**INTRODUCTION TO ECONOMICS**

SECTION A: MULTIPLE CHOICE ANSWERS

1. A
2. B
3. C
4. C
5. B
6. D
7. A
8. E
9. B
10. C
11. A
12. B
13. B
14. B
15. C
16. C
17. D
18. C
19. B
20. B

SECTION B

**5 QUESTIONS 20 MARKS EACH**



|  |  |  |
| --- | --- | --- |
| Price of samoosa (MK) | Quantity Demanded | Quantity Supplied |
| 200 | 1 | 10 |
| 150 | 3 | 7 |
| 100 | 5 | 5 |
| 50 | 8 | 2 |

1. **Define demand. Using the table above, draw a demand curve and clearly label it. (2 marks)**

Demand is the amount people are willing and able to purchase at each possible price.

Price of Samoosa

Demand

Quantity demanded

1. **The samoosas are very tasty and the customers tell their friends thereby leading to an increase in customers. How will this affect demand? Include a diagram. (2 marks)**

Price of Samoosa

New Demand

Demand

Quantity demanded

1. **Define supply. Using the same table above, draw the supply curve. (2 marks)**

Supply is the amount producers are willing and able to offer for a possible price.

Supply

Price of Samoosa

Quantity of samoosa

1. **Suppose the price of an ingredient used in making samoosas goes up, how will this affect supply? Include a diagram. (2 marks)**

New Supply

Supply will decrease.

Supply

Price of Samoosa

Quantity of samoosa

1. **At which point does equilibrium occur? Illustrate with a diagram. (2marks)**

Equilibrium is a situation in which there is no tendency for change. It occurs at a price where quantity demanded equals quantity supplied. K100

Supply

Price of Samoosa

Equilibrium

Demand

Quantity of samoosa

**(f) Explain the concept of price elasticity of supply. [4 marks]**

Up to 2 marks for definition:

- the responsiveness of supply to a change in price/the percentage change in quantity supplied of a product divided by the percentage change in price)

- how price affects supply/change in supply divided by change in price

Up to 2 marks for further development:

-elastic supply has value greater than 1. inelastic supply has a value less than 1 PES varies from perfectly elastic to perfectly inelastic. PES varies along the length of the supply curve. always positive

**(g) Discuss to what extent time is the main influence on the price elasticity of supply. [6]**

marks for why it might be the main influence:

- at a particular moment in time, it may be very difficult (or impossible) to increase supply

supply may be relatively inelastic

- the longer the period of time, the more responsive supply is likely to be to a price change. relatively elastic

marks for discussion of other possible influences:

- the ease with which a product can be stored , the easier it is to store the product, the more elastic the supply will be

- the availability of factors of production, e.g. supply may be inelastic in periods of full employment

-the cost of adjusting supply, e.g. it is cheaper to adjust the supply of pens than the supply of ships

2. **List the four main factors that influence the total demand for money? (4 marks)**

* The level of prices
* The level of interest rates
* The level of real national output (real GDP)
* The pace of financial innovation

1. **Money supply is the amount of money available within a specific economy. The supply is usually considered as three categories, M1, M2 and M3. Define the three categories. (4 marks)**

M1 is base money, bank notes, coins and central bank deposits. Part of the problem of M1 is that financial innovation has created new instruments that blur the line between accounts used for exchange transactions and account used for savings.

M2 is the most relevant category. It includes all assets in M1 plus savings deposits, money market funds and some other assets.

M3 represents all forms of money

1. **What are the functions of money and the desirable features associated with each function.(6 marks)**

* **A medium of exchange.**

Money is used as an intermediate object of trade as opposed to direct barter, it simplifies the process of trade by allowing trade to take place without the need for double coincidences.

Should have liquidity, easily tradeable, with a low spread between the prices to buy and sell (low transaction cost).It should be easily transportable and be durable.

* **It is a unit of account.**

When the value of a market good is frequently used to measure or compare the value of other goods or where its value is used to denominate debts then it is a functioning as a unit of account.

It should be divisible into small units without destroying its value. It should be fungible, that is one unit or piece must be exactly equivalent to another and it must be a specific weight or measure or size to be verifiable countable.

* **It is a store of value**.

When something is purchased primarily to store value for future trade then it is being used as a store of value.

It should be long lasting, durable. It must not be perishable or subject to decay. It should have a stable value and it should be difficult to counterfeit and the genuine money should be easily recognizable.

**d) Discuss whether a government should be concerned if people began to spend most of their money. (6 marks)**

marks for why it should be a concern:

* high levels of spending could cause inflation demand-pull inflation
* people may not have sufficient savings to cope with unexpected events , may get
* into financial difficulties and have to rely on the government
* lack of savings could reduce funds for lacking/investment which would reduce economic growth
* people may spend more on imports , exports could be diverted to the home market
* worsen the current account position of the balance of payments
* if increased spending is on demerit goods, creates social costs

marks for less of a concern:

* high levels of spending could encourage firms to increase their output leading to economic growth and a fall in unemployment
* higher output could result in firms taking greater advantage of economies of scale, lower costs of production could make firms more internationally competitive
* high levels of spending would increase tax revenue, both direct and indirect; this could be spent on, e.g. health care
* high levels of spending may attract multinational companies due to a larger market
* raises additional tax revenue for the government which can be spent on improving services/infrastructure

2. **Define the term GDP and how to calculate GDP using the expenditure method.(8 marks)**

- Gross Domestic Product (GDP) measures the value of final output (goods and services) produced within a country during a particular period, usually a year.

- It includes the output of the many foreign owned firms that are located in Malawi following foreign direct investment in the economy.

-Only final goods and services are included in GDP otherwise we would end up counting items twice if we included inputs that are used to make the final goods and services.

This is the sum of the final expenditure on Malawi produced goods and services measured at current market prices. The full equation is as follows:

GDP = C + I + G + (X –M)

Where C is Household spending (consumption)

I is Capital Investment spending

G is government spending

X is the exports of goods and services

M is imports of goods and services.

1. **What is Public sector net cash requirement? (2 marks)**

How much the public sector needs to borrow to finance its expenditure plans each financial year. It is borrowing by the central government, by local authorities and by public corporations. It is the combined deficit of central government + local government + the public corporations.

1. **How can a budget deficit be financed. (6 marks)**

A deficit is usually financed through the issue of new government debt to the capital markets. This can be in the form of government bonds.

Other methods include:

* Grants from foreign donors
* Borrowing from foreign governments/financial institutions
* Soft/concessional loans from the IMF/World Bank
* By raising taxes

1. **Describe the risks associated with a high level of domestic borrowing (3 marks)**

If the economy only has a small supply of savings, increased government borrowing may force up interest rates and crowd out the private sector investment.

Higher borrowing in a long- run requires an increase in the tax burden- this may dampen demand and economic growth.

If the national debt increases, annual interest payments on the debt goes up.

**4 Costs are defined as those expenses faced by a business in the process of supplying goods and services to consumers. In the short run, we make a distinction between fixed and variable costs.**

1. **Describe the difference between fixed and variable costs. Use examples of each. (4 marks)**

Fixed costs relate to the fixed factors of production and do not vary directly with the level of output. Examples are the rent of buildings, leasing of capital equipment, interest rates on loans and the cost of business insurance.

Variable costs vary directly with output since more variable units are required to increase output. Examples are the cost of utilities, costs of raw materials and components, wages of part time staff, etc.

1. **Discuss marginal revenue and at which point of marginal revenue total revenue is maximised? (4 marks)**

Marginal revenue is the change in total revenue as a result of selling one extra unit of production. The firm will increase quantity supplied as long as each additional unit adds more to total revenue than total cost – that is, as long as marginal revenue exceeds marginal cost.

Most firms face a downward sloping demand curve for their products. As AR falls, MR will fall as well (price has to be lowered to sell additional units). Total revenue will rise at a decreasing rate until marginal revenue is zero. At this point, total revenue is maximised. when marginal revenue =zero.

1. **What are economies of scope ? (2 marks)**

Changes in average costs because of changes in the mix of output between two or more products. The potential cost savings from joint production.

1. **What is the law of diminishing marginal returns and the criticisms against it ?(5 marks)**

The law of diminishing marginal returns states that as we add more units of the variable input to fixed amounts of land and capital the change in total output will first rise, then fall.

The underlying assumption is that a business operates in the short run with fixed factor resources and given constant technology. This concept may hold true for many small and medium sized businesses that have little access to additional resources in the production process. The process of globalisation and the ability of transnational corporations to source inputs from more than one economy and engage in rapid transfers of technology and other information , makes the concept of diminishing returns less relevant to the real world of business. In many industries, as a business expands, it is more likely to experience increasing returns rather than diminishing returns.

1. **Describe why marginal product first rises then falls. (5 marks)**

The behaviour of marginal product is linked directly to the productivity of each additional worker. At low levels of employment, the fixed factors of production are under utilised. Thus each additional worker will have plenty of capital to use and as a result, marginal product will rise. However beyond a certain point the fixed factors become fully utilised and new workers will not have much capital to work with. This is when we experience diminishing returns. Eventually, workers will get in each others way and as a result, the productivity of each additional worker falls.

**5 (a) Explain three potential benefits of free trade. [6 marks ] P142**

- countries can specialise in what they do most efficiently (comparative advantage)

-provides for a more efficient allocation of resources

- world output of goods and services increases, benefits from expansion of global trade

- raising standards of living

- consumers gain from a greater choice They can benefit from consumption of goods not produced in their country/variations in products

- consumers can gain from lower prices due to greater competition

- firms can have greater choice of raw materials, this will lower costs of production/improve quality of products made economies of scale

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**(b) Distinguish between quotas and export subsidies as methods of trade protection. [4] P149-150**

Quotas:

- a quota is a restriction/limit on the imports of goods into a country

- main beneficiaries are domestic producers who face competition

export subsidies :

- payment to a domestic producer who exports a good abroad

- If receiving an export subsidy, a frim can remain competitive abroad by exporting up to the foreign price (subsidy will cover some of the difference)yet receive a higher price domestically.

-The effects are the opposite of those of a tariff.

**(c) Explain how a subsidy could be used to protect an industry from foreign competition (5 marks). P 148**

Include diagram

- a tariff is a tax on imports

-Used to restrict imports and raise revenue for government

-a tariff raises the price of imports making domestic demand contract and domestic supply expands

-gives domestic firms a boost and reduces volume of imports

-effect of the tariff depends on the price elasticity of demand and the price elasticity of supply. If demand is inelastic, imposition of a tariff will have little effect on the level of imports

-However retaliation of tariffs can lead to trade wars

**(d) Discuss the Terms of Trade and its limitations. (5 marks)**

Terms of trade (ToT) refer to the relative prices of a country’s exports to imports. They measure the rate of exchange of one good or service for another when two countries trade with eachother. An improvement in a country’s ToT (an increase in the ratio) is considered to be good for the country in the sense that it has to pay less for the products it imports, that is, it has to give up fewer exports for the imports it receives.

ToT index is calculated as follows:

ToT = 100 × Average export price index/Average import price index

If export prices are rising faster than import prices, the ToT index will rise. Fewer exports need to be given up in exchange for a given volume of imports. And vice versa

ToT fluctuate in line with changes in export and import prices. Thus inflation and the exchange rate of inflation can both influence the direction of any change in the terms of trade

Limitations of ToT

Using the terms of trade to determine the health of a country's [economy](http://www.investopedia.com/terms/e/economy.asp) can draw the wrong conclusions. It is important to know why exports increase relative to imports, especially since the terms of trade are directly impacted by changes in export and import prices. Terms of trade measurement is often recorded in an [index](http://www.investopedia.com/terms/i/index.asp) for [economic](http://www.investopedia.com/terms/e/economy.asp) monitoring.