

FINAL EXAMINATION – ANSWERS (All out of 100 MARKS)

COMMUNITY ECONOMIC ANALYSIS

Instructions to students: Attempt all the questions

1. What do you understand by the following terms as they have been used in community economic analysis? (20 Marks)

- 1) **Economics** – A social science or a branch of knowledge dealing with production, consumption and transfer (distribution) of wealth. It can also be regarded as the condition of a region or a group's material prosperity.
- 2) **Micro Economics** – A branch where the unit of study is the behavior of an individual, firm or household. It is the study of how individuals make their choices about what to produce, how to produce and for whom to produce, and what price to charge.
- 3) **Macro Economics** – A branch of economics dealing with the performance, structure, behavior and decision-making of an economy as a whole for example using of interest rates and government spending to regulate an economy's growth and stability.
- 4) **Decision Making** – The process of selecting the suitable action from among several alternative courses of action.
- 5) **Demand forecasting** – the activity of estimating the quantity of a product or service that consumers will purchase.
- 6) **Investment** – This is an asset or an item that is purchased with the hope that it will generate income or appreciate in value at some point in the future. An investment always concerns the outlay of some asset today

- (time, money, effort etc.) in hopes of a greater payoff in the future than what was originally put in.
- 7) **International trade** – This is the exchange of goods and services across international boundaries or territories.
 - 8) **Privatization** – this is the incidence or process of transferring ownership of business from the public sector (government) to the private sector (business). In a broader sense, privatization refers to transfer of any government function to the private sector including governmental functions like revenue collection and law enforcement.
 - 9) **Globalization** – This can be described as the process of blending or homogenization by which the people of the world are unified into a single society and function together. This process is a combination of economic, technological, sociocultural and political forces.
 - 10) **Inflation** – This is an important indicator of the economy. It is the continuing rise in the overall price level of an economy. In a large part, it guides government policy. Long term inflation can be a major problem.

2. State ANY FIVE aspects taken to account while coming up with the scope of Managerial economics (10 Marks)

- 1) Demand analysis and forecasting
- 2) Production function
- 3) Cost analysis
- 4) Inventory management
- 5) Advertising
- 6) Pricing system

7) Resource allocation

3. State and briefly explain FIVE types of demand. (20 Marks)

- 1) **Direct and derived demand** – Refers to the demand for goods for final consumption. It is the demand for consumer goods like food items, readymade garments etc. By contrast, derived demand refers to demand for goods which are needed for further production. It is the demand for producer goods like industrial raw materials, machine tools and equipment.
- 2) **Domestic and industrial demands** – This refers to the demand of goods that can be needed both domestically and industrially like coal. This type of demand determines the packaging and pricing of said goods as they have different uses.
- 3) **Autonomous and induced demand** – When the demand for a product is tied to the purchase of some parent product, its demand is called induced demand. Autonomous demand loosely, directly refers to direct demand talked about above. In the present world of independence, there is hardly any autonomous demand as nobody really consumes one single product or commodity since everyone consumes a bundle of commodities.
- 4) **Perishable and durable goods' demand** – Both consumer goods and producer goods are further classified into perishables (these are non-durable, single use goods) and durable (these are non-perishable, repeated use goods.)
- 5) **New and replacement demands** – If the purchase or acquisition of an item is meant as an addition to the stock, it is a new demand. If the purchase of an item is meant for maintaining the old stock of capital/asset, it is replacement demand.

- 6) Final and intermediate demands** – This distinction is again based on the type of goods; final or intermediate. Final demand is the demand for goods that have undergone the whole production process and are complete for usage e.g., purchasing a new latest iPhone. Intermediate demand is the demand for goods that come in between two things in time, place, character etc. such as construction materials.
- 7) Individual and market demands** – Individual demand is the demand of goods for individual use or need. Market demand refers to the demands influenced by market price of commodities for example, when the price is very high, a low-income buyer may not buy something though a high-income buyer may buy something.
- Others:** company demand, industry demand, total market demand, segmented market demand etc.

4. State five factors that determine demand of a commodity. (5 Marks)

- 1) Price of the commodity
- 2) Prices of other related commodities
- 3) Level of income of the consumers
- 4) Taste and preferences of consumers
- 5) Size and composition of population
- 6) Distribution of income

5. State four types of investment (5 Marks)

- 1) Gross and net investment
- 2) Ex-ante and ex-poste investment
- 3) Private and public investment
- 4) Autonomous and induced investment

6. State and briefly explain FIVE theories of trade cycle (20 Marks)

- 1) Climatic theory – some years, the climate is favorable for trade and business development and then some are unfavorable. Changes in climate brings about changes in agricultural production and the cycle of agricultural production results in a cycle of industrial activity for trade industry is deeply affected by the state of agricultural production.
- 2) Psychological theory – According to the psychological theory of trade, there are moods of optimism alternating the moods of pessimism in the economy without a tangible basis. At some point, people just think trade is good and that it is going to remain good. Business activity is intensified and becomes feverish. Then, all of a sudden, people start thinking that the period has lasted long enough and adversity is around the corner, thus, although there is no valid reason for depression to come about, it is just brought about by people themselves. It's all psychological.
- 3) Underconsumption theory - According to the under- consumption theory, there is too much of saving during a boom and further additions to saving reduce the level of consumption. A reduction in the level of consumption, in the face of increasing productive capacity, must sooner or later lead to the collapse of the boom.
- 4) Monetary theory - According to the monetary theory, variations in the flow of money are the sole and sufficient determinants of business activity and account for alternating phases of prosperity and depression. Basically, when the business prospects are good, the banks freely extend credit facilities.

- 5) Over-investment theory – According to over-investment theory, fluctuations in the rate of investment are the main causes of trade cycles. Investment becomes excessive during a boom. That investment during the boom is borne out by the fact that investment goods industries expand faster than consumption good industries during the upward phase of the cycle. During the depression, investment goods industries suffer more than consumption goods industries.
- 6) Keynes theory – According to Keynes, the business cycle is a rhythmic fluctuation in the overall level of income, output and employment. Fluctuations in economic activity are caused by fluctuations in the rate of investment and fluctuations in the rate of investment are caused mainly by fluctuations in the marginal efficiency of capital. The rate of interest which is the other determinant of investment, is more or less stable and does not play a significant role in cyclical fluctuations in investment.

7. The currency exchange rate is the rate at which one currency trades against another on the foreign exchange market. State and explain FIVE factors which influence the exchange rate. (10 Marks)

- 1) **Inflation** – if inflation in a certain country is lower than elsewhere, then their imports will become more competitive and there will be an increase in demand for their currency. Also, foreign goods will be less competitive and so their citizens will supply less of their currency.
- 2) **Interest rates** – If the interest rates of a certain country rise relative to elsewhere, it will become more attractive to deposit money in that country thus the demand for their currency will rise. This is known as “hot money flows”. Therefore, the demand for their currency will appreciate.

- 3) **Speculation** – If speculators believe the value of a currency in a given country will rise in the future, they will demand more now to be able to make a profit. This increase in demand will cause the value to rise. By this factor, movements in the exchange rate do not always reflect economic fundamentals but are often driven by the sentiments of the financial markets.
- 4) **Change in competitiveness** – If goods from a given country become more attractive and competitive, this will also cause the value of the exchange rate to rise
- 5) **Relative strength of other currencies** – Some currencies rise in value when others drop their valuation. An example of this is between 1999 and 2001, the value of the sterling pound appreciated because the euro was seen as a weak currency.
- 6) **Balance of payments** – A large deficit on the current account means that the value of imports is greater than the value of exports. If this is financed by a surplus on the financial/ capital account then it is okay. A country that is struggling to attract enough capital inflows will see depreciation in the currency

8. Briefly explain FIVE types of unemployment (10 Marks)

1. **Structural unemployment** – It is also known as Marxian unemployment or long-term unemployment. It is due to slower growth of capital stock in the country. The entire labour force cannot be absorbed in productive employment because there are not enough instruments of production to employ them
2. **Seasonal unemployment** – This arises because of the seasonal character of a particular productive activity so that people become unemployed

- during the slack season. Occupations relating to agriculture, sugar mills, rice mills, ice factories and tourism are seasonal.
3. **Frictional unemployment** – This arises when the labour force is temporarily out of work because of perfect mobility on the part of the labour. In a growing and dynamic economy, in which some industries are declining and others are rising and in which people are free to work wherever they wish, some volume of frictional unemployment is bound to exist. This is because it takes time for the unemployed labour to learn new trades or to shift to new places where there is a demand for labour but the unemployed workers are either not fit for the jobs in questions or not in the right place to meet this demand.
 4. **Cyclical unemployment** – it is also known as Keynesian unemployment. It is due to deficiency of aggregate effective demand. It occurs when business depression occurs.
 5. **Disguised unemployment** – This is the most wide spread type of unemployment in underdeveloped countries. This is because stock capital does not grow fast. The capital stock has not been growing at a rate fast enough to keep pace with the growth of the population, the country's capacity to offer productive employment to the new entrants to the labour market has been severely limited.