KASNEB NOTES: NEW SYLLABUS

ECONOMICS 2021 NOTES

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REVISED SYLLABUS NOTES

ECONOMICS NOTES

FOUNDATIONAL LEVEL

REVISED SYLLABUS

2021

UNIT DESCRIPTION
This paper is intended to equip the candidate with knowledge, skills and attitude to identify the impact and interaction of economic principles in various situations and apply the principles in decision making.

LEARNING OUTCOMES
A candidate who passes this paper should be able to:

- Apply basic mathematical and graphical techniques to analyse economic relationships
- Apply the knowledge of economics in decision making
- Analyse economic problems and suggest possible policy related recommendations
- Apply knowledge of economics in international trade and finance
- Relate economics to income levels and development in a country

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
- Methodology of economics: positive and normative economics, scientific methods, economics as a social science.
- Economic systems: planned economy, free market economy, mixed economy
- Consumers' sovereignty and its limitations

2. Demand, supply and determination of equilibrium

- Demand analysis
- Definition
- Law of demand
- Exceptional demand curves
- Individual demand versus market demand
- Factors influencing demand
- Types of demand
- Movement along and shifts of demand curves
- Elasticity of demand
- Types of elasticity: price, income and cross elasticity
- Measurement of elasticity; point and arc elasticity
- Factors influencing elasticity of demand
- Application of elasticity of demand

3. Supply analysis

- Definition
- Individual versus market supply
- Factors influencing supply
- Movements along and shifts of supply curves
- Definition of elasticity of supply
- Price elasticity of supply
- Factors influencing elasticity of supply
- Application of elasticity of supply

4. Determination of equilibrium

- Interaction of supply and demand, equilibrium price and quantity
- Mathematical approach to equilibrium analysis
- Stable versus unstable equilibrium
- Effects of shifts in demand and supply on market equilibrium
- Effect of taxes and subsidies on market equilibrium
- Price controls: Maximum and Minimum price control
- Price decontrol: Effect of Minimum and Maximum price decontrol
- Reasons for price fluctuations in agriculture

5. The theory of consumer behaviour

- Approaches to the theory of the consumer - cardinal versus ordinal approach
- Utility analysis, marginal utility (MU), law of diminishing marginal utility (DMU)
- Limitations of cardinal approach
- Indifference curve analysis; Indifference curve and budget line
- Consumer equilibrium; effects of changes in prices and incomes on consumer equilibrium
- Derivation of a demand curve
- Applications of indifference curve analysis: substitution effect and income effect for a normal good, inferior good and a giffen good; derivation of the Engels curve
- Consumer surplus/Marshallian surplus

6. The theory of a firm: The theory of production

- Factors of production
- Mobility of factors of production
- Short run analysis
- Total product, average and marginal products
- Stages in production and the law of variable proportions/the law of diminishing returns
- Long run analysis
- Isoquant and isocost lines

- The concept of producer equilibrium and firm's expansion curve
- Law of diminishing returns to scale
- Demand and supply of factors of production
- Wage determination: demand and supply for labour
- Wage differential
- Trade unions: functions, effectiveness and challenges
- Transfer earnings and economic rent

7. The theory of costs

- Short run costs analysis and size of the firm's total cost, fixed cost, average cost, variable costs and marginal cost
- Long run costs analysis
- Optimal size of a firm
- Economies and diseconomies of scale

8. Market structures

- Definition of a market
- Necessary and sufficient conditions for profit maximisation
- Mathematical approach to profit maximisation
- Output, prices and efficiency of: Perfect competition, monopoly, monopolistic competition, oligopolistic competition

2. MACROECONOMICS

9. National income

- Definition of national income
- Circular flow of income
- Methods/approaches to measuring national income
- Concepts of national income: gross domestic product (GDP), gross national product (GNP) and net national product (NNP), net national income (NNI) at market price and factor cost, disposable income
- Difficulties in measuring national income
- Uses of income statistics
- Analysis of consumption, saving and investment and their interaction in a simple economic model
- Mathematical approach to the determination of equilibrium national income
- Inflationary and deflationary gaps
- The multiplier and accelerator concepts
- Business cycles/cyclical fluctuations

10. Economic growth, economic development and economic planning

- The differences between economic growth and economic development
- Actual and potential growth
- The benefits and costs of economic growth
- Determinants of economic development
- Common characteristics of developing countries
- Obstacles to economic development
- The need for development planning
- Short term, medium term and long term planning tools
- Challenges to economic planning in developing countries

11. Money and banking

Money
- The nature and functions of money
- Demand and supply of money
- Theories of demand for money: The quantity theory, the Keynesian liquidity preference theory

The banking system
- Definition of commercial banks
- The role of commercial banks and non-banking financial institutions in the economy
- Credit creation
- Definition of central bank
- The role of the central bank; traditional and changing role in a liberalised economy, such as financial sector reform, exchange rate reform
- Monetary policy, definition, objectives, instruments and limitations
- Classical theory of interest rate determination
- Interest rates and their effects on the level of investment, output, inflation and employment
- Harmonisation of fiscal and monetary policies
- Simple IS - LM Model
- Partial equilibrium and general equilibrium

12. Inflation and unemployment
- Inflation
- Definition and types of inflation
- Causes of inflation: cost push and demand pull
- Effects of inflation
- Measures to control inflation

13. Unemployment

- Definition of unemployment
- Types and causes of unemployment
- Control measures of unemployment
- Relationship between unemployment and inflation: The Phillips curve

14. Agriculture and Industry

- Role of agriculture in economic development
- Challenges facing agricultural sector in developing countries
- Policies to improve the agricultural sector
- Role of industry in economic development
- Benefits of small scale industries in developing countries
- Obstacles to industrial development in developing countries
- Policies to enhance industrial development in developing countries

15. International trade and finance

- Definition of International trade, advantages and disadvantages
- Theory of absolute advantage and comparative advantage
- World trade organisation (WTO) and concerns of developing countries
- Protection in international trade
- Regional integration organisations, commodity agreements and the relevance to less developed countries (LDCs)
- Terms of trade, balance of trade, balance of payments (causes and methods of correcting deficits in balance of payments)
- Exchange rates: Types of foreign exchange regimes, factors influencing exchange rates, foreign exchange reserves
- Foreign Direct Investment: case for and case against FDI
- Foreign Aid: Case for and case against foreign aid
- Bretton Woods financial institutions: International Monetary Fund (IMF) and World Bank
- Foreign debt management: causes, consequences of excessive debt and interventions
- Structural Adjustment Programmes (SAPs) and their impacts on the LDCs

TOPICS **PAGE NUMBERS**

MICROECONOMICS

MACROECONOMICS

TOPIC 1

INTRODUCTION TO ECONOMICS

Definition of Economics

Economics is a social science which studies the allocation of scarce resources which have alternative uses among competing and usually limitless wants of the consumers in the society. It is thus concerned with the way people apply their knowledge, skills and effort to the gift of nature in order to satisfy human their material wants

It is also defined as the study of how human beings strive to satisfy their unlimited wants using limited resources.

BASIC ECONOMIC CONCEPTS

ECONOMIC RESOURCES

These are ingredients that are available for providing goods and services in order to certify the human wants. A resource must be scarce and have money value.

Characteristics of economic resources

1. They are scarce in relation to their uses
2. They have a monetary value.
3. They have alternative uses.
4. They are unevenly distributed
5. They have utility
6. Can be combined to produce goods and services. They are transferrable from one place to another.

Types of economic resources

There are three main ways of classifying economic resources namely;

1. **Natural resources -**They are also called the gifts of nature and are fixed in such by they are held in trust by the government for the citizens. They include; forest, river, mountain, minerals and lakes.
2. **Artificial resources -**They are created by people through various production activities e.g. machinery,tools,roads,railway,airport,dams,bridges,h.e.p,harbours,soaps,books.

3. **Human resources-**They are mental/physical efforts offered by people to the production society. These efforts cannot be separated from their providers e.g. teaching, health services, mechanics, carpentry, engineers etc.

Natural Resources refer to anything given by God or nature such as fertile soil, rivers, lakes, mountains etc**.**

Man Made Resources refers to anything created by man to assist in further production such as tools, equipment's, roads and buildings etc.

HUMAN WANTS

This are basic needs that human beings need to function normally this include; food, shelter, clothing and air. Things like radio, education, watches, and vehicles are not very basic. They are meant to have an individual have a happy and comfortable and luxurious life.

- **Form utility -** This is created through changing the form of a raw material to a finished product. It is usually done during various manufacturing processes. The finished goods are in a better form for use than the raw materials.
- **Time utility -** this is created through warehousing or storage
- **Possession utility -** This is created through trade or exchange.
- **Place utility -** this is created through distribution. After goods have been produced, they must be moved to the places where they are required for use.

Characteristics of human wants

1. They are many, numerous and unlimited.
2. They continually change with time and other factors.
3. Some are repetitive e.g. supper, lunch etc.
4. Wants are competitive
5. Wants are complementary-Used together e.g. shoe polish and a shoe.
6. Wants are habitual that they always occur e.g. toothpaste, perfume etc.
7. Wants are universal-Everybody wants them.

Characteristics of basic wants

1. One can't do without them.
2. They are felt needs
3. Can't be postponed
4. They are satisfied before secondary wants.

Difficulties in satisfying human wants

Although human wants are there to satisfy man with lives requirements, it is not always possible to have them this is because;

- They are too many and new ones keep cropping up.
- Resources to satisfy them are never enough (limited).
- They are repetitive hence people will always strive for more resources.
- They continually change with time and other factors like age and gender.
- Some are habitual making life unbearable without them.
- Due to scarcity of resources, a problem of deciding which want to satisfy first with scarce resources arise.

Types of human wants

They are classified into two groups.

1. **Basic human needs-**This are things one cannot do without e.g. food. They always come at the top for the scale of preference and failure to satisfy them one can lead a miserable life or even die.
2. **Secondary human wants-**they are things one cannot do without. They help one lead a happy meaningful and comfortable life e.g. TV set, radio, cars, education, sodas etc.

NB: One must satisfy basic needs before attaining secondary wants.

Since the resources to satisfy human wants are scarce, one has to select on what wants are to be satisfied first and which can wait.

SCARCITY AND CHOICE

Scarcity and Choice if the resources available are not enough to produce goods and services to satisfy all the wants then they are said to be scarce. As a result, individuals and society cannot have all the things that they want. Since resources are limited, choices have to be made. The choice to satisfy one want implies others are forgone. Individuals have to make choices e.g. consumers with their limited income and unlimited wants have to choose how they spent their income.

Importance of scarcity

i. Makes people to work hard
ii. Stimulates usage of available resources

OPPORTUNITY COST

Opportunity Cost refers to the value of benefit expected from the best second alternative forgone. It is based on the fact that resources being scarce have competing alternative uses. The choice to satisfy one alternative means that another is forgone. The value of the second best forgone alternative is the opportunity cost.

Utility-this is the quality of that commodity that satisfies human want.
Economics-subject/discipline
Economy-this is the country's financial position.
Economies-this are the benefits of large scale.
Ceteris paribus - this is a major concept meaning, other factors held constant
Pareto efficiency - this is a situation in which it is not possible to make someone better off without making someone worse off.
Consumer sovereignity - this refers to the freedom of individuals and households to decide for themselves what they want to buy in a given market.

PRODUCTION POSSIBILITY FRONTIER/CAPACITY (PPF/PPC)

It provides a graphical illustration of the problem of scarcity and choice which is the basic economic problem. The curve shows what a country produces with existing supply of land, capital and entrepreneurship ability. With limited supply of economics resources a country has a wide variety of options and variety of goods and services it can produce. Assume a simple hypothetical economy where a country produces two types of goods i.e. agriculture and manufactured goods. The two extreme possibilities are:

a) The country commits all its resources to the production of agriculture and non to manufacturing.
b) All the resources are put to manufacture and none to agriculture.

These two extreme cases are unlikely and the country will most likely choose to produce goods of both commodities. The opportunity cost of producing either of them is increasing which the law of diminishing return.