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# Economics paper 2 set 1 and marking guide

## Section A

1. (a) With examples, distiguish between forward and backward integration in business

**Backward integration**

When a business joins, merges, establishes, takes over or acquires a business in the same industry but at an earlier stage of production such as tertiary sector buying a secondary sector (a supermarket buys a food processing industry or a manufacturer buying a distributor) or secondary sector buying a primary sector (e.g. a furniture industry buying a forest or a retailer buys a wholesaler)

Backward integration guarantees source of raw material or inputs or deny competitors sources of inputs, increased profit because the inputs are cheaper

**Forward integration**

When a business joins, merges, establishes, takes over or acquires a business in the same industry but at later stage of production such as secondary sector buying a tertiary sector (a food processing industry buying a supermarket or a distributor buying a manufacture) or primary sector buying a secondary sector (e.g. a wholesaler buys a retailer)

Forward integration guarantees outlets/market

(b) State any four factors that have hindered the development of appropriate technologies Uganda

Note : appropriate technologies is the production of techniques which is in line with a countries socio-economic goals and matches within a country's socio-economic development. It can be labour intensive or intermeadiate technology

Factors that have hindered it in Uganda

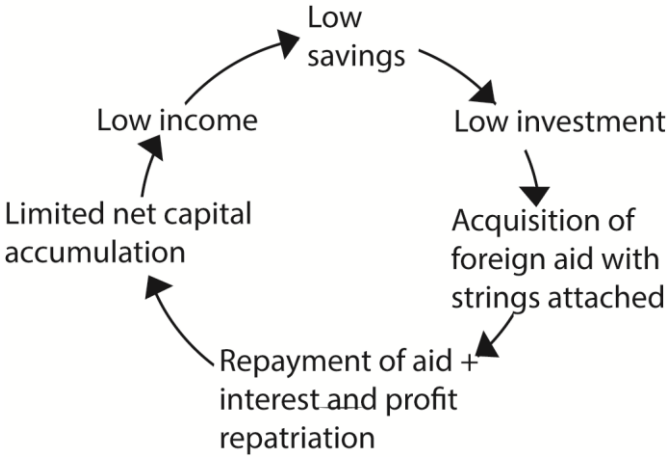
- Limited research due to inadequate funds and personel
- Limited markets for goods produced due to low income
- Poor planning and imlementation
- Over dependence on foreign technology which hinders inovation and invention
- a low level of interaction between universities and potentially innovative firms

- Insufficient national co-ordination
- Low IT literacy

(c) (i) What is meant by 'vicious cirle' in economics?

Viscous circle is a circular Constellation/collection of forces tending to act and react upon one another in such a way as to keep a poor country in a state of poverty such as low income leading to low savings leading to low investment which in turn lead to low capital accumulation and then lead to low income thereby completing the circle.

(ii) Illustrate the vicious circle of foreign aid




(d)(i) Give two reasons in support of a balanced growth strategy?

- it ensures full utilization of available resources
- it ensures constant supply of goods and services
- it creates more employment opportunities
- it increases technological development
- it expands the taxable base of the country as it increases economic activities
- it hinders rural-urban migration
- leads to fast socio-economic transformation

(ii) State two reasons agianst a balanced growth strategy

- there inadequate capital in LDCs to invest simultaneously in all sectors of economy.
- Limited internal and external market due to low income in LDCs
- Inadequate skilled labour
- Inadequate entrepreneurial skill

(e)(i) Distinguish between a planned and unplanned economy

In planned economy decisions about economic activities such as what, how, when and for who to produce are taken in advance by government or some central planning authority. While in case of unplanned economy decisions are not taken in advance rather they depend on the market forces by private individuals with limited government innervation.

(ii) Mention two advantages of a planned economy

- it is easy to control the production of harmful commodities

- it eliminates private monopolies
- there is less income inequalities
- it eliminates social costs such as pollution
- it stabilizes the prices of goods and services
- it provides equity in job opportunities
- it provides forward and backward linkages
- it leads to socio-economic transformation

**SECTION B**

2 (a) what are limitations to capital accummulation in your country>

Note:

- Capital accumulation refers to the process of increase in stock (quantity) of capital which enlarges the countries capacity to produce goods and services, leads to increase of machinery (which increase productivity of labour) and makes positive break the vicious circle of poverty.
- The level of capital accumulation in a country depends on savings, profit levels, labour productivity institutional framework and the number of entrepreneurs.
- Uganda is a low developed country

Limitations

- Low income: majority of people in Uganda have low levels of income which leads to low savings and low investments
- High population growth rate: Uganda has a very high population growth rate and the very many young dependents discourage saving and investment
- Political instability leads to high expenditure in security department leading to low capital accumulation
- Low level of education/ literacy: low levels of literacy leads to lower productivity and income and finally to low capital accumulation
- Poor infrastructure and financial institution. Poor infrastructure in form of roads and railway lines hinder movement of goods and services lowering productivity and capital accumulation
- Time preference: In Uganda majority of population prefer present consumption to future consumption and as such have low saving leading to low investments
- Demonstration effect in consumption: Uganda with better income have lavish expenditure of MDCs draining their savings
- Small size of the market discourages high productivity of goods and services
- Cultural factors hampers productivity by practices such free land acquisition and rejection of new methods of production
- Low level of entrepreneurship due to poor managerial skills and fear to start new enterprises
- The rate of capital inflow and outflow: Uganda has low capital inflows and high capital outflow due to importation
- Investment climate: the investment climate is low due high interest rate and unfavorable exchange rates these lead to low level of production and low levels of capital accumulation

(b) Account for weakness of private sector I Uganda.

(Note: to account for is to give reasons)

- There is a tendency of using capital intensive technique of production so as to increase output within the sector. This leads to limited employment prospects for available labour force. i.e. unemployment results
- The sector tends to be monopolistic in nature, specializing in one or a few production activities limiting people's freedom of choice.
- It does not promote the country's interests as individuals desires/aspiration tend to dominate at the cost of national interest
- The private sector in Uganda, often concentrate on small scale production activities. This does not enable it generate economies of scale
- The high degree of ignorance among the people also hinders the desired activities or targets of the private sector in the country
- The sector is faced with unpredictable political polies by the government, where there is the threat and fear of nationalization programs by the state
- Private sector activities are mostly located in urban areas. This leads to rural urban migration with its associated problems like increase in crimes rate, congestions and poor hygiene.
- The sector leads to underutilization of domestic resource potential, due to small capital not all resources in the country are utilized
- The private sector fear risks involved in business undertaking.
- Private sector leads to income inequalities since few people are engaged in productive activities.
- Capital outflow/profit repatriation occurs in Uganda since private sector is dominated by foreign ownership mostly Asians.
- The private sector in Uganda is usually profit motivated. This acts against the aspiration of the consumers.
- The private sector in Uganda engages rudimentary and out-dated technology that limits the scale of output.

3(a) How do you obtain Net National Product (NNP)?

NNP = GNP – depreciation

Obtaining NNP from GDP

NNP = GDP + Net Property Income from abroad – Depreciation

(b) What factors tend to limit the size of Uganda's Gross Domestic Product (GDP)

Note

GDP is the measure of flow of goods and services produced within the country irrespective of who produces them. It includes output produced in the country by both nationals (residents) and foreigners (foreign investors and expatriates) in a period of time usually a year.

Or

GDP is the total money value of goods and services produced by nationals and foreigners within the country in a given time period usually a year

**Causes of low GDP**

- Inadequate skilled manpower leads the country to operate below capacity resulting in limited GDP.
- Limited domestic consumer market limits productivity leading to low level of GDP
- Low technology leads to low productivity of good of low quality
- Limited political will toward industrialization, often government allocate little resource in development of infrastructures leading industrial development
- Lack of independence: Uganda still relies on foreign economies for her development projects which do not favor industrialization as aid given is tied to other expenditure, hence this limits the size of GDP.
- There is inadequate financial capital to invest in industrial projects to widen the size of GDP. Most people do not have access to financial credit especially in form of foreign exchange for importation of capital assets and basic raw materials for industrialization.
- Low levels of entrepreneurship and management skills limit production leading to low level of GDP
- Limited forward and backward linkages between different sectors in the country such as industries and agriculture
- Natural factors such unfavorable climate limits agricultural output – the major employer, leading to low GDP.
- Massive profit repatriation leads to limited growth and expansion of industries.
- Political insecurity discourage foreign investment in the country.

4 (a) Outline the types of inequalities found in Uganda

- Income inequality
- Sector inequality
- Regional inequality
- Social inequality
- Political inequality

(b) What are the advantages and disadvantages of these inequalities in Uganda

Advantages

- Income inequality encourages hard work especially among the poor who would wish to be like the rich. This at the end results into more output in the long run
- Income inequality results into an investment because the rich usually have high marginal propensity to save and invest in productive ventures
- The government is forced to undertake redistributive development policies which have long term effect on development of economy
- Innovations among the poor have been recognized which have resulted into entrepreneurship and hence higher output.
- Competitive production is encouraged since the less advantaged groups or regions strive harder to join advantaged group or region.
- Labour mobility is encouraged in order to get employment and better pay in areas or regions where such opportunities exist.
- There exist respect, e.g. between ruling and non-ruling groups. The rich and the poor. This bring about harmony in society

Disadvantages

- Misallocation of resources. Income inequalities tend to lead into misallocation of resources in economy because the rich influence demand therefore this means that the urgent needs of of the rich are the ones that are satisfied first before those of the poor.
- Reduction in government revenue because majority of the people have low taxable income.

- Capital outflow because majority of the investors are foreigners that repatriate profits leading problems of balance of payment
- Reduction in aggregate demand because majority of people have low income
- Leads to social injustice because income inequality makes the poor people to struggle to earn a living while the rich enjoy all the luxuries.
- Labour unrest because income inequality divides economy into two classes the haves and the have not. The have-not are exploited and overworked to earn a living
- Brain drainage due to unfair exploitation of worker and these leave the country for greener pasture.
- Rural urban migration: inequalities lead to people leaving the rural areas to urban area to seek for jobs and other incentives
- Income inequalities can lead to political instability when some group of people feel unsatisfied with the status quo.
- Vicious circle of poverty. Income inequality is associate with vicious circle of poverty where low income earner tend to have low saving, low investment, low capital accumulation and low economic growth
- Dualism. Inequalities bring about dualism in economy, the rich and poor, the developed and under developed regions. This retards uniform development.
- Poor standards of living for the poor people.

5 (a) What is meant by the intra-sectoral diversification?

This is the establishment of different components within a particular sector. For example establishing many types of crops and animals within the agricultural sector.

(b) What are arguments for diversification of agriculture in developing countries?

Note: Diversification of agriculture refers to the growing of various crops and rearing of different animals at the same time in a given economy. E.g. rearing of animals like goats, pigs, cows, birds and crops like coffee, maize, beans, etc.

Arguments for diversification of agriculture in developing countries

- It generates more jobs opportunity arising from the growing of different crops and rearing of different animals.
- It increases the level of total output from agriculture sector leading to an increase in the country's gross national product which promotes economic growth and development
- It brings about a more equitable distribution of income. This is because many people are employed in various agricultural activities where they are able to earn some income.
- It increases foreign exchange from different crops and animals exported
- It increases the availability of raw materials for agro-based industries which promotes industrialization
- It leads to full utilization of resources which in turn lead to increase in revenue as it forms a base for taxation
- Market expansion: agricultural diversification leads to inter-complementarity between industries such as agrochemical and veterinary services
- Reduction in rural-urban migration since agricultural sector is mainly rural
- Balanced regional development because it employs people throughout the country
- Leads to high standards of living since majority of the people are able to earn from agricultural industry.

6 Why is the government policy of encouraging Ugandans to stay in rural area likely to meet obstacles in its implementation?

- Localization of industries in town increase employment opportunities in towns and there encourages rural-urban migration

- High wage gap; the difference between the wages paid to worker in urban areas and rural area is high prompting people to migrate to urban areas for higher pay.
- Social service gap: there are better infrastructures such as roads, schools, hospitals in towns than in villages encouraging rural-urban migration
- Increase in population in rural areas; high production rate in rural areas cause population pressures in the rural area causing some of them to move to urban areas.
- Political instabilities; the common political instabilities in rural area force people to migrate to urban areas
- Low prices for agricultural products: low income from agricultural produces forces to people to move to urban areas in search for high income from wages
- Lack of credit facilities; credit facilities are mostly in urban areas
- Land and other conflicts in rural areas cause people to migrate to urban areas
- Weak implementation machinery; there is no obvious effective implementation machinery

7(a) Explain the concept of economy of high wages

The concept of high wages is an economy refers to a policy undertaken by government and other employment agencies to set high wages levels and other fringe benefits. This is aimed attracting increased labour productivity and output.

(b) Examine consequences of increased wages in an economy

Positive effects

- Increased labour productivity due to increased interest of workers for their job
- It reduces voluntary unemployment because workers are attracted by high wages
- It leads to market (aggregate demand) expansion due to increased purchasing power
- Leads increased labour efficiency due to increased interest in work
- Labour unrest is minimized
- Increase standards of living due to high income for workers
- Reduced brain drainage because workers are satisfied by the working conditions in their country
- Increased saving due to high income
- Increased government revenue through taxation such as from pay as you earn tax
- Increased equity in income distribution
- Increased development due to high demand and market

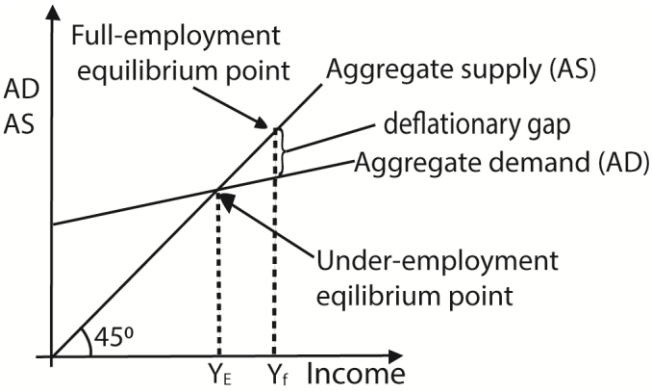
Negative effects

- It leads to inflation due to high amount of money in the circulation from wages
- It leads to high cost of production which discourages investment leading to unemployment
- High wages increase labour supply that could cause diminishing return since labour is increased on fixed production factors.
- It leads high government expenditure compelling government to borrow increasing government debt.
- Small firms may fail to pay workers leading to unemployment
- Can lead to income inequality between employed and non-employed peoples.

8(a) What is the relationship between

(i) Deflamatory gap and the level national income

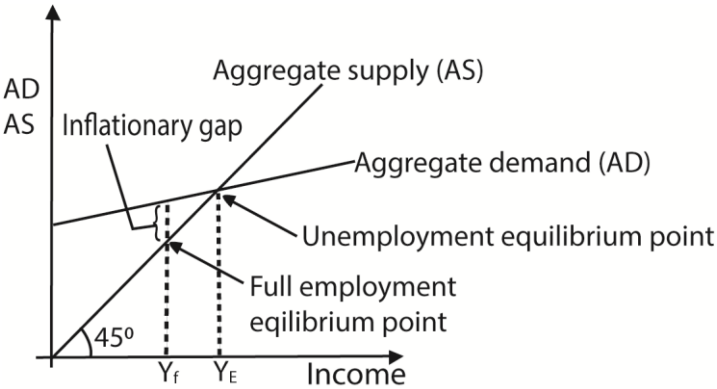
Deflationary gap is the amount by which aggregate demand falls short of aggregate supply at level of full employment'. As shown in the figure below deflationary gap is a measure of amount of deficiency of aggregate demand.




The bigger the gap the national income since the income increases from $Y_E$ to $Y_f$.

(ii) Infalationary gap and level of national income

Inflationary gap is the amount by which the actual aggregate demand exceeds 'aggregate supply at level of full employment'.




The diagram above shows that the bigger the inflationary gap, the smaller the level of national income since income increases from $Y_f$ to $Y_E$.

(b) Discus the measures that can be employed in an economy experiencing a deflationary gap?

- **Fiscal policy**: the government should reduce taxes on people's personal income so that they are left with enough disposable income to spend.
- The government should increase her expenditure on social services so as to increase the amount of money in the circulation which leads to increase in aggregate demand.
- There is a need to reduce the interest rates so that people can be encouraged to borrow for consumption which increases aggregate demand
- Government should increase wages as well as encouraging trade unions to demand increases in wages from private institutions to increase aggregate demand
- The government should encourage tourist and immigrants into the country to increase aggregate demand.
- The government should encourage export of excess output to reduce on the aggregate supply and the earnings to increase aggregate demand
- The government should control political instability so that people are encouraged to work and earn incomes to increase aggregate demand
- Adopt expansionary monetary policy: the government through the central bank print or issue more currency to increase the level of aggregate demand.
- Discourage imports which tend to increase aggregate supply and reduce aggregate demand for domestic good and service

- Encourage subsidies, the consumer can be offered subsidies to increase their levels of consumption thereby increasing aggregate demand.

9. Distinguish the role of commercial bank from that of central banks in an economy.

The role of commercial banks is:

- They accept deposits from the public on various accounts such as current accounts, saving accounts and fixed accounts. This money is repaid on demand
- They provide credit facilities and mortgages to the deficit spending units (borrowing) who in turn pay interest on the borrowed fund
- They provide safe custody for clients' valuables such as education certificates, land titles, etc.
- They operate foreign exchange bureaus which facilitate international trade and foreign aid.
- They provide facility to transfer money from one place to another, from one bank to another, from one account to another and so on.
- They receive payments from employers on behalf of employees and distribute it to the accounts of the employers
- They assist the central bank in implementation of monetary policy through various policy instruments
- They discount bills; commercial banks can cash their customers and hold bills of exchange until they mature to be presented for payment in their own business names
- They offer advisory services and training to their customers with regard to business
- They provide facilities to pay customers tax and bills
- The assist government in tax collection since taxes are paid through banks
- Credit Creation: Whenever a loan or credit is provided to the customer, he/she is not given any cash. In fact, a bank account is opened in the name of that person and amount is transferred to that account. Through this process, the bank is able to create money.
- Purchasing and Selling of the Securities: For this function, banks give you a facility for purchasing and selling the securities.
- Bullion Trading: the commercial banks trade with many countries in the world. They trade in gold and silver and provide the same facility for their customers.
- Information Banks: commercial banks are primarily an information bureau, that collects the economic, statistical, and financial data related to the trade, commerce, and industry.
- Merchant services: Most commercial banks offer merchant services that include credit card processing, mobile payment solutions, gift cards, and electronic check services.
- Leasing: Many companies use leasing as a financing method for acquiring real estate, automobiles, factory equipment, and other major fixed assets.
- Treasury management services: Commercial banks offer funds collection, disbursement, and fraud prevention.
- They accelerate trade by offering agency services, overdraft facilities, and other solutions to wholesale and retail businesses.

Functions of central bank

- **It issues currency,** it is the only financial organ responsible for issuing and renewing all notes and coins in an economy and to make sure that there is no counterfeit money in the circulation.
- It designs money that is hard to counterfeit
- **Banker, Agent and Adviser to the Government:** Central bank, everywhere, performs the functions of banker, agent and adviser to the government. It keeps all government deposits and makes sure that it effects all payments due to both internal and external on behalf of government
- **It advises government concerning financial matters**
- **It manages external debts**
- It links the government or economy to other international financial institution notably the world bank and others
- **It is a banker's bank**. All regal reserves requirements by banks are kept by the central bank

- **Lender of Last Resort:** Central bank is the lender of last resort, for it can give cash to the member banks to strengthen their cash reserves position by rediscounting first class bills in case there is a crisis or panic which develops into 'run' on banks or when there is a seasonal strain. Member banks can also take advances on approved short-term securities from the central bank to add to their cash resources at the shortest time.
- **Clearing House:** Central bank also acts as a clearing house for the settlement of accounts of commercial banks. A clearing house is an organisation where mutual claims of banks on one another are offset, and a settlement is made by the payment of the difference.
- It keeps country's foreign exchange reserves.
- **Protection of Depositors Interests:** The central bank has to supervise the functioning of commercial banks so as to protect the interest of the depositors and ensure development of banking on sound lines.
- **Implementation of the monetary policy**: The essential job of central banks is to formulate monetary policy, which entails engaging in actions (like controlling interest rates and conditions of credit) to impact the amount of money supply in the economy. The policy ensures price stability, protect the value of the native currency, maximise employment, and establish a long-term growth environment.

10. (a) How does economist express the burden of public debt?

- the debt as percentage of GNP $= \frac{Total\ debt}{GNP}\ x\ 100\%$
- the debt as percentage of export $= \frac{Total\ debt}{Export}\ x\ 100\%$
- the debt as percentage of imports $= \frac{Total\ debt}{Imports}\ x\ 100\%$
- the debt as percentage of total population $= \frac{Total\ debt}{Population}\ x\ 100\%$
- the debt as percentage of government revenue $= \frac{Total\ debt}{Government\ revenue}\ x\ 100\%$
- the debt as percentage of foreign earning $= \frac{Total\ debt}{Foreign\ earning}\ x\ 100\%$

In each case the higher the percentage the higher the burden

(b) In which ways do governments pay back public debt

- through fiscal and taxation policies
- By use of benefits or profits from state enterprises or accumulated revenue from penalties
- Use of accumulated foreign reserves or through surplus financing
- Borrowing from internal sources in order to service the loan
- Issue new government stock, bonds, shares securities which are redeemable
- Export promotion: production for export market should be encouraged so that adequate foreign exchange revenue is realized to pay of the pending external debt.
- Debt cancellation or debt wave off.
- Barter trade which minimizes the use of foreign exchange
- Privatization: public enterprises are privatized to raise income to settle the debt
- Obtaining fresh debts from a different country to pay old debts
- Debt re-rescheduling i.e. bargaining with creditor to change the dates of repayment.
- Selling foreign investments to raise money to pay foreign debts.
- Defaulting i.e. cancellation or refusal to pay indefinitely.
- Operation of surplus budget. The extra funds raised in the budget is used to pay the debt
- Printing of more money: an expansionary monetary policy is used to cover internal public debts.
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Thank you

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