to ensure that borrowed funds are spent to achieve intended goals.
- By the formation of regional trading blocs in order to expand export markets and hence export earnings.C Alleviate balance of payment problems by an export promotion policy which is a policy closer to free trade
- Soliciting increased debt forgiveness given the debt burden is already crushing better use of borrowed funds could be ensured by the use of conditionally by multilateral agencies.

QUESTION 15

May 2017 Question Four B

Economic reforms that could be put in place to boost the growth of the informal sector in developing countries

- The sector government .should charge low interests on borrowings made by informal sector businesses
- The government should urge informal sector workers to form co-operative societies that assist the informal sector to mobilize funds
- The government should search for commodities produced by informal sector locally & internationally.
- The government should support and regulate the development of informal businesses.

QUESTION 16

November 2016 Question Four A

Strategies that could be implemented by governments in developing countries to spur growth in the industrial sector

- Adoption of modern technology in production
- Infrastructure development
- Trade and investment reforms e.g. reduction of tariffs on exports.
- Imposing import restrictions
- Formation of trading blocks
- Increased incentives for industries to relocate in rural areas e.g. tax incentives and government subsidies to small scale industries. Investment in human resources e.g. trade programs.
- Reforms on the financial markets should be done to ensure efficiency and flexibility.
- The issue of corruption and resource management should be incorporated in the school curriculum.
- Trade and investment reforms should be encouraged e.g. export promotion & import substitution programs.

QUESTION 17

November 2016 Question Seven C

Challenges that hinder successful achievement of national development targets set by developing countries

- Lack of trained staff: non availability of experienced and trained staff is a hindrance for development planning. Political interference and corruptions.
- Lack of capital.
- Inflation
- Plans are over ambitious
- Foreign domination
- Unanticipated economy factors
- Natural calamities
- Insecurity
- Lack of public participation and ownership by the public Poor planning in itself .Co
- Non-coordination of various policy making agents.

QUESTION 18

May 2016 Question Three A

Policy measures that developing countries could adopt to reduce regional imbalances

- Devolution of resources e.g. from national government to county governments Special programmes for development of backward and less developed areas. There should be separate areas. There should be a separate development programme for each region bases on region - wise techno economic surveys.

- Policies for development of irrigation, agriculture and related activities.
- Policies aimed at industrialization of lagging regions through an industrial location policy whereby large industrial estates are set up near small towns in backward areas and all initial facilities provided by concerned national / county government. Policies aimed at providing infrastructurel facilities such as transport, communications, banking etc in backward regions.

TOPIC 8

MONEY AND BANKING

QUESTION 1

December 2021 Question three A and B

Effects of expansionary fiscal policy in an economy.

- This involves the government seeking to increase aggregate demand through higher government spending and/or lower tax. It has the following effects:
- Lower income tax may increase the incentive to bank
- Higher government spending on education and training, could increase long-term labour productivity and help the long-term trend rate of economic growth.
- Accelerating economic growth
- Rising interest rates
- Rising budget deficits

Qualities of money as a medium of exchange.

- Acceptability: It should be acceptable to everyone to settle transactions e.g gold and silver
- Portability: Should be easy te transport from one place to another
- Durability: Money must not easily deteriorate, either in itself or as a result of wear and tear
- Homogeneity: All portions or specimens of the substance used as money should be homogenous, that is of the same quality, so that equal weights have exactly the same value
- Divisibility: The money material should be capable of division and the aggregate value of the mass after division should be almost exactly the same as before. Malleability: The money material should be able capable of being melted, beaten and given convenient shapes
- Cognizability: Money should have distinct marks which nobody can mistake Stability of value: Money should not be subject to fluctuations in value

QUESTION 2

December 2021 Question Five C

Limitations of the loanable funds theory of interest rates.

- Assumes full employment: Keynes opined that loanable funds theory is based on the unrealistic assumption of full employment. As such, this theory also suffers from the defects as the classical theory does.
- Indeterminate: Like Classical theory, loanable funds theory is also indeterminate. This theory assumes that savings and income both are independent but savings depend on income. As the income changes, savings also change and so does the supply of loanable funds
- Savings not interest elastic: The theory overemphasis the influence of the rate of interest on savings. It regards savings as interest elastic. Generally speaking, people save not to car rate of interest but to satisfy precautionary motive. So savings are interest clastic.

- Cash balances not elastic: The loanable funds theory states that the supply of loanable funds can be increased by releasing cash balances of savings and decreased by absorbing cash balances into savings This implies that the cash balances are cash clastic. This is incorrect because the total cash balances available with the community are fixed and equal the total supply of money at any time

QUESTION 3

August 2021QuestionThreeC

Factors that may limit independence of the central bank

Making the appointees of central bank board of directors appointed by politicians. This makes them to be loyal to appointing authority.

Approval of central bank budgets by a body other than it. Thus, they may be starved of funding if they don't dance to the tune of budget approval authority.

Legislation like interest capping law was an attempt by parliament to direct the central bank on what to do.

QUESTION 4

August 2021 Question Seven A

Explanation of the term "credit creation".

The ability of banks to create deposit money is what is referred to as credit creation.It depends on the fact that bank need to be only fractionally backed by notes and coins, This737 is because the bank does not need to keep 100% reserves. It can use some of the money deposited to purchase income yielding investments.

Factors that limit the effectiveness of credit creation by commercial banks.

1. Leakages: Imply the outflow of cash. The credit creation process may suffer from leakages of cash.
2. Amount of cash: the higher the cash of commercial banks in the form of deposits, the more will be the credit creation. However, the amount of cash to be held by commercial banks is controlled by the central bank. The central bank may expand or contract cash in commercial banks by purchasing or selling government securities. Moreover, the credit creation capacity depends on the rate of increase or decrease in cash reserve requirement by the central bank.
3. Cash reserve requirement: Refers to reserve ratio of cash that need to be kept with the central bank by commercial banks. The main purpose of keeping this reserve is to fulfil the transaction needs of depositors and to ensure safety and liquidity of commercial banks. In case, the rapid falls, the credit creation would be more and vice versa.
4. Habits of people: The habit regarding cash holding can affect credit creation.
5. Preferences for liquidity will mean less liquidity on the part of the bank which will be forced to lend less. In"countries where banking system is less developed, people prefer to hoard cash. This reduces the credit creation power of banks.

6. Business environment: loans are taken only when sound investment opportunities are available. Deposits tend to go down in depressions and recessions. The business environment is a critical factor which determines credit volume.
7. Lack of securities: banks cannot expand deposits by granting loans and advances unless proper securities are available. Crowther observes, "The banks does not create money out of thin air, it transmutes other forms of wealth into wealth." the total volume of income yielding securities available in the country sets the overall limit to the process of credit creation.

QUESTION 5

May 2021 Question Two A

Effects of removing interest rate capping in /Impact of interest rate decontrol in an economy

- It leads to appreciation of local currency 0707
- It leads to an improvement in the country's balance of payment position.
- It leads to an increase in foreign investments
- Increases investment and promotes employment creation
- The government earns revenue through taxes from increase in investment and employment.
- Encourages investment in the banking industry.
- High interest rate discourages borrowing leading to a reduction in money supply which helps to control inflation.

QUESTION 6

May 2021 Question Four A

Causes of a deflationary gap in an economy

Fall in investment due to a banking collapse and credit control

Fall in consumer spending doe to higher interest rate and falling wages. Economic growth falls below the average trend rate of growth. That is aggregate demand increasing at a slower rate productive capacity.

Fall in money supply - a central bank may use a tighter monetary policy by increasing interest rates. Thus, people instead of spending money immediately prefer to save more of it. In addition, increasing interest rate led to higher borrowing cost which also discourages spending in the economy.

Technological advances - advances in technology or rapid application of new technology in production can cause an increase in the aggregate supply. Technological advances will allow producers to lower costs. Thus, the prices of products will likely go down.

Lower production cost - a decline in price for key production input. E.g. oil will lower production costs. Producers will be able to increase production output, which will lead to an oversupply in the economy. If demand remains unchanged producers will need to lower their prices on goods to keep people buying them.

QUESTION 7

May 2021 Question Four B

The term "monetary policy".

Refers to action taken by a country's central bank to control money supply and achieve macroeconomic goals that promote sustainable economic growth.

Objectives of monetary policy in an economy.

- Full employment - full employment is the foremost objective of monetary policy. It is an important goal not only because an employment leads to wastage of potential output but also because of the loss of social standing and self-respect.
- Price stability - one of the policy objectives of monetary policy is to stabilize the price level. Both economist and laymen favor this policy because fluctuations in prices bring uncertainty and instability to the economy.
- Economic growth - one of the most important objectives of the monetary policy in recent years has been the rapid economic growth of an economy. Economic growth is defined as the process whereby the real per capital income of a country increases over a long period of time.
- Balance of payment - another objective of monetary policy since the 1950s has been to maintain equilibrium during the balance of payment.
- Currency exchange rate - using its fiscal authority a central bank can regulate the exchange rate between domestic and foreign currencies .For example the central bank may increase the money supply by issuing more currency. In such a case the domestic currency becomes cheaper relative to its foreign counter parts.

QUESTION 8

May 2021 Question Seven A

Roles of commercial banks in an economy (May 2016 Q 4c)

- They provide a safe deposit for money and other valuables.
- They provide a safe and non-inflation means of debt settlement through the use of cheque in that number cash is actually handled this is critical where large sums are involved.
- They offer management advisory services especially to enterprise which borrow from them to ensure that the loans are utilized properly. They act as agent of the central bank in dealings involving foreign exchange on behalf of the central bank and issues travelers' cheque on instructions of the central bank.
- They lend money to borrowers partly because they charge interest on the loan which is a source of income for them and partly because they usually lend to commercial enterprise and help in bringing development. Banks provide a payments mechanism clearing system source of notes and coins for the public.
- Acting as financial intermediary
- Help exporters and importers.
- Insurance broker
- Leasing
- Debt factoring
- Unit trust business

QUESTION 9

November 2020 Question FiveA

Factors that determine the velocity of money in circulation

Velocity of money refers to the average number of times a single unit of money changes hand in an economy during a given period of time

Factors affecting velocity of circulation include;

- Payment system: Affected by the frequency with which labour is paid (weekly, monthly, bi-monthly) and how fast the bills for various goods are settled. Regularity of income: Regularity of income and enables people to spend their money more freely leading to a rise in velocity of circulation
- Frequency of transactions: As the number of transactions increases so does the velocity of money
- Value of money
- Volume of trade
- Credit facilities available in the economy Business conditions

QUESTION 10

November 2020 Question Six A

Reasons for differential interest rates in an economy

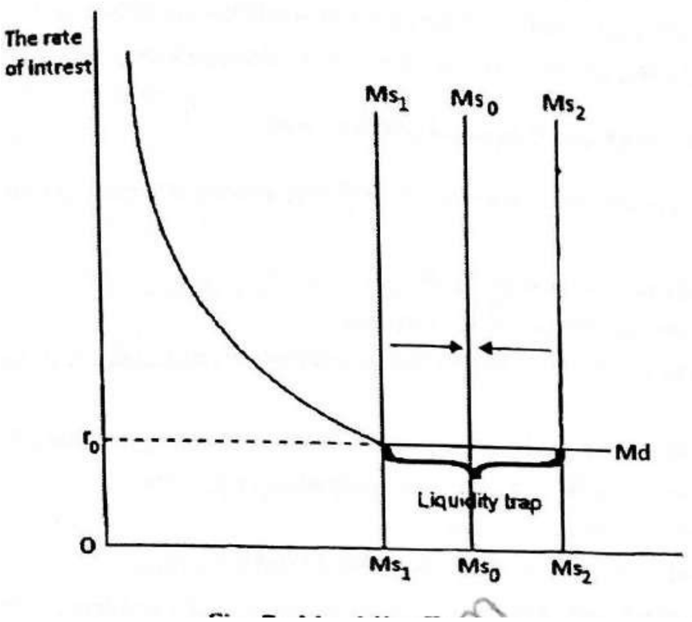
- Differences in risk
- Period of loan
- Nature of security
- Volume of loan
- Financial standing of the borrower
- Market imperfection
- Variation in demand and supply of money

QUESTION 11

November 2020 Question Six B

Concept of liquidity trap

Liquidity trap is a situation when expansionary monetary policy (increase in money supply) does not increase the interest rate any come and has does not stimulate economic growth. It is a situation in which the general public is prepared to hold on whatever amount of money is supplied, at a given rate of interest. They do so because of the fear of adverse effects like deflation and war. In such a case, monetary policy is powerless to affect the interest rate. There is a liquidity trap at short-term zero percent interest rate. When the interest rate is zero, public would not want to hold any bonds, since money, which also pays zero percent interest, has the advantage of being usable in the transactions.



QUESTION 12

November 2020 Question Six C

Reasons for interest rate decontrol.

- Encourages investment in the banking industry.
- High interest rate discourages borrowing leading to a reduction in money supply which helps to control inflation.
- The government earns revenue through taxes from increase in investments and employment. This is because interesting the controls increases in investment and employment. This is because interest decontrols increases investments and promotes job creation.
- It leads to an improvement in the country's balance of payment position.
- It leads to an increase in foreign investment. This is critical source of foreign currency in an economy.
- It leads to appreciation of local currency.

QUESTION 13

November 2020 Question Six D

Reasons that make it possible for commercial banks to create credit.

Market forces; Availability of profitable lending opportunities increase is credit creation.

Regulatory policies e.g. capital reserve requirements. A low reserve ratio means banks can loan out more.

Availability of securities; refers to securities against which banks grant loan. Thus, availability of securities is necessary for granting loan otherwise credit creation will not occur

Monetary Policy: Level of policy interest rates influence the aggregate demand for loans. Availability of deposits: Deposits made by customers make credit available

QUESTION 14

November 2019 Question Five A

Benefits of a contractionary monetary policy to an economy

- The main purpose is to slow down inflation that accompanies a booming economy.
- Stabilizing prices: Inflation causes ever increasing prices, which can adversely impact consumer spending power. This price fluctuation can make consumers nervous and erratic in their spending patterns. A monetary contraction policy stabilizes prices in the market as the inflation slows. This increase in consumer confidence keeps the economy on even level and encourages state spending patterns.
- Contradictory monetary policy leads to a decrease in bond prices and an increase in interest rates. Higher interest rates make domestic bonds more attractive, so the demand for domestic bonds increases lending to an inflow of foreign capital.

QUESTION 15

May 2019 Question one A

Explain the Keynesian liquidity preference theory of demand for money

As per lord John Maynard Keynes, the rate of interest is determined by the :supply of. Money and the desire to hold money. Money is the most liquid asset,.Moreover,as perKeynes,the three motives for holding money include:

- Transactions motive: holding money to meet the day today expenses
- Precautionary motive : holding money to take care of unexpected occurrences
- Speculative motive: holding cash to take care of profitable opportunities that might arise.

Criticisms of Keynesian liquidity preference theory of demand of money

- One sided: it lays more emphasis on liquidity preference i.e. demand side and completely ignores the analysis of factors on supply side.
- For advanced economies: applicable mostly in developed countries which have well organized and wide money markets and people make choices in speculative markets amongst different types of securities. As such, it does not apply in backward developing economies, where the choice of assets is limited..
- The Keynesian theory explains interest in the short run only. It gives no clue to the rates of interest in the long run
- Keynes ignores saving or waiting as a source or means of investible funds. To part with liquidity without there being any saving in meaningless.
- This theory does not explain the existence of different rate of interest prevailing in the market at the same time.
- Liquidity preference is not the only factor governing the rate of interest there are several other factors which influence the rate of interest by affecting the demand for and supply of investable funds.

- Interest rate is not purely a monetary phenomenon. Real forces like productivity of capital and thriftness also play an important role in the determination of the rate of interest.

QUESTION 16

May 2019 Question Six D

Functions of non-banking financial institutions in an economy

As per World Bank, non-banking financial institutions are financial institutions that do not have a full banking license and do not accept deposits from the public.

Functions of non- banking financial institutions

- They build confidence in investors e.g. insurance companies that provide cover to businesses.
- Act as a channel for donor funds
- They lend money for specific purposes
- They support investments in those areas that are not supported by commercial banks.
- Provide investment capital/ long term loans to existing and new businesses
- They carry out feasibility study for potential investors.
- Create employment in the economy
- They generate revenue to the government through taxes
- Provide advisory services to investors on how to set and run businesses Mobile savings for development
- Financial markets development: NBFIS form a significant part of financial markets. They under write public issues of corporations. They provide much needed capital to new startups through venture capital. They are source of liquidity in these markets. The effective functioning of financial markets largely depends on NBFIS.

QUESTION 17

May 2019 Question Seven C

The IS function

A closed economy is a country with no interaction with outside world in form of exports and imports and there is also no interaction with outside world in form of exports and imports and there is also no government intervention in form of government spending and taxation in a closed economy national income (Y) equal to expenditure (E)

$$\text{Therefore } Y = E$$

$$E = C + I$$

$$\text{Thus } Y = C + I$$

Where

Y: -> National income

E - Expenditure

C - Consumption spending

I -> Investment

Thus, IS Function

$Y = 200 + 0.4Y + 1900 - 12r$

$Y = 200 + 1900 + 0.4Y - 12Y$

$Y = 2100 + 0.4y - 12r$

$y - 0.4 = 2100 - 12r$

$0.6/0.6=2100/0.6-12r/0.6$

$Y=-3500-20r$……….. IS function

LM function

In money market, equilibrium is said to exist when money demand is equal to supply

$$MD = MD_T + MD_S$$

$$= 0.5 + 100 - 10r$$

$$\dots MD = MS$$

$$1500 = 0.5Y + 100 - 10r$$

$$0.5Y = 1500 - 100 + 10r$$

$$0.5Y/0.5+1400/0.5+10r/0.5$$

$Y=2800+20r$……………..LM function

The equilibrium level of interest rate

$$3500-20r=2800+20r$$

$$20r+20r=3500-2500$$

$$40r/40=700/40$$

$$r = 17.5\%$$

Equilibrium national income solving for Y by taking the LM function.

$$Y = 2800 + 20r =$$

$$2800 + (20 \times 17.5)$$

$$= \text{sh. } 3150 \text{ million}$$

QUESTION 18 Tanya.com

November 2018 Question Five A

Negative effects of contractionary monetary policy in an economy

A contractionary monetary policy is a type that is intended to reduce the rate of money supply expansion to fight inflation negative effects of a contractionary monetary policy.

- Increased unemployment: an unwanted side effect of a contractionary monetary policy is a rise in unemployment. The economic slowdown and lower production causes firms to hire fewer employees. Therefore, unemployment in the economy increases.
- Slow down economic growth: reducing the money supply usually slows down economic growth. As the money supply in the economy decreases, individuals and businesses generally halt major investments and capital expenditures and companies slow down their production.
- Contractionary monetary policy can lead to lower valuation of equity which can deter household consumption as they perceive. Value of their wealth to be lower.
- It can lower equity prices of firms which decrease their net worth and there will be higher concerns for adverse selection of borrowers by banks. Reduces credit availability and reduces working capital of firms.
- It leads to an increase in interest rates which worsens the debt payment obligations of companies.

QUESTION 19

May 2018 Question Two A

Determinants of money supply in an economy

Money supply is the total quantity of money in an economy at a point in time. Also called supply of money.

Determinants of money supply include:

- Money multiplier: Money multiplier has a positive influence on money supply with an increase in money multiplier leading to an increase in money supply and vice versa.
- Monetary base: This refers to the supply of funds available for utilization either as reserves of central bank or cash. Monetary base is a key influencer of money supply and it changes due to the policy of government and it is also influenced by money value.
- Reserve ration: This is the amount of deposits that central bank requires banks to keep either at branches or certain bank. A lower cash reserve ratio leads to credit expansion by banks which increases the money supply and vice versa .
- Value of money: The values of money in terms of other goods and services has positive influence on monetary base and hence on the money supply.
- Seasonal factors: They have a negative effect on the money multiplier and hence on the money stock multiplier and hence on the money stock. During holiday periods, the currency ration will tend to rise, thus, reducing the money multiplier and thereby the money supply.

- Interest rates: interest rates have a positive effect on the money multiplier and hence on the money supply. A rise in interest rates will reduce the reserve ratio, which versa.raises the money multiplier and hence increases the money supply and vice

- Time - deposit ratio: A rise in time deposits in comparison with demand deposits201 reduces money multiplier and therefore the supply of money decreases
- Velocity of money: The extent to which the economy is monetized for example if the economy is majorly barter trade oriented then supply of money will be less.

QUESTION 20

May 2018 Question Five B

Methods government can use to strengthen its currency

Intervening in the forex markets through the purchase of its currency thereby pushing its price

- Reduce inflation
- Increase interest rates e.g. on treasury bills and bonds
- Revaluation
- Long term supply side policies

QUESTION 21

May 2018QuestionFiveC

Differences between the "quantity theory of money" and the "liquidity preference theory of money"

The quantity theory of money states that quantity of money is some proportion of the total spending in an economy and implies the quantity equation of exchange.

$$\textit{Money supply x velocity} = \textit{price} \times \textit{real output}$$

Holding velocity and real output constant, any increase in the money supply with lead to a proportionate increase in the price level.

According to liquidity preference theory of money, money is held to help meet transaction, precautionary and speculative reasons.

Differences between"quantity theory of money"and the"liquidity preference theory of money" are as detailed below.

i. According to quantity theory of money real output is constant. This is because they assumed the economy is always at full employment. But as per keyness the proponent of liquidity preference theory of money, an equilibrium could exist even when resources are not fully employed. Keynes argued that output determines employment. Lastly, since the economy is not always at full employment that shows that output levels are unstable and not constant.
ii. Whereas quantity theory of money assumed that money only as a medium of exchange, Keynes asserted that money is a store of value and standard of deferred payment,
iii. According to quantity only real variables will influence rear output but keynes related a real variable(interest rate) in determining a monetary variable.

iv. Keynes assumed that there was only one asset whereas for quantity theory of money we had three assets.

v. Modern quantity theory of money predicts that interest rate changes have little effect on money demand unlike liquidity preference of money

QUESTION 22

November 2017 Question One C

- **Functions of money**
- Medium of exchange: hereby money is used to facilitate day to day transactions. Unit of account: money is used to measure and record financial transactions as also to value goods or services produced in a country over time.
- Standard of deferred payment: hereby money permits post-ponement of spending from the present to some future occasion. Also refers to expressing value of debt.
- Store of value: this can refer to any asset whose "value" can be used now or used in the future i.e. its value can be received at a later date. This means that people can save now to fund spending at a later date.

QUESTION 23

November 2017 Question Two A

Relevance of interest rates in an economy

They are key factor when valuing assets like bonds, commodities and stocks. Their values will change as interest rates stimulate asset values. But a highly indebted economy is unable to a cope with a sharp increase in interest rates as debt results to quick upward movements in interest rates which affects economic growth adversely.

Interest rates change more often than people realize. Low interest rates mean people generate less income from savings made on the other hand high interest rates stifle capital investment, disseminate the bond market and reduce capital spending.

QUESTION 24

November seven Question B

Contractionary monetary policy measures to combat inflation.

- Increasing the reserve requirement for cash the implication is that there will be less money for commercial banks to lend out and this decreases money circulation in the country.
- Selective credit control in which case the central bank can raise margin requirements and regulate consumer credit with the aim of lowering money supply thereby controlling inflation.
- The central bank can adopt the use of open market operations. To help achieve the central bank will sell short term securities e.g treasury bills which lowers money supply thus reducing inflation.

- Increasing the discount rate which increases the rates at which commercial banks lend. Higher interest rates make it expensive for individuals to obtain loans and this reduces spending thus controlling inflation.

QUESTION 25

May 2017 Question Five A

Monetarists view on the quantity theory of money

Monetarists view on the quantity of money..In monetary economics the quantity theory of money states that the general price level of goods and services is directly proportional to the amount of money in circulation or money supply.

QUESTION 26

May 2017 Question Five C

Advantages of interest rate decontrols in an economy

- It leads to appreciation of local currency
- It leads to an improvement in the country's balance of payment position
- It leads to an increase in foreign investments.
- Increases investments and promotes employment creation
- The government earns revenue through taxes from increase in investments and employment.
- Encourages investment in the banking induce
- High interest rate discourages borrowing leading to a reduction n in money money supply which helps to control inflation.

QUESTION 27

November 2016 Question Six A.

Determinants of the rate of exchange of a country's currency

- Inflation rate: leads to currency depreciation
- Interest rates: a decrease in interest rates leads to depreciation of currency and vice versa
- Government taxation: a decrease in taxation leads to appreciation of a currency Speculation: if there is speculation that a particular currency will depreciate, this leads to a depreciation of the currency.
- Prevailing political situation: political instability leads to the depreciation of a currency.
- Balance of payment: A surplus in balance of payment leads to appreciation of a currency.

QUESTION 28 737

November 2016 Question Six B

Role of the central bank in an economy

- Issue of notes and coins
- Governments banker
- Bankers bank: hereby central bank acts as the clearing house of commercial banks
- Operating monetary policy
- Banking supervision Managing national debt
- Lender of last resort
- Stabilizes exchange rates.

QUESTION 29

November 2016 Question Seven B

Advantages of a floating exchange rate system in an economy

- Floating exchange rate system is one in which exchange rates is determined by demand supply forces. It has the following advantages:
- Flexible exchange rates adjust to terms of trade shocks and thus dampen the effect on output and employment.
- Floating exchange rate prevents rapid inflation in a country.
- Floating exchange rate provides an indication of relative scarcity of a currency which leads to better allocation of resources.
- Floating exchange rate permits a gradual smooth and automatic adjustment for a country's exchange rate
- Floating exchange rate enables maintenance of lower reserves of foreign currencies to defend domestic currency. Thus, more reserves are more likely to facilitate more investment and production.
- Floating exchange rate leads to automatic stabilization, since balance of payment dis equilibrium can be rectified by changing the exchange rate.

QUESTION 30

May 2016 Question Two A (II)

Distinction between the following sets of terms as used in economics ii) "Narrow money" and "broad money"

Narrow money refers to financial assets which perform the functions of money. Refers basically to currency in circulation and demand deposits broad money on the other hand includes financial assets, but not as liquid as narrow money plus time deposits, deposits in non bank financial institutions, foreign exchange deposits a fall resident in country and treasury bills

QUESTION 31

May 2016 Question Four C

Roles of commercial banks in economic development

- They provide a safe deposit for many, and other valuables.
- They provide safe and non-inflation means of debt settlements through the use of cheques, in that no cash is actually handled. This is critical where large sums are involved.
- They offer management advisory services especially to enterprises which borrow from them to ensure that the loans are utilized properly.
- They act as agents of the central bank in dealings involving foreign exchange on behalf of the central bank and issue travellers Cheques on instructions from the central bank.
- They lend money to borrowers partly because they charge interest on the loans, which is a source of income for them, and partly because they usually lend to commercial enterprises and help in bringing development.
- Banks are employers: banks have opened branches across the country, which has led to creation of job opportunities for the people.
- Filler utilization of resources: savings pooled by banks are employed to a greater extent for development purposes.
- Financing the government: to this end banks helps government to meet its financing needs by taking part in purchase of securities issued by government e.g treasury bills and bonds. The funds raised can be used to facilitate development93 like infrastructure spending.

QUESTION 32

May 2016 Question Six C

Functions of non- banking financial institutions

As per World Bank, non banking financial institutions are financial institutions that do not have a full banking license and do not accept deposits from the public.

Functions of non- banking financial institutions businesses.

- They build confidence in investors e.g. insurance companies that provide cover to
- Act as a channel for donor funds
- They lend money for specific purpose
- They support investments in those areas that are not supported by commercial Banks.
- Provide investment capital long term loans to existing and new businesses
- They carry out feasibility study for potential investors.
- Create employment in the economy
- They generate revenue to the government through taxes
- Provide advisory services to investors on how to set and run businesses Mobile savings for development

- Financial markets development: NBFIS form a significant part of financial markets. They under write public issues of corporations. They provide much needed capital to new startups through venture capital. They are source of liquidity in these markets. The effective functioning of financial markets largely depends on NBFIS.

QUESTION 33

May 2016 Question Six D

Ways in which government could use fiscal policy to stimulate economic growth

Fiscal policy is a government's decision concerning spending and taxing the government in an attempt to raise economic growth can use an expansionary fiscal policy which can entail:

i. The government can cut taxes. The lower income taxes will increase disposable income and encourage consumer spending which boosts economic growth.
ii. The government can also increase spending e.g. infrastructure spending high government spending will create jobs and provide an economic stimulus.

QUESTION 34

November 2015 Question Five A

Instruments of monetary policy that could be used to control the level of money supply in an economy

- Moral suasion and direct control: the central bank can attempt simply to use "moral suasion to persuade the commercial banks to restrict credit when they wish to limit monetary expansion. Its effectiveness depends on the co-operation of commercial banks.
- Open market operations. The central bank can either purchase or sell securities issued by the government to affect money supply. For example central bank can purchase government bonds. As a result, banks will obtain more money to increase the lending and money supply in the economy.
- Discount rate: A central bank can influence interest rates by changing the discount interest rates by changing the discount rate. The discount rate is an interest rate charged by a central bank to banks for short-term loans for example, if central bank increases the discount rate, the cost of borrowing for the banks increases. Subsequently the banks will increase the interest rate they charge their customers. Thus, the cost of borrowing in the economy will increase and the money supply will decrease.
- Reserve requirements: central banks usually set up the minimum amount of reserves that must be held by a commercial bank by changing the required amount, the central bank can influence the money supply in the economy. If monetary authorities increased the required reserves amount, commercial banks find less money available to lend to their clients and thus money supply decreases.
- Supplementary reserve requirements: if the central bank feels that there is 07too much money in circulation, it can in addition require commercial banks to maintain over and above cash or liquid assets some additional reserves In the form of special deposits. The commercial banks are asked to maintain additional deposits in their accounts at the central bank deposits which cease to count among their reserve assets as a cover for their liabilities.
- General and selective credit control: These are imposed with full apparatus of the law or informally using specific instructions to banks and other institutions. For instance, the central bank can dictate a ceiling value to the amount of deposits the bank can create. This is more effective in controlling bank lending than cash and liquidity ratio. It can also encourage banks to lend more to certain sectors of the economy e.g. agriculture than in other e.g. estates building.

QUESTION 35

November 2015 Question Five B

Factors that limit the effectiveness of monetary policies in developing countries

- Shortage of real factors: There is a shortage of real factors like capital, entrepreneurial ability etc.therefore monetary policy can do nothing about it. Non-banking financial institutions: According to Gurley and Shaw, non-banking financial institutions like CC life insurance corporations, state financial institutions and other credit financial institutions greatly hampers, the achievement of objectives of monetary policies in a less developed countries.
- Disequilibrium in a balance of payments: In less developed countries, monetary expansion generally leads to increased imports and unfavorable balances of payment. This puts a limitation on monetary policy.
- Limited application of weapons of credit control: in the developing economies, people mostly rely on currency in circulation and bank deposits which forms only a small proportion of money supply. This being the case weapons of credit control have only limited application.
- Lack of honesty: In underdeveloped countries administrative honesty and firmness are not very rigorous. This leads to the problem of tax evasion, antisocial elements, black money etc. this parallel economy helps speculations and illegal trading and thereby reduce the efficiency of monetary policy

- Only persuasive policy: generally monetary policy in developing countries is 737 soft, lenient, persuasive and this leads to ineffectiveness. As its role is not 7 compulsivebutpermissiveonlywhichcreatesseriouslimitontheefficiencyof monetary policy.

- Black money: in underdeveloped countries, large quantity of black money exist due to political and economic factors. Black money is used for activities such as hording and speculative etc. as a result, it hinders the true spirit of the various objectives of monetary policy.
- Deficit financing: In the modern world, deficit financing is the main source of financing development activities. But heavy doses of deficit financing has proved inoperative to achieve the objectives of monetary policy. For example,monetary wants to check the supply of money while deficit financing helps to increase its supply. Thus, how can those factors operate simultaneously?
- High liquidity: a large proportion of commercial banks posses high liquidity so that they are not influenced by the credit policy of central bank. This makes monetary policy ineffective.
- Undeveloped money and capital markets; The money and capital markets are undeveloped. These markets are undeveloped. These markets lack in bills and stocks which limit the success of monetary policy. Foreign banks: in almost every developing country foreign owned commercial banks exist. They also render monetary policy less effective by selling foreign assets and drawing money from their head offices when the central bank of the country is following a tight monetary policy.

QUESTION 36

November 2015 Question seven A

Determinants of money supply in an economy

Money supply is the total quantity of money in an economy at a point in time. Also called supply of money.

Determinants of money supply include:

- Money multiplier: Money multiplier has a positive influence on money supply with an increase in money multiplier leading to an increase in money supply and vice versa.
- Monetary base: This referstothesupplyoffundsavailableforutilizationeither737 as reserves of central bank or cash. Monetary base is a key influencer of money supply and it changes due to the policy of government and it is also influenced by money value.
- Reserve ration: This is the amount of deposits that central bank requires banks to keep either at branches or central bank. A lower cash reserve ratio leads to credit expansion by banks which increases the money supply and vice versa.
- Value of money: The values of money in terms of other goods and services has positive influence on monetary base and hence on the money supply.
- Seasonal factors: They have a negative effect on the money multiplier and hence on the money stock multiplier and hence on the money stock. During holiday periods, the currency ration will tend to rise, thus, reducing the money multiplier and thereby the money supply.
- Interest rates: interest rates have a positive effect on the money multiplier and hence on the money supply. A rise in interest rates will reduce the reserve ratio, which raises the money multiplier and hence increases the money supply and vice versa.
- Real income: A rise in real income will tend to increase the money multiplier and thus the money supply multiplier and monetary policy: influences money supply positively or negatively depending on whether its expansionary or contractionary an expansionary monetary policy e.g. through lowering reserve requirements, will increase the money multiplier and thus the money supply and vice versa.
- Time – deposit ratio: A rise in time deposits in comparison with demand deposits reduces money multiplier and therefore the supply of money decreases
- Velocity of money: The extent to which the economy is monetized for example if the economy is majorly barter trade oriented then supply of money will be less.

QUESTION 37

November 2015 Question seven B

Differences between commercial banks and non-banking financial institutions

- Commercial banks provide current account facilities/issue cheque books while non-bank financial institutions do not provide current account facilities.
- Commercial banks are regulated by the central/banking act while non-bank financial institutions are not regulated by banking act but other acts.
- Commercial banks provide foreign exchange services while nonbank financial 737 institutions do not exchange foreign currency.

- Commercial banks offer safety locker facilities while non-bank financial0707 institutions do not offer safety locker facilities.
- Commercial banks provide short term loans while non-bank financial institutions provide long term loans.
- Commercial banks lend money to all sectors while non-bank financial institutions lend to specific sectors.
- Commercial banks are members of clearinghouse/clear cheques through clearing house while non-bank financial institutions do not participate in clearing cheques.

QUESTION 38

September 2015 Question C

Functions of money

- Medium of exchange: hereby money is used to facilitate day to day transactions.
- Unit of account: money is used to measure and record financial transactions as also to value goods or services produced in a country over time.
- Standard of deferred payment; hereby money permits post-ponement of spending from the present to some future occasion. Also refers to expressing value of debt.
- Store of value: this can refer to any asset whose "value" can be used now or used in the future i.e. its value can be received at a later date. This means that people can save now to fund spending at a later date.

QUESTION 39

September 2015 Question A

Instruments of monetary policies

The instruments of monetary policy used by the Central Bank depend on the level of development of the economy, especially its financial sector. The commonly used instruments are discussed below.

- Reserve Requirement: The Central Bank may require Deposit Money Banks to hold a fraction (or a combination)of their deposit liabilities(reserves) cash and or deposits with it. Fractional reserve limits the amount of loans banks can make to the domestic economy and thus limit the supply of money. The assumption is that Deposit Money Banks generally maintain a stable relationship between their reserve holdings and the amount of credit they extend to the public.
- Open Market Operations: The Central Bank buys or sells ((on behalf of the Fiscal Authorities (the Treasury)) securities to the banking and non-banking public (that is in the open market). One such security is Treasury Bills. When the Central Bank sells securities, it reduces the supply of reserves and when it buys (back) securities-by redeeming them-it increases the supply of reserves to the Deposit Money Banks, thus affecting the supply of money.
- Lending by the Central Bank: The Central Bank sometimes provide credit to Deposit Money Banks, thus affecting the level of reserves and hence the monetary base.
- Interest Rate: The Central Bank lends to financially sound Deposit Money Banks at a most favorable rate of interest, called the minimum rediscount rate (MRR). The MRR sets the floor for the interest rate regime in the money market (the nominal anchor rate) and thereby affects the supply of credit, the supply of savings (which affects the supply of reserves and monetary aggregate) and the supply of investment (which affects full employment and GDP).

- Direct Credit Control: The Central Bank can direct Deposit Money Banks on the maximum percentage or amount of loans (credit ceilings) to different economic sectors or activities, interest rate caps, liquid asset ratio and issue credit guarantee to preferred loans. In this way the available savings is allocated and investment directed in particular directions.
- Moral Suasion: The Central Bank issues licenses or operating permit to Deposit Money Banks and also regulates the operation of the banking system. It can, from this advantage, persuade banks to follow certain paths such as credit restraint or expansion, increased savings mobilization and promotion of exports through financial support, which otherwise they may not do, on the basis of their risk/return assessment.
- Prudential Guidelines: The Central Bank may in writing require the Deposit Money Banks to exercise particular care in their operations in order that specified outcomes are realized. Key elements of prudential guidelines remove some discretion from bank management and replace it with rules in decision making.
- Exchange Rate: The balance of payments can be in deficit or in surplus and each of these affect the monetary base, and hence the money supply in one direction or the other. By selling or buying foreign exchange, the Central Bank ensures that the exchange rate is at levels that do not affect domestic money supply in undesired direction, through the balance of payments and the real exchange rate. The real exchange rate when misaligned affects the current account balance because of its impact on external competitiveness. Moral suasion and prudential guidelines are direct supervision or qualitative instruments. The others are quantitative instruments because they have numerical benchmarks.

TOPIC 9

INFLATION AND UNEMPLOYMENT

QUESTION 1

December 2021 Question Four A

Explanation of the term "hidden unemployment".

Refers to a portion of the labour force involved in redundant work with very minimal to no production. It does not impact the aggregate output of an economy eg for a small family farm with ten employees doing the same work if three or four individuals were to discontinue working, the overall output of the farm would remain unchanged. The three or four individuals can be seen as providing disguised unemployment

QUESTION 2

December 2021 Question Seven A

Definition of the term "inflation targeting".

This is central bank strategy of specifying an inflation rate as a goal and adjusting monetary policy to achieve that rate inflator targeting primarily focuses on maintaining price stability, but is also believed by its proponents to support economic growth and stability

Disadvantages of inflation targeting in a country.

- Can conflict with economic growth
- Economies may need higher inflation
- Limited guide to economy
- Inflexible
- Unrealistic in nature
- Side effects

QUESTION 3

August 2021 Question Two C

Reasons why devaluation in developing countries tends to be inflationary.

1. Imports will be more expensive. Any imported good or raw material will increase in price yet developing countries are heavy importers of most things.
2. Aggregate demand increases causing demand pull inflation.

3. Exporters have less incentive to cut costs because they can rely on the devaluation to improve competitiveness. The concern is in the long-term devaluation may lead to lower productivity because of the decline in incentives

QUESTION 4

May 2021 Question Four C

Reasons why developing countries are concerned about the high rate of unemployment in their countries. (May 2018 Q7 A)

- Exploitation of labour: Due to unemployment labourers are exploited. They have to accept low wages and work under un-favourable conditions.
- Industrial disputes: Industrial disputes alise because of unemployment. It has adverse effects on employer-employee relations. Due to industrial disputes, the unemployment rises.
- Political instability: There is political instability in the country due to unemployment. Unemployed persons engage themselves in destructive activities. They consider Governments, worthless. Economic development becomes difficult under conditions of political instability.
- Social problem: Many social evils like dishonesty, gambling and immorality etc. arise due to unemployment. It endangers law and order situation of the country. It causes social disruption in the society.
- Increase in poverty: Under the situation of unemployment a man has no source of income. Unemployment causes poverty. Burden of debt increases. Economic problems increase.
- Loss of human resources: Due to unemployment, human resources go waste. No constructive use of labour force is made. If human resources are properly used, economic growth of the country will increase.

QUESTION 5

November 2020 Question Four B

Difference between ”seasonal unemployment” and ”frictional unemployment”

Seasonal unemployment occurs when there is a limited need for a type of work to be performed during a particular period of the year, based on factors such as deadlines or climate. For example, in Kenya employees in tourism sector are in high demand during July to September peak season after which most people are rendered jobless.

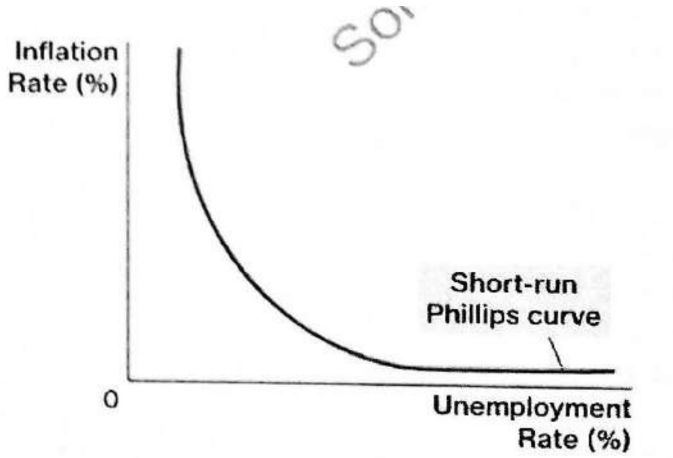
Frictional unemployment is a result of employment transitions within an economy. Frictional unemployment entails workers voluntarily becoming and team unemployed while searching for a better job or moving for unrelated reasons

QUESTION 6

November 2019 Question Five D

Trade-off between inflation and unemployment level

This is depicted by the Philips demand curve which shows the relationship between inflation rate and unemployment



The curve shows that as the rate of increase in the price level increases the unemployment rate falls and vice versa

This therefore forces policy makers to choose the best combination of unemployment rate and inflation rate that are suitable for the economy

QUESTION 7

May 2019 Question Five A

Distinction "demand deficient unemployment" and "disguised unemployment"

Demand deficient unemployment occurs when there is insufficient demand in the economy to maintain full employment e.g in recessionary times. This is also called cyclical unemployment moves in tandem with the business cycle.

Disguised unemployment refers to a situation where some people are employed apparently but if they are withdrawn from this job, total production remains the same.

QUESTION 8

May 2019 Question Five B

Inflation refers to the persistent decline in purchasing power of money.

Effect of inflation on functions of money

- Hyper inflation e.g. in case of Zimbabwe makes people reluctant to use money as a medium of exchange. They will resort to use of other assets like gold. Money is used as a store of value. Savings are made today with view of consumption in future. If inflation exceeds interest rates savings is discouraged as doing otherwise is running down the value of your cash saved.
- Money as a standard for deferred payment inflation makes creditors wary about making credit supplies to clients. The reason for this is due to decline in the
- Money purchasing as a power unit of of account: money loaned value of out.various goods and services of money is priced which makes monetary terms. Inflation creates uncertainty about value people reluctant to use money as unit of account

QUESTION 9

November 2018 Question Six A

Measures that developing country could adopt to curb against high levels of urban unemployment

- Rural development: by developing rural areas, the government not only creates employment in those areas but also gives incentives to investors to locate industries in those areas which create more employment opportunities. When more jobs are created in the rural areas, rural urban migration is reduced strengthen and expand quality apprenticeship programs and other work experience programs.
- Geographical subsidies to help working and firms move.
- Decentralization of industries: industries should be encouraged to establish in different regions of a country through enhanced provision of incentives such as tax relief, free room for expansion, security and improvement of infrastructure. This helps reduce- rural urban migration and urban unemployment.
- Provision of more education and training facilities including retraining schemes to keep workers who want to acquire new skills to improve their mobility.
- Promote entrepreneurship and self employment to unlock new sources of job growth.
- Remove obstacles to geographical labour mobility within countries and maximize the benefits of migration by helping migrants achieve better employment outcomes.
- Develop an integrated strategy to facilitate the transition of informal enterprises and workers in informal jobs into the formal economy in both rural and urban areas.
- Population growth control through family planning education programs
- Increasing information dissemination on labour market opportunities
- Moving towards greater investment in research and development which will lead to greater use of natural resources.

QUESTION 10

November 2018 Question Seven A

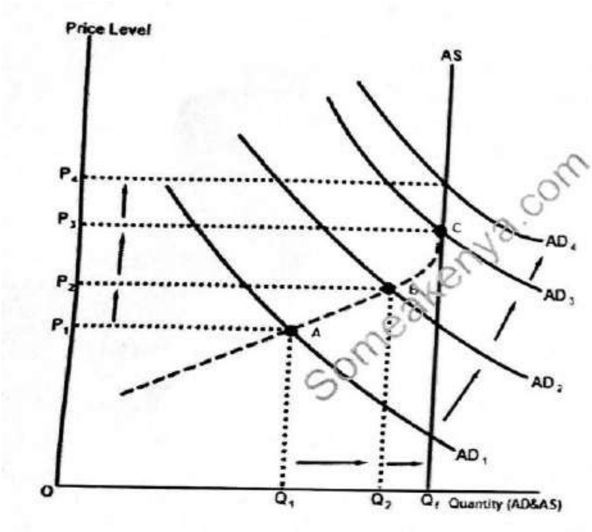
Explanation of the term “hyperinflation” as used in economics

Hyperinflation refers to a scenario where prices of goods and services rise more than 50 percent a month.

Description of demand pull inflation

Inflation caused due to excessive demand is termed as demand pull inflation.It exists in the economy when overall price of goods and services increase due to increase in aggregate demand, but the aggregate supply remains the same.

When the economy is at full employment, it is not possible to produce goods and services any further because the available resources have been optimally utilized. In this case, the supply of commodities is limited, but the demand is increasing. Consequently, the price of the commodity rise and leads to inflation.



In the diagram, the horizontal line shows quantity (Aggregate Demand & Aggregate Supply), whereas the vertical line shows price. As shown in the figure, aggregate demand (AD1) intersects aggregate supply (AS) at point A where, the equilibrium price level is P1 and the quantity is Q1. When the aggregate demand increases, the initial AD1 curve shifts rightwards to AD2 and AD3 which intersects the initial AS curve at point B and C in which the new equilibrium price level are P2 and P3 respectively.

The increase in price from P1 to P2 and P3 is known as semi inflation. The price rise from P_1 to P_2 and P_3 is because of the rise in aggregate demand for goods and services at a given supply situation. Corresponding to the P3 level of price level, the economy has reached full employment level.So, the aggregate supply curve(AS) becomes vertical

Further rise in AD to AD4 increasesthepricetoP4butthereisnoincreaseinoutput since, the economy is at full employment. Such increase in price is known as inflation.As shown in the diagram, the price continues to rise if the aggregate demand keeps increasing but the output will remain constant at Qr.

Causes of demand pull inflation.

- Government spending: when government spends more freely, prices go up.
- Inflation expectation: companies may increase their prices in expectation if inflation in near future.
- More money in the system: an increase in the money supply with too few goods to buy makes prices increase.
- Asset inflation: a sudden rise in exports force an undervaluation of the currencies involved.
- A growing economy: when consumers feel confident, they spend more and take on more dept. this leads to a steady increase in demand, which means higher prices.
- A quick increase in consumption and investment along with extremely confident firms.

QUESTION 11

May 2018 Question One A

Negative effects of inflation in an economy

- Inflation refers to decline in purchasing power of money. It has the following negative impacts:
- Currency debasement which lowers the value of a currency and sometimes causes a new currency to be born.
- Causes an increase in tax brackets people will be taxed a higher percentage if their income increases following an inflation increase.
- Causes business cycles: many businesses will have to go out of business because of the losses they incurred from inflation and its effects.
- Income diffusion effect which is basically an operation of income distribution.

- Other things constant, during inflation moredisposableincomeswillbeallocated737> to consumption since prices will be high and real income very low. In this way, marginal propensity to save will decline eliminating in inadequate saved funds. This hinders the process of capital formation and thus the economic prosperity of the country.
- When inflation imply that domestic commodity prices are higher than the world market prices, a country's
- Exports fall while the import bill expands. This is basically due to the increased domestic demand for imports much more than the foreign demand for domestically produced goods (exports). The effect is a deficit in international trade account causing balance of payment problems for the country that suffers inflation.
- Illusion of making profits: companies will think they are making profits while in reality they are losing money if they don't take into consideration the inflation rate when calculating profits.
- Fixed income recipients will be hurt: this is because while inflation increases, their income doesn't increase and therefore their income will have less value over time. Existing creditors will be hurt because the value of money they will receive from their borrowers later will be lower than the money they gave before.
- Distortion of relative prices usually the prices of goods goes higher,especially the prices of commodities.
- Increased risk: higher uncertainties (uncertainties in business always exist) but with inflation risks are very high, because of the instability of prices.

QUESTION 12

May 2018 Question One B

Conditions that could favour effective use of price discrimination in an economy

Price discrimination occurs when a firm sells a good or service to different buyers at two more different prices, for reasons not necessarily associated with the hoist detailed are the conditions that favour price discrimination.

- The consumers should have imperfect knowledge of the commodity traded in the market.

- The cost of separating the markets should be as low as possible.The main aim of price discrimination is to increase profits therefore the additional this should be as low as possible.
- The producers must be able to avoid or control resale of the product to avoid people who pay lower prices to rescue the product to those charged high prices. The producers must have some monopoly power or be able to control the supply of the commodity otherwise it will be difficult to raise prices in a market if you have competitors.
- The different markets should have different elasticities of demand so that they can respond differently to price changes. The producer may raise the price in a market whose demand is in elastic and reduce price in a market with elastic demand.
- Nature of product: direct services allow room for price discrimination. Government policies should also permit price discrimination.

QUESTION 13 nya.com

May 2018 Question Four C

Ways in which inflation can cause unemployment

- Monetary authorities will tend to increase interest rates to reduce inflation. A sharp increase in interest rates can cause economic growth to fall, leading to recession and unemployment
- Inflation creates uncertainty and lower investment: a period of high and volatile inflation discourages firms from investing. Because inflation is high, firms are less certain investments will be profitable. It is argued that countries with higher inflation rates tend to have lower investment and therefore lower economic growth. Therefore if there are poor levels of investment, this could lead to higher unemployment in the long term.
- Labour is derived demand. Inflation will cause price of goods to rise and production costs to rise. This would reduce aggregate demand therefore less output would mean less workers are needed
- Causes business cycles. Many firms will have to go out of business because of the losses they incurred from inflation and its effects which causes unemployment.

QUESTION 14

May 2018 Question seven A

Negative effects of unemployment in an economy

- Exploitation of labour: Due to unemployment labourers are exploited. They have to accept low wages and work under un-favourable conditions.
- Industrial disputes: Industrial disputes arise because of unemployment. It has adverse effects on employer-employee relations. Due to industrial disputes, the unemployment rises.
- Political instability: There is political instability in the country due to unemployment. Unemployed persons engage themselves in destructive activities. They consider Governments, worthless. Economic development becomes difficult under conditions of political instability.
- Social problem: Many social evils like dishonesty, gambling and immorality etc. arise due to unemployment. It endangers law and order situation of the country. It causes social disruption in the society.

- Increase in poverty: Under the situation of unemployment a man has no source of income. Unemployment causes poverty Burden of debt increases. Economic problems increase.
- Loss of human resources: Due to unemployment, human resources go waste. No constructive use of labour force is made. If human resources are properly used, economic growth of the country will increase.

QUESTION 15

May 2018 Question seven B

Consequences of wage control.

- Reduces employment
- .Increases poverty
- Damaging to businesses because excessively high minimum wages require businesses to raise the prices of their product or service to accommodate the extra expense of paying a higher wage.
- Companies may outsource more jobs to countries with lower (or non- existent) minimum wage standards.
- Businesses may freeze new hires, limiting opportunities for recent college graduates and entering or re-entering the job market.

QUESTION 16 737

May 2017 Question Seven C

Reasons why unemployment is a major policy issue in developing countries

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QUESTION 17

November 2016 Question Six C

Policy measures that could be adopted to reduce the level of unemployment in a developing country

- Rural development: by developing rural areas, the government not only creates employment in those areas but also gives incentives to investors to locate industries in those areas which create more employment opportunities. When more jobs are created in the rural areas, rural urban migration is reduced strengthen and expand quality apprenticeship programs and other work experience programs.
- Geographical subsidies to help working and firms move.

- Decentralization of industries: industries should be encouraged to establish in 737 different regions of a country through enhanced provision of incentives such as tax relief, free room for expansion, security and improvement of infrastructure. This helps reduce- rural urban migration and urban unemployment.
- Provision of more education and training facilities including retraining schemes to keep workers who want to acquire new skills to improve their mobility. Promote entrepreneurship and self employment to unlock new sources of job growth.
- Remove obstacles to geographical labour mobility within countries and maximize the benefits of migration by helping migrants achieve better employment outcomes.
- Develop an integrated strategy to facilitate the transition of informal enterprises and workers in informal jobs into the formal economy in both rural and urban areas.
- Population growth control through family planning education programs Increasing information dissemination on labour market opportunities
- Moving towards greater investment in research and development which will lead to greater use of natural resources.

QUESTION 18

November2016Question Seven

Relationship between money supply and the level of inflation in an economy

An increase in money supply stimulates increase in demand for goods and services which leads to inflation

QUESTION 19

May 2016 Question two A (i)

Distinction between the following sets of terms as used in economics

"Structural unemployment" and "Keynesian unemployment"

Structural unemployment is the permanent dislocations within labor markets, such as a mismatch between skills a growing company needs and the experience job seekers have cyclical unemployment or Keynesian unemployment on the other hand results from not enough demand in the economy e.g.in times of recession cyclical unemployment is a result of business cycle

QUESTION 20

May 2016 Question seven A

Causes of inflation in developing countries

- Inflation is the persistent fall in the value of money.
- Government spending: when government spends more freely, prices go up. Inflation expectation: companies may increase their prices in expectation if inflation in near future.
- More money in the system: an increase in the money supply with too few goods to buy makes prices increase.
- Asset inflation: a sudden rise in exports force an undervaluation of the currencies involved.
- A growing economy: when consumers feel confident, they spend more and take on more dept. this leads to a steady increase in demand, which means higher prices.
- A quick increase in consumption and investment along with extremely confident firms.
- Component costs: e.g. an increase in the prices of raw materials and other components. This might be because of a rise in commodity prices such as oil, copper and agricultural products used in food processing.
- Rising labour costs – caused by wage increases, which are greater than improvements in productivity. Wage costs often rise when unemployment is low because skilled workers become scarce and this can drive pay levels higher. – Higher indirect taxes – for example a rise in the duty on alcohol, fuels and cigarettes, or a rise in Value Added Tax.
- A fall in the exchange rate – this can cause cost push inflation because it leads to an increase in the prices of imported products such as essential raw materials, components and finished products
- Monopoly employers/profit-push inflation – where dominants firms in a market use their market power (at whatever level of demand) to increase prices well above costs

QUESTION 21 737

November 2015 Question Six A

Effects of inflation on the functions of money

Hyper inflation e.g. in case of Zimbabwe makes people reluctant to use money as a medium of exchange. They will resort to use of other assets like gold. Money is used as a store of value. Savings are made today with view of consumption in future. If inflation exceeds interest rates savings is discouraged as doing otherwise is running down the value of your cash saved.

Money as a standard for deferred payment inflation makes creditors wary about making credit supplies to clients. The reason for this is due to decline in the purchasing power of money loaned out.

Money as a unit of account: value of various goods and services is priced in monetary terms. Inflation creates uncertainty about value of money which make people reluctant to use money as unit of account

QUESTION 22

September 2015 Question four C

Effects of high levels of inflation in an economy

- Income redistribution: One risk of higher inflation is that it has a regressive effect on lower-income families and older vulnerable citizens who might be living on a fixed income. If prices are rising faster than wages, then there will be a steep decline in real incomes.
- Negative real interest rates: If interest rates on savings accounts in banks are lower than the rate of inflation, then people who rely on interest from their savings will be poorer.
- Increased cost of borrowing: High inflation may also lead to higher borrowing costs for businesses and people needing loans and mortgages as financial markets seek to protect themselves against rising prices and increase the cost of borrowing on short and longer-term debt.
- Government spending: High inflation puts pressure on a government to increase the value of the state pension and unemployment benefits and other welfare payments as the cost of living climbs higher.

- Business uncertainty and planned investment: High and volatile inflation is not good for business confidence partly because firms cannot be sure of what their costs and prices are likely to be. This uncertainty might lead to a lower level of capital investment spending which might then damage a country's productivity growth and long run productive potential.
- Social costs of high and volatile inflation: It puts severe pressure on democratic institutions and can lead to growing political protest and social unrest. Falling real living standards can prompt a brain drain of some a country's most able and mobile people leaving the country with a diminished labour force. Higher inflation can bring an end to progress in reducing poverty.
- Functions of money: Hyperinflation destroys the internal purchasing power of money and undermines its value as a medium of exchange and as a unit of account. Alternative currencies that at least hold some of their value may take the place of the domestic unit of exchange and shadow markets with products traded at unofficial prices often become the norm.

QUESTION 23

September 2015 Question Six B

Types of unemployment

- Classical unemployment unemployment: dominated is economic caused when theory wages before are the too 1930,s high. This when explanation workers of737 themselves were blamed for not accepting lower wages.
- Structural unemployment: it occurs when certain industries decline because of long term changes in market conditions.
- Demand deficient unemployment. This is caused by a lack of aggregate demand, with insufficient demand to generate full Employment.

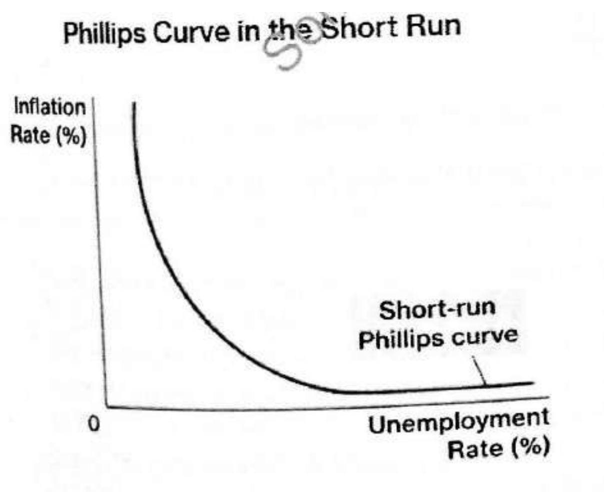
- Disguised unemployment: occurs when people can be withdrawn from employment without reduction in output

QUESTION 24

September 2015 Question Six C com

Relationship between unemployment and inflation using the Phillips curve

This is depicted by the Philips demand curve which shows the relationship between inflation rate and unemployment



The curve shows that as the rate of increase in the price level increases theu nemployment rate falls and vice versa

This therefore forces policy makers to choose the best combination of 0707 unemployment rate and inflation rate that are suitable for the economy.

TOPIC 10

AGRICULTURE AND INDUSTRY

QUESTION 1

August 2021 Question Two E

Explanation of the term "transfer payments".

This a payment made or income received in which no goods or services are being paid such as the payments made to the elderly in Kenya over 65 years and subsidies for fuel too.

QUESTION 2

August 2021 Question Three A

Economic factors that may contribute to poor performance of the agricultural sector in developing countries.

1. Low use of irrigation
2. Limited public investment and institutional support.
3. The use of outdated technology
4. Climate change
5. Land ownership issues
6. High cost of farm inputs
7. In accessibility to markets and finance

QUESTION 3

November 2020 Question one A

Methods used by the government to stabilise agricultural prices

- The case of for the diversification: farmer.This is done to reduce the uncertainty in the livehood of the farmer.
- Buffer stock and stabilization funds: In this case, the government buys part of737890 the supply when output is excessive,stores this surplus and resells it to consumers in times of shortage or reduced supply. The amounts that the government must buy or sell to stabilize prices will therefore depend on the elasticity of demand. In practice, this normally operates through a marketing board controlling the industry, with monopoly powers to fix prices for producers. The Board will usually guarantee a minimum price for the commodity and may make an initial payment to the grower followed by an additional payment if sales by the board subsequently realize in excess of the minimum. Producers of the crop are thus encouraged by the knowledge that any decrease in price during the season will be moderated by government action in this stabilization funds, the government fixes the price. When the demand is high in the government shall retain the difference and subsidize the price to producers when demand is low.

- Ceilings and floors: Government can establish a price ceiling, above which prices shouldn't go beyond, and price floors, which are the lowest prices. Recently, government announced a price floor for milk farmers.
- Trainings about future shocks: This enables farmers and growers to predict the onset of other potential shocks so that they can react quickly.

QUESTION 4

May 2019 Question Four B

Reasons for fluctuations in prices of agricultural products.

- Perishable nature of products: most agricultural products are perishable and cannot be stored for long and especially since storage facilities would be very expensive to establish and maintain.
- Gestation period (the period between planting and harvest)- once planted) agricultural products take time to mature and become ready for harvest; thus supply tends to be relatively in elastic during this period in that quantity of a product cannot be increased. Thus, prices with tend to be high during planting time and low during harvest time.
- Inelasticity of demand- since agriculture products are used in small quantities as inputs (raw material) in manufacturing processes, they are purchased in small quantities, thus production may not always be sufficient to achieve the required

- Processing: most of the farm products have to be processed before their consumption by the ultimate consumers. This processing function increases the price spread of agricultural commodities. Variation inequality of products: there is a large variation in the quality of agricultural products, which makes their grading and standardization somewhat difficult. There is no such problem in manufactured products since their quality is uniform.
- Bulkiness of products: The characteristic of bulkiness of most farm products makes their transportation difficult and expensive. This fact also restricts the location of production to somewhere near the place of consumption or processing , the price spread in bulky products is higher because of the higher costs of transportation and storage.
- Small size of holdings and scattered production: farm products are produced throughout the length and breadth of the country and most of the producers are of small size.This makes the estimation of supply difficult and creates problems in marketing

QUESTION 5

May 2018 Question Three B

Reasons why wages in the agricultural sector tend to be lower than wages in the industrial sector

- Most workers in the agriculture are unskilled or semi-skilled thus low wages unlike the industrial sector where most workers are skilled
- The low productivity of agricultural sector workers unlike their counterparts in the industrial sector.

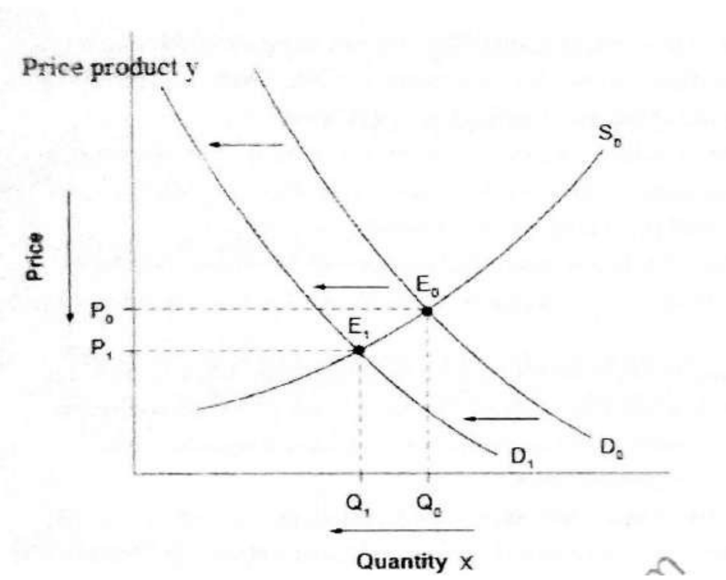
- Differences in the prestige of various jobs. For example some industrial workers have more prestigious position in society than agricultural workers
- Differences in the degree of difficulty or unpleasantness of the work: for example, miners work under unpleasant conditions relative to farmers.

- Difference in the cost of performing the job: for example dentists, psychologists and doctors in general require expensive equipment and incur high expenditure for running their practice as compared to agriculture employees
- Differences in the cost of training industrial occupations require large investments in training while agricultural workers require less expenditure for training.
- Labour constitutes a small percentage of an industrial inputs put a higher proportion in agriculture that is, the more inelastic demand for labour in industry. Industries are capital intensive activities compared with agriculture which is labour intensive.
- Agriculture workers accept lower wages because they supplement their farm wage income with subsistence production of their own family plots. This is not always the case for industrial workers industrial workers do not have supplement and hence demand more to compensate them.
- Labour unions tend to be stronger and better organized in industry and commerce than in agriculture where they seem to lack strong collective bargaining. Industry workers have awareness about union activities and are in urban areas.
- Wages like other prices are determined by the interaction of demand and supply. The use of relatively unskilled labour which is abundant in supply in the agricultural sector tends to depress wages

QUESTION 6

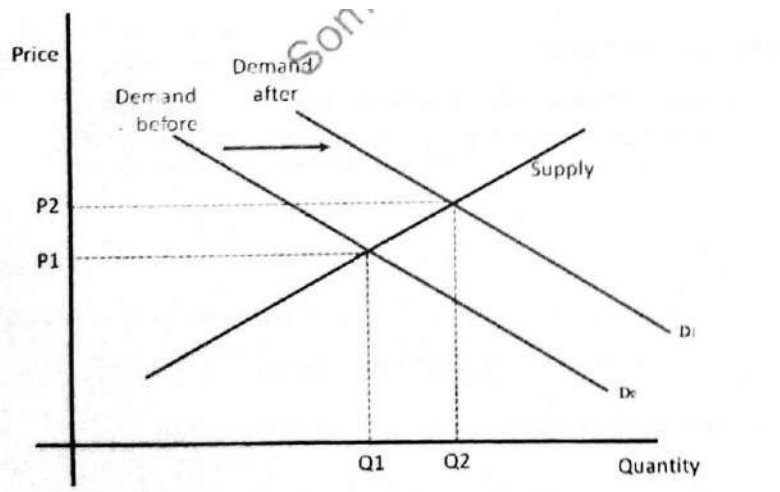
November 2017 Question Three B

Effects of a reduction in the price of product Y which is a close substitute for product X on the market equilibrium price and quantity of an agricultural product X



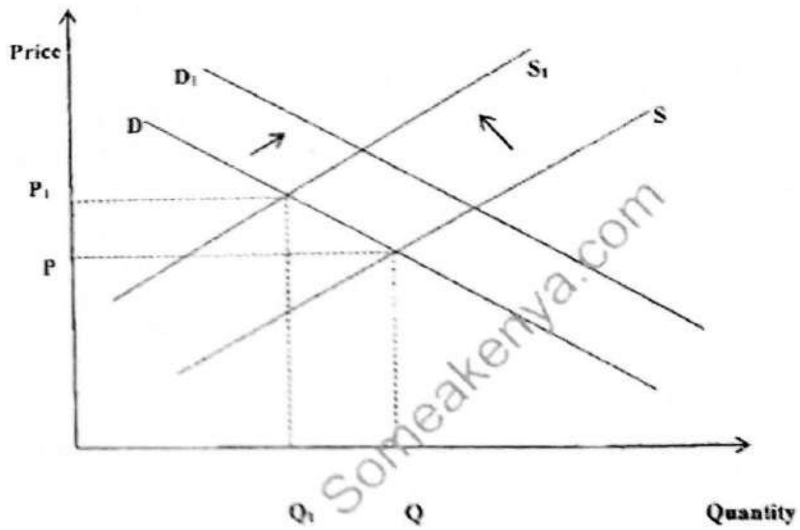
Reduction in price of Y from Po to PI will lead to an increase in quantity demanded of product X from Qo to Q1. This will make the demand to shift from Eo to El

Impact of successful promotional campaign on the market equilibrium price and quantity of an agricultural produc X



A successful promotional campaign to the right from D0 to D1, thus quantity demanded will increase from Q0 to Q1. Additionally price charged for product x will increase from P0 to P1

Effects of a discovery of a new use for product x accompanied by a bad weather condition on the market equilibrium price and quantity of an agricultural product X

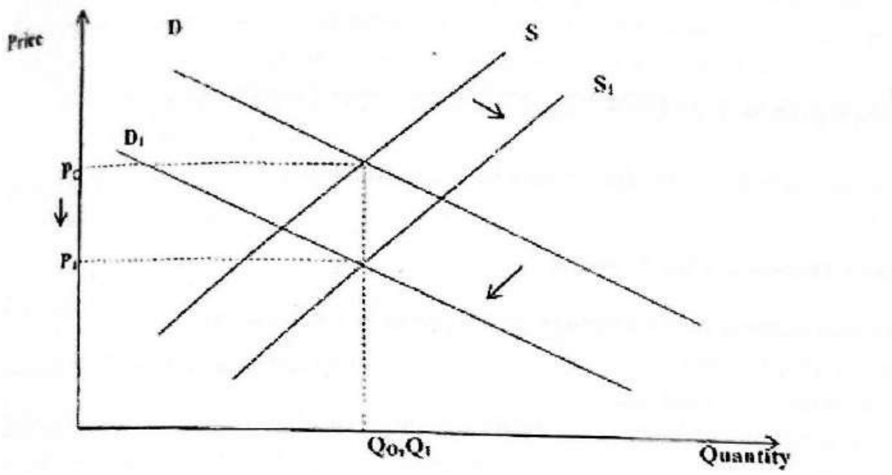


Discovery of new use of product x will push the demand for product x from D) to DI thus increasing price from PO to Pl

Bad weather will affect supply negatively and will reduce supply thus shift of supply from s0 to sl

Effects of a simultaneous increase in government subsidy for product x accompanied by a reduction in the price of the substitute product y on the market equilibrium price and quantity of an agricultural product X

Increase in government subsidy will increase in government subsidy will lead to an increase in supply of product x due to a reduction in production costs. Reduction in substitute product price will reduce demand for product x



Increase in government subsidy will increase supply from S to S1 whereas decrease in price of substitute produce will reduce demand from Do to DI.

QUESTION 7

November 2017 Question Five C

Problems faced by the agricultural sector in developing countries.

- The discovery to some extent the replacement of agricultural commodities hence reducing the demand for agricultural products.
- Agricultural sector production is seasonal by nature hence it is characterized by seasonal unemployment.
- Agricultural sector is particularly vulnerable to natural disasters e.g. floods, diseases, pests and drought which may lead to a fluctuation in the output.
- Many farmers in developing countries are subsistence farmers who may lack necessary capital resources to effectively implement modern agricultural practices.
- Insufficient and inadequate marketing channels in the agricultural sector e.g. poor marketing boards and corruption.
- Many farmers in developing countries still use insufficient traditional methods of production e.g. land fragmentation which limits and increase in productivity in agricultural sector.
- The agricultural sector is subjected to the law of diminishing marginal returns i.e high population growth rate creating pressure on land resulting to disguised unemployment.
- Developing countries usually depend on the exports of one or two main agricultural products and this makes the government vulnerable to change in international economic conditions.

- Agricultural products are subject to long run dealing terms of trade compared to manufactured goods leading to low prices of exports and high price of imports.

- Agricultural products are subject to frequent price fluctuations in terms leading to fluctuations in the farmers' income.

QUESTION 8

November 2015 Question Four B

Changes in tax policy that could be implemented by a government to spur growth in the agricultural sector

- Policy co-ordination between central government and sub-national authorities is crucial for efficient and transparent taxation. Local tax administrations need to be strengthened and their rights and obligations clearly stated by law. Policy coordination and harmonization by the central government help avoid inconsistencies and overlaps in the tax system. Sub – national authorities need to tap into both national and local tax revenues to provide public goods and services at local level, such as rural infrastructure to improve the transport of agricultural produce.
- Investors are generally willing to accept a higher tax burden in exchange for a more attractive business climate offering a sound and transparent regulatory framework, skilled labour, secure access to inputs or adequate infrastructure. In order to effectively attract investment, government should thus focus more on certainty and consistency of tax treatment, the avoidance of double taxation than on tax incentives.
- Tax incentives can encourage investors to target the agricultural sector or to invest in specific agricultural sub-sectors or regions. In order to effectively attract agricultural investment, governments should thus focus more on certainty and consistency of the treatment, the avoidance of double taxation and efficient tax administration than on tax incentives.
- Efficient tax collection should rely not only good governance standards but also on supporting tax payers by simplifying tax payments and in fluctuating businesses, in particular small business on how to handle tax filling and documentation. While tax policy should be in line with agricultural investment objectives, tax administration should be transparent and efficient to ensure effective policy implementation and facilitate access to tax information by all investors to inform their investment decisions. Transparent tax policy implementation can also enhance the credibility and accountability of the public sector vis – a – vis its citizens and the business community.

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TOPIC 11

INTERNATIONAL TRADE AND FINANCE

QUESTION 1

December 2021 Question Five A and B

Advantages of using a free exchange rate system in an economy.

- Automatic stabilization
- Low requirement of reserves
- Less probability of speculative attacks
- Independence
- Market determined rates
- Avoiding inflation
- Flexibility

Criticisms levelled against the theory of comparative advantage.

- The theory only considers labour costs and neglects all non-labour costs involved in the production of the commodities
- The theory considers all labour to be homogenous. However, in reality, labour in heterogeneous due to different grades and kinds
- The theory assumes similar tastes for all. However, the tastes differ with the growth of economies and income brackets
- Transport costs play an essential role n determining the pattern of the trade. But the Ricardo theory neglects this independent factor of production.
- The assumption of the factors of production being mobile internally is unrealistic. The factors do not move freely from one region to another or one industry to another. The greater the degree of specialization in an industry, the more immobile the factor will be
- The assumption of the theory of having only two countries and two commodities is unrealistic as international trade takes place among countries trading numerous commodities
- Every country implements restrictions on the movement of goods to and from the countries.Thus,tariffs and trade restrictions play a role in world imports and exports. However, the theory assumes free and perfect world trade
- The theory assumes full employment. However, every economy has an existence of underemployment
- The Ricardian theory considers only the supply side of world trade and neglects the demand side

QUESTION 2

December 2021 Question Seven C

Limitations of regional economic integration in developing countries.

- It is faced with the problem of dumping of cheap and substandard goods and services from member countries
- It may kill infant firms in a country as a result of imports from member countries Loss of revenue from tariffs due to reduction of tariff barriers thus limited funds for development. Va. Hinders trade
- Political instability between member countries themselves which hinders trade between them.
- It is faced with the problem of production of similar products thus this limits trade between the member countries
- Regional economic integration benefits are not equally distributed among member countries
- It has led to trade diversion
- It encourages overdependence on other countries for goods and services thus this kills the spirit of self reliance

QUESTION 3

August 2021 Question Five D

Roles played by the International Monetary Fund (IMF) in the world economy.

- To promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.
- To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- Help deal with economic crisis by providing international coordination loans, plus advice.
- To help deal with balance of payments adjustments.

QUESTION 4

May 2021 Question Five B

Reasons for deteriorating terms of trade for developing countries

- Regional economic grouping – the growth of economic groupings among the advanced country such as European Union has promoted trade amongst themselves. As a result, the growth of exports of less developed country has slowed down worsening the terms of trade.
- Protectionism policies – as some of the developing countries have started developing their countries the advanced countries have adopted the protectionist policies. They have raised tariff against the manufactured products of developing countries. Consequently, the terms of trade have turned against the developing countries.
- Nature of product – the less developed countries are mainly primary producing countries. Their exports mainly include primary products and their import includes capital goods. On the contrary, the developed countries produce and export manufactured good. The terms of trade between the primary and manufactured products are generally determined against the former and in favor of the latter.

- Backward technology – the less developed country use backward technology compared to the developed countries. As result, their relative productivity is low, cost ratio are high and price structure is also relatively high this leads to the diverse term of trade for the poor country placing it at a disadvantages bargaining position.
- High population growth – most of less developed country experience over population and high population growth as a result there is high internal demand for the good and low exportable surplus more over the import demand of this country is highly in elastic this causes their terms of trade to fall.
- Lack of import substitute – developing countries are greatly dependent ,07on advanced country for their imports and have not developed import substitute. On the other hand the advanced countries are not so much dependent on the poor countries because they are capable of producing import substitutes. Thus the poor countries have weak bargaining position in the international trade.
- Lack of adaptability – unlike the advanced countries the less developed countries cannot quickly adopt the supply of goods which are high in demand and whose price is rising. The reasons for these are backward technology, market imperfection and immobility of factors of production. Thus the terms of trade of less developed countries tend to deteriorate and these countries fail to reap gains by increasing their supplies of export during inflation.

QUESTION 5

May 2021 Question Six B

Advantages of currency devaluation to a country's economy

- Devaluation is a deliberate reduction in the value of one currency relative to another. It realizes the following benefits for the devaluing country.
- Wage increases – since devaluation causes an increase in the price of imported products, wages are often increased in order to improve the purchasing power of consumers and limit the impact of inflation.
- Lower trade deficit – as exported product become cheaper foreign demand for these products increases. The volume of imported product which is now expensive falls, along with the country's trade deficit.
- More competitive exports – a weaker currency leads to a drop in the price of exported goods.
- The quantity of product sold abroad increases as these products become more affordable to a greater number of consumers overseas.
- With a decision to devalue the currency the central bank can cut interest rate as it longer needs to "prop up" the currency with the high interest rate.

QUESTION 6

November 2020 Question Seven A

Corrective measures that developing countries should institute to correct the persistent deficits in their balance of payments position

- Investment in modern critical infrastructure to support businesses and industries involved in international markets.
- Use of protectionist measures such as import quotas and tariffs.
- Investment in education and health care: this will help to boost human capital and increase competitiveness in fast – growing and high value industries such as biotechnology, engineering, finance and medicine policies to encourage business start-ups; successful small businesses with export potential.
- Policies to raise productivity: measures to bring about more innovation and incentives to increase investment in industries with export potential are supply side measures designed to boost performance and compete more effectively with imports.
- Devaluation of a currency the central bank may lower the exchange rate which helps improve competitiveness and making imports more expensive
- Demand management: reduction in government spending, higher interest rates and taxes could all have the effect of dampening consumer demand reducing the demand for imports. This leads to an increase in spare productive capacity which can then be allocated towards exporting.

QUESTION 7

November 2020 Question Seven B

Policy regional recommendations imbalances in their that economies developing countries should institute to reduce regional imbalances in their economies

- Devolution of resources e.g. from national government to county governments
- Policies for development of irrigation, agriculture and related activities.
- Policies aimed at industrialization of lagging regions through an industrial location policy whereby large industrial estates are set up near small towns in backward areas and all initial facilities provided by concerned national / county government. Policies aimed at providing infrastructural facilities such as transport, communications, banking etc in backward regions.
- Security, law and order e.g. the influx of refugees in areas such as the northern parts of Kenya.
- Factor rewards, differentials e.g. different in wage compensation between different regions – hardship allowance for those working in designated hardship area etc.
- Comprehensive development plans and strategies.

QUESTION 8

November 2020 Question Seven C

Reasons why external debt problems is a major policy issue in developing countries

- Growing levels of debt can discourage foreign and private investment because of concerns that the debt is becoming unsustainable.
- If a country is struggling to make interest payments they may be tempted to borrow to meet debt interest payments but then the problem can spiral and magnify.
- Countries in regional areas may suffer from original downgrade in credit assessment. For example, many sub-Saharan African countries experienced rising external debt ratios and is made investors reluctant to lend at cheap rates
- Demand-side shock which reduce GDP. For example, conflict or global recession which hits demand and GDP
- Unexpected devaluation in the exchange rate which increases the real value of debt interest payment denominated in foreign currency.

QUESTION 9

November 2019 Question Five B

Factors that determine the level of induced investments in an economy

- Determinants of induced investment in an economy
- Population growth
- Inventions and innovations
- Political stability
- Consumer demand
- Existing stock of capital
- Initial cost of capital goods and its useful life.
- Government: the government's effect on investment is either: Direct that is government is itself a large investor however not profit motivated e.g. fiscal and monetary policies or Business expectations: there is an element of uncertainty regarding business prospects in future, which regardless of the interest rate will influence investment decisions.
- Rate of interest: firms make decisions to invest on the expectation of making again since most investment will involve money, investment decisions will involve money, comparing the rate of return on an investment to the interest rate, which is
- Level of national income: a higher national income stimulates investment because the cost of borrowing of the following
- It makes business prospects

QUESTION 10

November 2019 Question Five C

Positive economic effects of a prolonged fall in the value of money in an economy

Inflation and lower real expected returns also weakens the currency, potentially helping trade.

Inflation provides governments a mean of diminishing the value of historically issued long-term government debt, reducing debt/GDP.

To the extent that tax bracket don't keep up with inflation (they generally lag), inflation also increases government inflows, as people "creep" into higher tax rates due to inflation despite the fact their purchasing power may be unchanged.

Inflation diminishes the real value and returns of long -term fixed income assets, which are generally held by the wealthy and institutions. However employees and borrowers get increases in nominal wealth, whichiftheykeeppacewithinflation.737 hold workers flat. So inflation, reduces wealth inequality to some extent.

It helps prevent deflation: deflation can cause an increase in the real debt burden and discourage spending and investment. Deflation was a factor in the great depression of the 1930's in the U.S.A. better investment returns: during, inflation, investors and entrepreneurs receive added incentives for investing in productive activities. Therefore, they receive better returns increase in production: once the producers receive the right investment, they create more goods and services. Hence inflation leads to an increase in production of products/services.

More employment and better income since production increases, there is an increased demand for the various factors of production, including man power. Therefore, employment and income increases during inflation.

QUESTION 11

November 2019QuestionSixA

Reasons against international trade restrictions

International trade restriction may encounter resistance from those firms that are not protected since they feel economically sidelined

International trade restrictions might discourage health competition among firms in the industry, because few firms will be allowed to produce goods.

International trade restrictions limit consumer sovereignty or choice because the consumers will have a limited variety of products to choose from in the market. In the short-run period, international trade restrictions may facilitate the production of low level of output, leading to shortage of goods in the market International trade restriction can easily lead to creation of monopoly power among the few firms in the industries. This is likely to experience exorbitant prices being set.

QUESTION 12 890

November 2019 Question Six B

Functions of World Trade Organisation (WTO)

- The world trade organization is an intergovernmental organization dealing with the rules of trade between nations. Its main functions include:
- Administering WTO trade agreements
- Providing a forum for trade negotiation Handling trade disputes
- Monitoring national policies
- Providing technical assistance and training for developing countries
- Ensuring cooperation with other international organizations

QUESTION 13

November 2019 Question Six C

Case for foreign directs investment

- The foreign direct investments iculcate of risk taking among the entrepreneurs belonging to less developed countries (LDCS) They become interested in undertaking investments in other LDCS
- Increase in real wages: the setting if a new enterprise through foreign investment causes an increased demand for skilled and other categories of labour that result in an increase in real wages. Sometimes the foreign investors secure the services of special categories of labour from their home countries. They are invariably paid higher wages. As the local labour acquires similar skill and training, they can also secure higher wages.
- The increase in productivity in the firms managed by foreign entrepreneurs and managers also brings in higher wages for the workers. Thus, direct foreign investments can become instrumental in raising the real wages or real purchasing power of the working classes in the host country.
- Creation of employment: the setting up of new enterprises and diversification of activities by the foreign investors help in the creation of more and more employment opportunities in the LDCS. That brings about a larger generation of incomes and alleviation of poverty.
- Larger tax revenues: in the LDCS, the activities of foreign investors result in the737 generation of production and profit by the taxation of profits, production and exports, the government can get hold of larger tax revenues that can be diverted towards the execution of development programmes.
- Risk bearing by foreigners: the investment activity remains inhibited in the LCDS on account of a higher rate of risk. Since the indigenous capitalist are risky – shy, the investment process remains clogged. The foreign investors undertake risks and make a significant contributions in in furthering the industrialization of the LCDS, Higher social return. The value added as a result of foreign direct investment is invariably than the return on foreign investments. It signifies social return from FDI is greater than the private return
- Reinvestment of profits: A part of the profits earned by the foreign investors is reinvested for financing the expansion of modernization program me. In this way, the country can maintain a higher rate of investment and capital formation.
- Efficient control and management: In case, of foreign direct investment; the control and management of the business are handred by the foreign investors their expertise in

management and policy making endures both internal and external economies. The large inflow of FDI can certainly improve industrial efficiency in a great measure.

Case against FDI

- Political domination: the foreign investors after they assume control of some vital sectors in LCDS, start interfering with their economic and political decision making. They dictate terms which may be more in the interest of their mother countries, rather than the host countries.
- Emergency of monopolies: the enterprises set up by the foreign investors drive out the indigenous competitors from the market. They also acquire patent rights about the products and processes. Slowly they emerge as powerful monopolies and exploit the hose countries.
- Discouragement for domestic capital and enterprises. The foreign direct investment has a discouraging effect on domestic capital and enterprise since the more profitable investment opportunities are grabbed by the foreign investors, the indigenous entrepreneurs get greatly demoralized. The already shy domestic capital fails to find proper investment avenues.
- No skills formation. The FDI are supposed to assist in skill formation by providing training facilities to the workers in advanced and modern techniques. In fact, the foreign enterprises show little interest in providing training facilities to the indigenous labour. Some lower and middle level routine posts are offered to the native work force. All senior executive and technical posts are reserved for the personnel from their own countries.
- No transfer of technology. The LDCS expect that foreign investment will result in the transfer of latest production techniques and technical know- how to the host countries. In reality, the production techniques being used by foreign enterprises are kept as guarded secrets by them. They do not permit the indigenous entrepreneurs to have access to it. Sometimes obsolete plants and equipment are thrust upon LDCS in the form of transfer of turnkey projects.
- Heavy cost: in order to induce the foreign investors to undertake investments on a substantial scale, the host country has to bear a heavy cost in the form of providing land, water power and transport and communication facilities. In addition, they are provided such facilities as development rebates, rebate on undistributed profits additional depreciation allowances, subsidized supply of inputs and tax holiday for some specified period. Thus the cost of foreign direct investment to the LDCS is definitely on the high side.
- Economic exploitation: FDI it responsible for the exploitation of the human and natural resources and markets of the LOCS. The manufactured goods are exported to their mother countries by the foreign investors at very low prices. Those products are then re-exported to trird countries with or without processing at very remunerative prices. In addition, there is regular repatriation of capital & remittance of profits by the foreign investors to their home countries.

QUESTION 14

November 2019 Question Seven C

Distinction between "depreciation of a currency" and "demonetization of the currency"

Depreciation is a fall in the value of a currency in a floating exchange rate system. Currency depreciation can occur due to factors such as economic fundamentals, interest rate differentials political instability or risk aversion among investors. Demonetization is the act of stripping a currency of its status as a legal tender. It occurs whenever there is a change of national currency. The current form or forms of money is pulled from circulation and retired, often to be replaced with new 737 notes or coins.

QUESTION 15

November 2019 Question Seven D

Effects of demonetization of the currency:

- Rate of capital form action growth will go down as no investments will take place.
- Reduction in money supply in the short run
- It will bring more business in taxation
- It leads to a better business environment, less corruption and transparency
- Less currency in circulation will reduce inflation in the short run
- GDP formation will be effected with the reduction in consumption demand consumption

QUESTION 16

May 2019 Question Five C

Limitations of comparative advantage as used in international trade

The low of comparative advantage states that a country should specialize in producing and exporting those commodities which it can produce at relatively lower costs and that it should import those goods in which it is a relatively high cost producer.

Limitations of comparative advantage

- Government may restrict trade
- Comparative advantage measures static advantage but not any dynamic advantage e.g. Kenya can be a good car manufacturer if it makes the necessary investment.
- Increased specialization may lead to diseconomies of scale.
- Transport costs may outweigh any comparative advantage.
- The theory assumes that markets are perfectly competitive – in particulars there is perfect mobility of factors without any diminishing returns and with no transport
- Costs.Therealityisoutputfromfactorinputsissubjecttodiminishingreturnsand. transport costs.
- Complete specialization might create structural unemployment as some workers cannot transfer from one sector to another.
- Relative prices and exchange rates are not taken into account in the simple theory of comparative advantage. For example if the price of X rises relative to Y , the benefit of increasing output of X increases.
- Many countries strive for food security meaning that even if they should specialize in non-food products, they still prefer to keep a minimum level of production. The principle of comparative advantage is derived from a highly simplistic two good/ two country model. The real world is far more complex, with countries exporting and importing many goods and services.

QUESTION 17

May 2019 Question Six A

Roles of foreign exchange reserves in an economy

Foreign exchange reserves are the foreign currencies usually held by the central bank of a country

Roles of foreign reserves

- Maintain a reserve for emergencies and national disasters
- Provide assurance to markets that a country can meet its external depts.
- Assist the government in meeting its external debt obligations and its foreign exchange needs.
- Support and maintain confidence in the policies for monetary and exchange rate management including the capacity to intervene in support of the national or union currency.
- Demonstrate the banking of domestic currency by external assets
- Limit external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of crisis or when access to borrowing is curtailed.

QUESTION 18

May 2019 Question Six B

Factors that determine the terms of trade in a country

The terms of trade are concerned with the rate at which one country's goods exchange for those of other countries. Changes in terms of trade indicate whether a country must export more or less in order to purchase a given volume of imports. A terms of trade index (TOT) can be calculated as:

$$\text{TOT}=\frac{\textit{weighted average of export price}}{\textit{weighted average of import price}}\times 100\%$$

Factors that determine terms of trade:

1. Import substitutes: if a country adopts an import substitution policy, then there will be less demand for such goods which will improve terms of trade inflation.
2. Inflation makes exports expensive due to arise in domestic prices which spurs demand for imports which will be relatively cheaper thus worsening terms of trade on the other hand deflation makes imports expensive and exports cheaper which improves terms of trade.
3. Balance payment: We can either have a deficit or a surplus. A surplus leads to the appreciation of exchange rate which leads to a reduction in exports and encourages imports and results to unfavorable trade terms. A deficit leads to depreciation of exchange rate which leads to an increase in exports and discourages imports and results to favorable trade terms.
4. Tariffs and quotas: Tariffs refer to taxes imposed on goods imported or exported. Quotas refer to a maximum quantity that can be exported or imported. Quotas and tariffs limit imports thus leading to favorable terms of trade.

5. Tastes and preference: In case the people love foreign made goods, then they will demand more foreign made goods that will lead to a deterioration in terms of trade due to increase in

imports devaluation. This makes exports cheaper and imports expensive leading to favorable terms of trade.

QUESTION 19

November 2018 Question Five B

Limitations of export promotion strategy

- Developed countries often provide a high level of effective protection for their industries producing simple labor- intensive commodities in which developing countries have or can soon acquire comparative advantage.
- Exporting is more sensitive to tariff and other trade barriers and exchange rate fluctuations.
- The exporter country has fewer opportunities to acquire and learn knowledge about customers, competitors and the market place meaning it may fail to perceive opportunities and threats.

QUESTION 20

November 2018 Question Six C

Disadvantages of adopting an import substitution.strategy to control unfavourable balance of payments in a developing country

Import substitution is an economic theory adhered to by developing countries that wish to decrease their dependence on development countries import substitution targets the protection and incubation of newly formed domestic industries to develop sectors fully, so the goods produced are competitive with imported goods.

Demerits of such a policy include.

- The presence of polarized internal income distribution. The ownership of means of production will be monopolistic creating an extended gap between the rich and poor. This results in high in equalities in a country.
- The small sized domestic markets may not exploit the economies of scale from the home production. In such a case, it hinders production and growth thus the collapse of the same industries
- Trade protection due to import substitution may lead to overvalued. Exchange rates that causes arise in domestic prices (inflation) moreover it forces governments to spend more to subsidize industrial investment. Inflation takes place causing exports to be less competitive. Also it causes high budget deficits.
- Failure to meet consumer demands by the growing domestic industries may result in the development of "black markets" financial leakages take effect reducing government revenue and the overall capital base of the economy.
- Lack of external competition affects the efficiency of the in fact there stricti on domestic industries. Hence, tariff this walls would would negatively hinder trading affect across growth.nations.Also Inefficiency reduces total output that leads to reduced growth rate.

- Deliberate promotion of import substitution goes against the principle of comparative advantage.

- Domestic industries enjoying various incentives will develop vested interests and ask for such concessions all the time.

QUESTION 21

May 2018 Question Two B

Reasons why a country might impose international trade restrictions

- To earn more revenue: taxes on imports and exports are a source of government revenue. Tariffs also raise the price of the imported good and lower its consumption.
- Protection from "dumping": Dumping is when an importer sells products at below average cost of production. Anti-dumping duties are imposed to protect locally manufactured products from unfair competition.
- To protect "infant industries"- Countries want to give newly developing industries (known as infant industries) time to grow and become competitive. This is a reasonable argument for imposing trade barriers. However, in some cases, government protection never ends. These industries become competitive only because the government has given the benefit of trade barriers.
- To improve a trade deficit:- trade barriers make imports more expensive and as a result, they also decrease the demand for imports. However, in retaliation trade partners can do the same and increase prices for exports.
- To protect domestic jobs from "cheap" labour abroad: Wages in industrialized countries are higher because their output per worker is higher than developing country. To protect local jobs, government imposes taxes to raise price of imported goods produced with cheap labor.
- Bargaining: even when a country can see no economic benefit in protection, it may find it useful to have tariffs and restrictions bargaining gambits in negotiating better terms with other nations
- Structural unemployment: the decline of the highly localized industry due to international trade causes greater problems of regional (structural) unemployment. If it would take a long time to re-locate the labour to other jobs, them this can put the government under considerable political and humanitarian pressure, to restrict imports that are causing the industry to decline.

QUESTION 22

May 2018 Question Two C

Roles of international monetary fund

The international monetary fund is a global organization found in the past-war economic settlement which included the Bretton- woods system of managed exchange

Rates. Roles of IMF include.

- To promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.
- To promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems?

- To facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
- To give confidence to members by making the general resources of the fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity. In accordance with the above, to shorten the duration and lessen the degree of disequilibria in the international balances of payments of members.

QUESTION 23

November 2017 Question Five B

Advantages of export promotion strategy in developing countries

- Since export promotion industries are exposed to competition from foreign producers, they are likely to strive for greater efficiency in production and higher quality of goods.
- This will ensure their competitive both in the domestic and foreign markets.
- Creation of employment: generation of employment opportunities is a major consideration in any industrialization strategy. In this regard, export oriented industries absorb labour, thereby helping to reduce the problem of unemployment in the country for example, people will be employed directly in a particular export promotion industry, as well as indirectly in allied industries such as transport and insurance.
- Addition of value to primary exports by establishing export oriented industries, a country is able to process its primary products instead of exporting them in their raw form. This adds value to primary exports, hence increasing foreign exchange earnings.
- Full utilization of plant capacity due to the fact that export promotion industries have a wide market, they are able to fully utilize the existing plant capacity, in this way, they can take advantage of large scale production. This will lead to lower production costs.
- Greater utilization of resources: export promotion industries have a wider market for their produce for both domestic and foreign markets. They are therefore able to produce for a greater capacity production for export enables them to increase utilization of locally available resources that would otherwise be idle.
- Earning of foreign exchange: export promotion leads to expansion of goods for the foreign market. These goods earn foreign exchange that can be used to facilitate development.
- Export oriented strategies permit more ready access to the import of intermediate and capital goods.
- Export promotion may also promote competition in the lines of comparative advantage.
- Export oriented regime may also attract foreign direct investment hence transfer of technology and employment.

QUESTION 24 890

May 2017 Question six A

Case for regional economic integration by developing countries

- Reduction of production cost
- Enjoyment of regional economies of scale established from
- Enhances competitive business environment since countries are able to compete within themselves.
- Enlarge the size of the market
- Increases industrialization since people are free to invest everywhere Leads to joint infrastructural development through cost shared project or programmes
- It leads to improvement of balance of payment since it involves the exchange of exports and imports
- It leads to increased employment opportunities since there is free mobility of labour from one another country to another.CO
- It leads to specialization in areas of comparative advantage.

Case against regional economic integration by developing countries

- Trade diversion effect
- Benefits arising from free trade may be distributed unequally
- Government may suffer tax losses in revenues set from a free trade area.
- Importation of inappropriate technologies may make countries to suffer capital and revenue losses.
- It is faced with the problem of dumping of cheap and substandard goods and services from member countries
- Political instability between member countries themselves which hinders trade between them.
- It may kill infant firms in a country as a result of imports from member countries. It is faced with the problem of production of similar products thus this limits the scope of trade between the member countries.

QUESTION 25

May 2017 Question Seven A

Causes of balance of payment deficits in developing countries

- Importation of capital goods like machineries by developing countries which are expensive as well as increase in other imports.
- Natural calamities lead to a decrease in supply of domestic agricultural commodities
- Lack of sufficient funds to meet the expenditure thus developing countries are forced to borrow debt from other countries
- Decline in markets for domestic agricultural commodities and since agricultural commodities are highly perishable, they deteriorate before fetching any foreign exchange.

- Unfavourable terms of trade, that is, the value of imports is higher than the value of exports in world markets thus more payments as compared to receipts leading to a deficit.

QUESTION 26

May 2017 Question Seven A

Limitations of theory of comparative advantage

- Government may restrict trade
- Comparative advantage measures static advantage but not any dynamic advantage e.g. Kenya can be a good car manufacturer if it makes the necessary investment.
- Increased specialization may lead to diseconomies of scale.
- Transport costs may outweigh any comparative advantage.
- The theory assumes that markets are perfectly competitive – in particulars there is perfect mobility of factors without any diminishing returns and with no transport costs. The reality is output from factor inputs is subject to diminishing returns and transport costs.
- Complete specialization might create structural unemployment as some workers cannot transfer from one sector to another.
- Relative prices and exchange rates are not taken into account in the simple theory of comparative advantage. For example if the price of X rises relative to Y , the benefit of increasing output of X increases.

QUESTION 27

November 2016 Question Five A

Likely economic effect of Brexit" on the United Kingdom's

i. Exchange rate: the steering pound may depreciate against other currencies like the euro.
ii. Interest rates: Brexit is likely to lead to a rise in interest rates to avert depreciation of sterling pound and alsorestrictionsonfinancing.com
iii. Inflation rate: Brexit will lead to a reduction in economic activity. This will lead to a depression and consequently decline in inflation rate.
iv. Securities exchange: Brexit creates uncertainty which will most likely lead to a decline in share prices in the stock market leading to capital losses.

QUESTION 28

May 2016 Question Six A

Balance of payment explanation

Balance of payment is a record of all financial transactions between residents of a country and residents of foreign country. Residents refers to individuals, companies and government transactions are recorded whether they drive from trade in goods and services or transfer of capital. If exports value exceed import value then the balance of payment is said to be in trade surplus and if reverse holds trade deficit.

QUESTION 29

September 2015 Question Six A

Measures that developing countries can use to correct balance of payment deficit

Investment in modern critical infrastructure to support businesses and industries in international markets.

.Use of protectionist measures such as import quotas and tariffs.

Investment in education and health care: this will help to boost human capital and increase competitiveness in fast – growing and high value industries such as biotechnology, engineering, finance and medicine policies to encourage business start ups; successful small businesses with export potential.

Policies to raise productivity: measures to bring about more innovation and incentives to increase investment in industries with export potential are supply side measures designed to boost export performance and compete more effectively with imports.

Devaluation of a currency: the central bank may lower the exchange rate which helps improve competitiveness and making imports more expensive

END

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