Economics

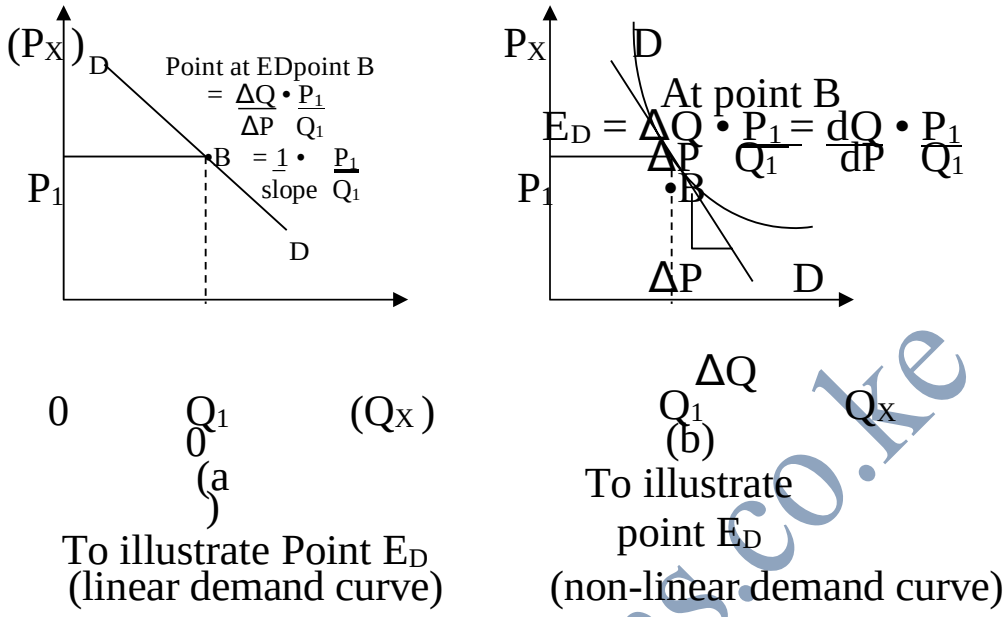
Part I: Introduction

Although the economic orientation keeps changing, the underlying concept remains the same. This revision kit is in recognition of the fundamental principle that economics is a development and learning is a process. It is absolutely necessary to have a systematic approach to studies, right up to the examination. A proper examination strategy is required irrespective of the mode of study.

The purpose of this booklet is to assist accounting students revise economics in preparation for the KASNEB Examinations. It is not intended to be a perfect substitute of either the Distance Learning Centre study pack or other economics reference textbooks. This kit serves no new purpose in that a serious student ought to look at examination papers for the past few sittings and whether compelled or not write out the answers to some of the questions in order to gain practice in self-expression.

To assist the candidate in the mastery of the subject, the explanation of questions is devoid of any economics jargon – the language used in explaining concepts is as simple and practical as possible, and with a view to enabling candidates to easily articulate economic

Where P/Q is the price divided by the quantity at the relevant point and $\Delta Q/\Delta P$ is the reciprocal of the slope of the demand curve.



For a non-linear demand curve $\Delta Q/\Delta P$ refers to the inverse of the slope of the tangent to the curve at the relevant point as shown in the diagram (b) above.

Arc elasticity of demand refers to a measure of price elasticity between two points on a demand curve (along a range of a demand curve)

It can be calculated both for linear and non-linear demand curves using the following formula:

$$\text{Arc } E_D = \frac{\Delta Q \bullet (P_1 + P_2)/2}{\Delta P} = \frac{\Delta Q \bullet P_1 + P_2}{(Q_1 + Q_2)/2 \quad \Delta P \quad Q_1 + Q_2}$$

Where P_1 and Q_1 represent the initial price and quantity respectively and P_2 and Q_2 represent the new price and quantity respectively.

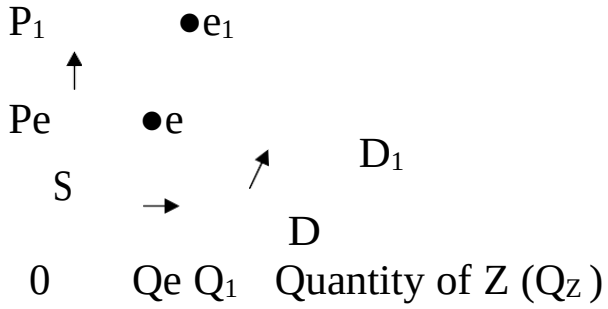


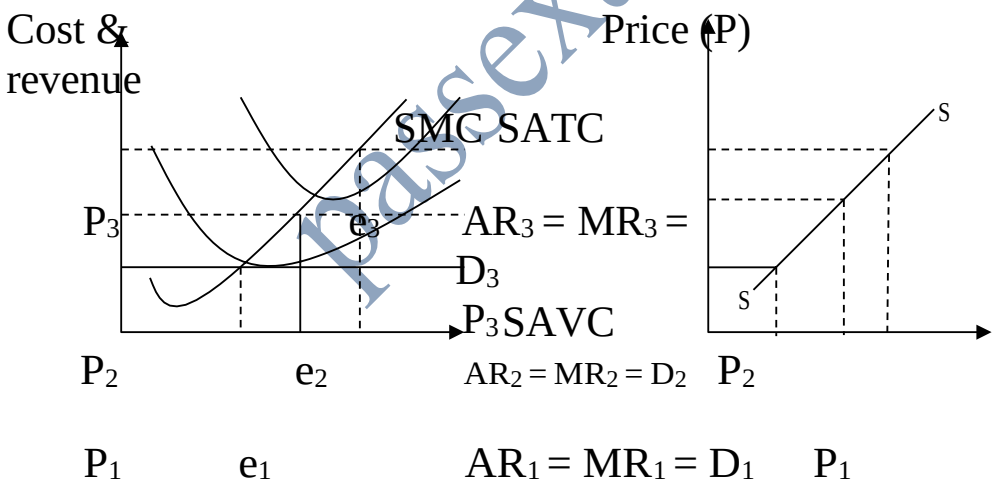
Fig 11.10: Increase in demand for Z

The increase in demand for commodity Z denoted by the upward shift of the demand curve from DD to D_1D_1 eventually increases both the price and quantity of Z from Pe to P_1 and Qe to Q_1 respectively.

NB: On its part, the diagram for commodity Y upon the successful advertising would be as below:

Below this price (OP_1), say at price OP_3 , the firm will be at equilibrium at point e_3 producing an output of OQ_3. At this point, the firm its not covering its average variable cost and continuing production will see the firm increasing its losses. So at the point where the firm is not covering its average variable costs it would benefit the firm to quit production. Therefore at some point, though a firm produces while selling at a loss it can not indefinitely continue doing so. This is because when it is not covering its average variable cost (AVC) losses are reduced by ceasing production.

(ii) The short-run is the period where at least one factor of production must be fixed. The supply curve will show that when price increases quantity supplied increases (ceteris paribus). To explain the short-run supply curve of a firm under perfect competition consider the diagrams below:



To illustrate the short-run supply curve of a firm under perfect

Relevance Of Multiplier

The Keynesian Model of the Multiplier however is a Short Run Model which puts more emphasis on consumption than on savings. It is not a long run model of growth since savings are the source of investment funds for growth. It is appropriate for mature capitalist economies where there is excess capacity and idle resources, and it is aimed at solving the unemployment problem under those conditions – (i.e. problem of demand deficiency with the level of investment too low, because of lack of business confidence, to absorb the high level of savings at full employment incomes.

It is not a suitable model for a developing economy because:

1. In less developed economies exports rather than investment are the key injections of autonomous spending.
2. The size of the export multiplier itself will be affected by the economies dependence on two or three export commodities.
3. In poor but open economies the savings leakage is likely to be very much smaller , and the import leakage much greater than in developed countries.
4. The difference, and a fundamental one, in less developed countries is in the impact of the multiplier on real output, employment and prices as a result of inelastic supply.

The Accelerator:

Suppose that there is a given ratio between the of output Yt at any time t, and the capital stock required to produce it Kt and that this ratio is equal to α hence:

$$Kt = \alpha Yt$$

The coefficient α is the capital – output ratio, $\alpha = K/Y$ and is called the **accelerator co-efficient**. If there is an autonomous increase in investment, ΔI this through the multiplier process will lead to