Economics paper 1 set 1 and marking guide

1. (a)(i) Explain the term opportunity cost

This is the cost of an alternative foregone or sacrificed. It is referred to as real cost or alternative cost or increment cost. For example given two alternatives as X and Y, a choice in favour of X will lead Y as an alternative foregone

(ii) Give circumstances where the demand for commodity may not fall despite a rise in cost

This leads to abnormal demand curve since a rise in cost of a commodity will lead to increase in price of it even though not always

The circumstances here include

- When the commodity in question is a good of ostentation
- Price expectation
- Ignorance effect
- When the commodity is a giffen (a Giffen good is a product that people consume more of as the price rises and vice versa)
- When the commodity is a necessity
- Presence of habitual consumers such as smoker

(b) Explain why the law of variable proportions apply when the fixed inputs are combined with variable inputs in the process of production

Law of variable proportions states that as you add more units of variable factor to a fixed factor in the same state of technology in a short period of time, the marginal product of the variable factor increases up to a maximum level and then reduces.

Hence the law applies since there is excessive utilization of the fixed factors as a result of use of constant technology and given the fact time is short and as such technology cannot be improved to increase the marginal product of the variable factor.

(c) What is meant by

(i) resale price maintenance

This is the price set by the producer/manufacturers of a product and it is maintained up to the final consumer e.g. the price of a newspaper, postage stamps, and soft drinks

(ii) Reserve price

This is a price below which a seller is not willing to sell his product. It could be due to the nature of good, speculation or level of liquidity preference

(d) (i) Define income multiplier

It is the number of times a change in total autonomous expenditure multiplies its self to give rise to a final change in the level of income

(ii) Calculate the multiplier magnitude when the marginal propensity to consume is 0.6

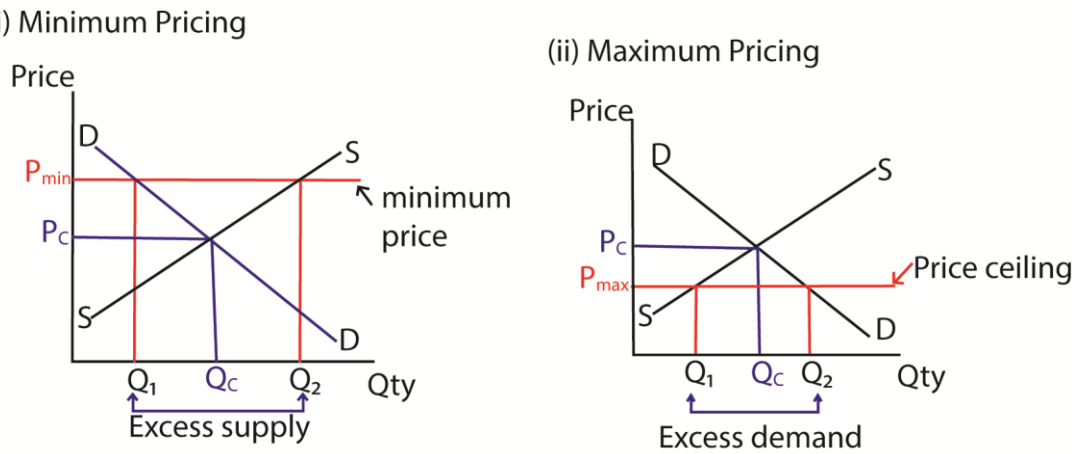
Multiplier = $\frac{1}{MPS} = \frac{1}{1-MPC} = \frac{1}{1-0.6} = \frac{1}{0.4} = 2.5$

(e) Distinguish between money wages from real wages

Money wage is the wage (earning) of a worker measured in monetary terms while real wage is the purchasing power of the money wage

SECTION B

2. (a) Using a diagram, explain what is meant by minimum and maximum prices



Qc is equilibrium quantity, PC is equilibrium price
Pmin is minum price and Pmax is maximum price fixed by government

(i) A minimum price is a price set by the government above equilibrium price below which it is illigal to sell or by a commodity. It is meant to protect producers against exploitation by the consumers. When the government fixes P_{min} above P_C the demand falls to Q_1 while the supply rises to Q_2 hence this creates surplus.

(ii) Maximum is the a price set by the government below equilibrium price above which it is illigal to sell or by a commodity. It is meant to protect customers against exploitation by the producer. When the government fixes P_{max} below P_C the demand falls to Q_2 while the supply falls to Q_1 hence this creates excess demand.

(b) What are the augment for and against government control of prices for essential goods?

Arguments for government control of prices of essential good

- Price stability: resale price maintenance ensures that prices are stable since retailers cannot increase the set prices which are indicated on the commodities. This reduces inflation

- Through maximum price legislation: price control protects the consumer against exploitation by producers because the producer cannot sell the commodity above the price
- Improves customer's standard of living: it achieved by maximum price legislation which enables customers to afford the commodities
- Controls monopoly: maximum price legislation controls monopoly power in an economy since the prices of the commodities are set below the equilibrium prices and this encourages new firms to join the production process as the monopolists will not be earning too high abnormal profit which tend to increase their economic power
- Stabilization of producer's income: as price control ensures price stability, this lead to stability in producers income from their sales. This enables them to effectively plan their production activity since they are certain about their expenditure and revenue.
- Reduce income inequality; this is achieved as all produces receive equal incomes from their produce as well as paying the same amount of money on factors of production. Consumers also pay the same amount of money hence reducing income inequality among then
- Save time: resale price maintenance save time that would be spent on bargaining. Customers are aware of the prices and have one option of paying for the commodity or not.
- Minimum price legislation encourages production. Prices are set above the equilibrium prices and this encourages producers to produce more output in order to maximize profit since prices are higher than would be equilibrium price
- Enables fair distribution of commodities across the society: through rationing, price control ensures that essential commodities that are seemingly scare are availed to different people
- Discourages consumption of undesirable goods: when the prices are set high demand for undesirable goods falls reducing consumption.
- Easy to calculate total sales: this benefits the producer in estimating his total sales and revenue since the prices are indicated on the commodities. This helps the tax officials to charge a meaningful corporate tax without under tax or overtax.
- Helps an economy to offset an economic depression by selling a price that is higher than equilibrium price.

Arguments against government control of prices

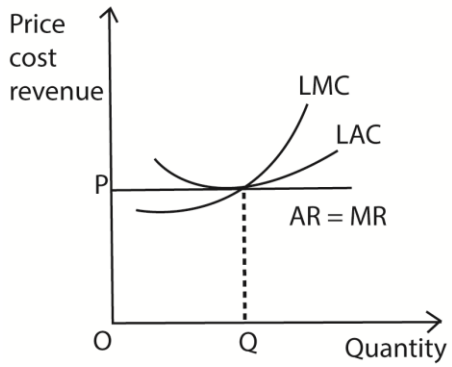
- Reduces incentives to work hard: the maximum price legislation discourages produced since their prices are set below equilibrium prices. This finally leads to reduced output
- Leads to multi-practices: the fixing prices below equilibrium prices lead to hoarding, black market, bribery, corruption and selling of scarce commodities only to friends.
- Leads to shortage on the market caused by increased demand and reduced production
- It leads to unemployment: prices set below equilibrium prices discourage investment and some firms may pull out of business.
- Leads to increased surplus on the market: the minimum price legislation increases the level of output. The surplus leads to wastage of resource.
- Increased cost of living: the minimum legislation increases the prices of commodities
- Increased cost of production: when the price factor inputs are fixed high above equilibrium, it leads to increased cost of production which may force small producers to close down and lead to monopolistic tendencies
- Leads to inefficient allocation of resources: the price mechanism is not allowed to operate freely and this lead to misallocation of resources since the market forces of demand and supply are not allowed to operate freely

- Resale price maintenance denies customers from bargaining price reduction because prices are fixed. Produces may not be able to reduce their prices reducing demand for commodities.

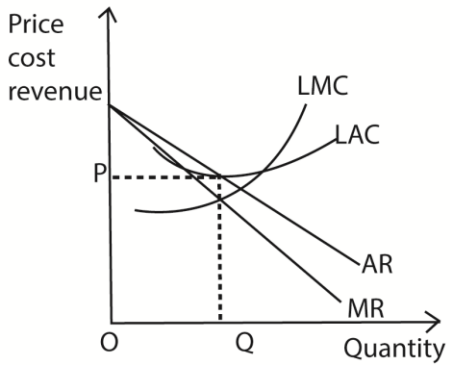
3. (a) What are the underlying assumptions of a free market?
   - There are many buyers and sellers in the market. Each one being to small to determine the output or pricing decision of an industry
   - There is free entry and exit into and from the industry
   - Products produced are homogeneous
   - There are perfect knowledge among producers and consumers regarding price and quality of output
   - There is no government intervention in the activities of firms especially in fixing prices and directing production
   - There is perfect mobility of factors of production
   - There is no advertisement costs incurred by the firms
   - Firms are price takers and an industry is said to be price marker
   - There is absence of collusion
   - Firms are maximizing profits
   - Price determines the allocation of the resource
   - Consumers are said to be indifferent

(b) Using illustrations distinguish between profit maximization positions of perfect competitive and monopolistic firms in the long run

(i) Long run perfect competition



(ii) Long run monopolistic competition



Note that the curves are not random

(i) **Long run-profit maximization of a firm under perfect competition**.
Due to abnormal profit enjoyed by firms in the short run, many other firms are attracted to join the industry due to free entry and exist. This increases the level of output on the market and hence reduction in prices. At the same time these new firms compete for the factor inputs and hence leading to rise in in the cost of production and increase average cost. Thus in the long run the AC curve is tangential to AR curve hence the firms earn normal profit

(ii) Long –run profit maximization of a firm under monopolistic competition

New firms are attracted by abnormal profits enjoyed in the short run, as a result the new firms increase competition for firm inputs which increase AC. At the same time the increased level of output lead to fall in prices up to the point where the demand curve is tangential to AC curve. This leads to earning normal profit

4. (a) Distinguish between standard of living and cost of living
   - ***Standard of living*** refers to conditions of living as measured in terms welfare or material wellbeing. It is usually indicated by the quantity of goods and services consumed.
   - ***Cost of living*** is the expense incurred by an individual household to maintain a given standard of living. For example during inflation the cost of living tends to be high and low during deflation.

   (b) Explain why changes in national Income of a country do not necessarily imply change in economic and social welfare of its citizen.
   - Type of goods produced. National income increases when a country produces capital goods, which do not necessarily improve welfare in the short run
   - When people work hard and forego leisure national income increases at the expense of quality of life
   - National income figures can be low due to omissions in measuring GNP for example due to large fraction of subsistence sector non-monetary output.
   - National income of a country can be low when illegal activities carried out by its citizen such as gambling, drug dealing and smuggling are not included in national figures and ye contribute significantly to people's welfare.
   - Income distribution: a country can have high national income figures when income is in the hands of a few people while the majority are suffering
   - Price structures: figures of national income can be high because of inflation and this does not mean that people are better off. Also a commodity can be cheap in the country and this does mean that people are worse off due to low figures of national income.
   - Differences in taste: Tastes of people in a country differ because of age, sex, education, tribal, cultural and religious differences. National income figures can be high when commodities produced or imported do not fit the tastes of the majority
   - National income figures can increase when there is unemployment, this affects welfare of people/household
   - National income figures can increase when government allocates expenditure in economically non-productive ventures like purchase of arms, paying foreign debts.
   - Countries which earn their national income abroad may rise their national income figures but with little influence on the welfare of the population
5. Discus the adoption of capital intensive strategy of economic development in developing countries

   Capital intensive strategy is a strategy employed in the production process where more of capital is used as compared to labour force. LDC should adopt capital intensive strategy because of the following merits
   - It is associated with the production of high quality products which command high prices
   - It is associated with mass production which accelerates the rate of economic growth
   - It encourages the development of skills since it requires highly skilled labour hence encouraging research, innovation and invention
   - It reduces the chances of labour unrest inform of strikes and demonstrations, since machines do not strike. Consequently, this increases production
   - It improves on productivity and efficiency of labour due to constant research and training
   - It encourages transfer of modern and efficient technology from MDCs to LDCs i.e. it bring about technological transfer
   - It encourages exploitation of idle resources such as swamps, forest, minerals and lead to increased development

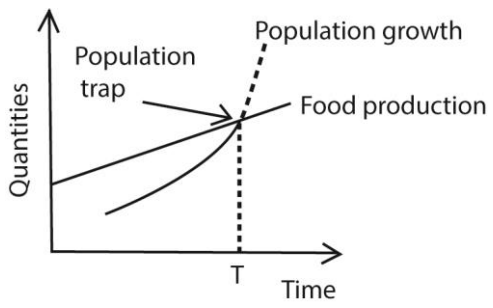
- It promotes industrialization and development of other infrastructure hence promoting the manufacturing sector.
- It save time because a worker who employs a machine does his job in a short time and gets less exhausted than manual labour.
- It brings high profits for the entrepreneur because it reduces on the wage bills for labour.
- It encourages specialization and production of surplus at low cost and export to earn foreign exchange
- It increases assets in the country, which can be used as securities for getting loans.
- It encourages the used of modern method of farming e.g. use of tractors and fertilizers

However, adoption of capital intensive strategy in LDCs has got shortcomings which among others include

- It is costly to buy machines. LDCs depend on foreign aid and loans to finance their budget, if they adopt this strategy for their development it will make them heavily indebted.
- It leads to technological unemployment, since more machines are preferred to abundant labour; this means that human beings will remain idle without jobs
- It leads to income inequality. The few highly skilled manpower will be employed to rum machines and majority without skills will not be employed and as a result the income inequality gap widen
- Cost of maintenance in terms of repairs, replacements and depreciations are high
- It requires high expenditure of foreign exchange on raw materials, skilled labour and spare parts
- Machines are not applicable at some stages of production for example in printing books where sorting of printed paper is done manually.
- It encourages large-scale production which requires a big market for commodities, which may not be available
- It is not helpful in eradication of poverty since there would be a few people engaged in production.
- It encourages creation on monopolies that restrict output so as to charge high prices
- It is not always profitable in areas with land shortage considering use of tractors, chemicals, fertilizers which are normally costly
- It encourages rural-urban migration since it is used mainly in urban areas.

6. (a) Explain
   (i) Malthusian theory of population
   The theory states that **food production will not be able to keep up with growth in the human population, resulting in disease, famine, war, and calamity**.

   The Malthusian theory attempts to explain the consequence of human population that grows exponentially where the food supply grows linearly. It suggests that there will came a given point in time, T, when the population would outstrip the means of subsistence leading to starvation, diseases, wars and death



Thomas Malthus an 18th-century British philosopher and economist developed his theory from the following observations:

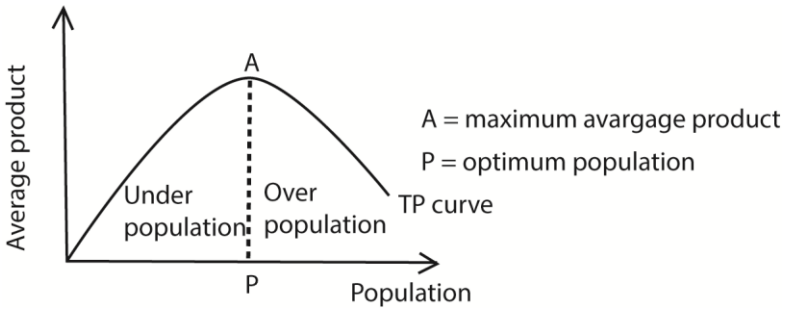
- According to Malthus, population is growing at an exponential rate e.g. 2^2, 2^3, 2^4 …
- Food supply grows at a linear rate e.g. 2, 4, 6, 8 ……
- The population depends on the amount food available
- Time will come when the population growth rate would equal to food supply and if the population exceeds food supply beyond this point (population trap) there will be suffering from starvation
- He attributed the increasing poverty, low wages and unemployment of the time to increase in population

He also made the following advices

- Need for world intervention to control population growth using preventive checks and measures such as late marriage, abstinence from sex and family planning
- Attempts to increase food supply, health care, shelter to sustain growing population
- He discouraged foreign aid in catering for growing population because people would produce more children hoping they would cater for them using foreign aid.

(ii) The concept of optimum population

The optimum population is the ideal population which when combined with other available resources or means of production of a country yields maximum return or income per head.



Features of optimum population

- There is high production with maximum average product (AP)
- There is full utilization of resources since the existing population size equal to available resource
- There is advanced technology which is constant
- The birth rate is equal to death rate as there is no natural population growth.
- There is economic stability as aggregate demand is equal to aggregate supply

- There is full employment of labour as there are no problems of unemployment and under employment
- There is zero net migration i.e. migration is equal to emigration
- The resources are evenly distributed according to regions so that there is no overpopulation or under population

(b) Explain the relationship between the Malthusian theory of population and the concept of optimum population

- The Malthusian population theory predicts the trend of population growth over a time period while the concept of optimum population is applicable at a given period of time.
- For different period of time when population is growing the concept of optimum population is applied to determine the existing relationship between population and resources
- As the population grows, the relationship between population and resources indicates under population at the beginning and then optimum population and then after over population
- Malthusian theory discusses the population problems from the demand point of view while the optimum population theory from the supply point of view
- Malthusian theory indicates a maximum number of population for a country sustainable by available food supply which if exceeded leads to misery, starvation, poverty and death whereas the optimal population theory does not believe in such a rigid or fixed maximum. It is flexible approach.
- Malthusian theory focussed attention only on land and food production as a factor hindering population growth whereas optimum population theory considers all the resources and all types of production
- Malthusian theory has only a note of warning to LDCs which are constrained by low food supply, while the optimum population theory shows them a ray of hope that efficient resource utilization will fight poverty despite the size of the population
- Malthusian theory is pessimistic as it forecast a gloomy future as it predicts starvation, famine. The optimum population theory assures than an increase in population by itself is not bad if resources can be better exploited.
- Malthus was worried about the dangers of overpopulation only; he ignored the problems of under population. Not only per capita output but the economic development is bound to be slow due to shortage of labour.

7. (a) What measures can be used to fight inflation

- ***A tight monetary policy:*** for example increase in bank rate, selling securities to public, increasing reserve ratios, credit squeeze.
- ***Fiscal policy;*** this includes the reduction of government expenditure and increase taxes to reduce aggregate demand
- ***Reorganization of distribution channels of goods;*** for example rationing of scarce commodities and nationalization of major distribution channels; e.g. former Foods and Beverages which used to supply scarce consumer goods at controlled prices in Uganda
- ***Price and income policies*** this includes control of wages, rent, interest and administered prices of commodities.
- ***Production policy;*** this includes provision of subsidies to producers of scarce commodities, removing bottlenecks, and improving transport and markets.
- ***Import and export policies;*** this includes limitation of exports of scarce commodities and encouragement of importation of scarce commodities into domestic market

- ***Saving schemes*** the government can popularize saving schemes like national lottery, old age saving schemes, this reduces money supply
- ***Exchange rate policy;*** foreign exchange should be availed to sectors producing scarce essential commodities to increase their supply
- ***Reduction of imports;*** imports from countries affected by inflation can be reduced by imposing high taxes on them. Local production of raw materials should be encouraged.
- ***The marginal propensity to save should be increased.*** As more income is saved, little will be left for consumption, thereby decreasing demand and prices in general.
- ***Increase in credit to expand investment.*** Credit facilities and foreign exchange possibilities should be relaxed to encourage investment with hope of increasing output. This is an attempt to solve inflation by credit policy.
- ***Debt repayment/servicing*** should be postponed or rescheduled until such a time when inflationary pressures are checked.
- ***The excessive demand*** could be as a result of large and increasing number of consumers. In this case the government is encouraged to reduce the ever increasing population growth rates
- ***The government is advised to control and reduce rural-urban migration***. This would reduce the pressure on commodities especially in urban area
- ***Labour productivity should be increased*** and hard works, seriousness and devotion emphasized, in order to reduce tendencies of optimism, speculation and gambling to increase output
- ***Promotion of technology through research*** in order to increase productivity
- ***Rehabilitation of the crippled industries*** so as to increase production and output
- ***Change of currency (currency reform)*** both the nationals and foreigners to regain public confidence in the legal tender.

(b) Discus the effects of the measures to curb inflation on employment of factors of production.

- ***A tight monetary policy*** in form of increase in bank rates; increase in reserve ratio and selling securities to the public will lead to less money in circulation, and with less money in circulation means that saving will be low leading to unemployment of labour force in the country
- ***Re-organization of distribution channels of goods*** in form of rationing of scarce commodities will discourage the business community who are after profit maximization hence the entrepreneurs decline to invest in such venture
- ***Reduction of government expenditures*** on productive sectors reduce employment especially in LDCs where government is the major employer of labour force
- ***Price and income*** policies in form of wage control leads to brain drainage hence leading to low production of goods and control of prices of goods will result into losses by the entrepreneurs as the inflation could have been as a result of high prices of inputs imported.
- ***Production policy*** in form of provision of subsidies to producers of scarce commodities, removing bottlenecks and improving transport will lead to high production which entails increased employment of the factors of production
- ***Using inflationary policies*** such as increase in credit to expand investment in controlling inflation can instead worsen matters as there could be too much money in the circulation that cannot be controlled, so this discourages investment by entrepreneurs.
- ***Postponement of debt repayment*** discourages donors availing grants that promote vital ventures such as infrastructure and health leading to low production of goods

- ***Reduction of propulsion growth*** rate to fight excessive demand could to reduction in labour force hence leading to low production
- ***If maximum prices are fixed*** below the equilibrium process, the entrepreneurs are discouraged from employing factors of production

8. The quantity theory of money stated by Fisher that $P = \frac{MV}{T}$ is complete explanation of why prices change. Discuss.

   The theory is based on the following assumptions

- The demand and supply for money are equal and therefore proportional
- The supply of money is exogenously determined i.e. minted by the Central Bank
- Barter engagement do not alter the quantity of money
- Price is the only affected by changes in money supply
- There is full employment
- The number of transactions (T) and velocity of money (V) do not change
- No money is withheld that is all of it is spent
- It is operational in the long run

However the theory is not complete as to why prices change. These are the reasons

- It assumes that velocity and number of transactions are kept constant, but this is not true because money supply increases also the volume of transactions increase and this affects velocity of money
- It assumes that the quantity of money (M) is directly proportional to the general price (P). But prices of different commodities do not change in the same proportions even if money (M) doubles. Therefore assumed general price level does not exist.
- The theory ignores existence of barter trade in which transactions take place without use of any money supplied. Therefore in some cases, price is determined by other factors other than the amount of money in the circulation. The theory fails to consider other factors that lead to change in price other than the quantity of money in the circulation
- In case of high liquidity preference, an increase in the quantity of money does not lead to an increase in price since much of the money is kept and mot spent
- The theory only considers the transactions motive of holding money but again ignores motives of holding money such as precautionary and speculative motives. This is unrealistic because people do not only hold money for transaction purposes.
- The theory attempts to explain changes in the value of money but does not explain how the value of money is determined. Therefore the theory is weak in explanations and assumptions.
- The theory emphasizes the supply of money and does not talk about money demand yet practically the level of money demand determines how the money is to be spent and consequently affects economic activities in economy.
- The theory only gives relationship between money and the general price level but fails to give relationship between money and real factors in the development process
- The theory ignores the effect of government price control through minimum and maximum price legislations where an increase in money where an increase in money supply in economy will not lead to change in general prices level.
- It is assumed that increase in money supply lead to increase in the general price level assuming that whenever money is supplied is used for consumptions. However in case where there is marginal propensity to save (MPs) is high, it does not lead to an increase in general prices, since the additional quantity of money is the circulation is saved.

- This is not a theory at all, if it is a truism shows that M, V, P and T are related if it does not show us how these variable change,
- According to the theory, M, V, P and T are independent of each other, which is not true. A change in M can affect V and T so a rise in M can increase P but T can increase as well due to an increase in aggregate demand.

9. (a) What is meant by a perspective plan?
   Perspective also called a strategic planning refers to long term broad objective planning where targets are fixed for long period say 10 to 25 years.
   (b) Explain the qualities of a good development plan

   (i) It is Based on Clearly Defined Objectives:
   A good plan is based upon clear, well-defined and easily understood objectives. General objectives like increasing profits are ambiguous in nature and do not lend to specific steps and plans. If possible, objectives must be quantified for sake of simplicity, for instance this could be reducing inflation or unemployment by 5% in 4 years

   (ii) ***Feasible;*** the project in this plan should be achievable. Planners should be able to estimate and quantify achievements.

   (iii) ***Consistence;*** requires the planning committee to have up to date knowledge of the levels GDP or per capita income in a given time

   (iv) ***Compatibility;*** planners should draw up projects which are related to minimize costs i.e. to ensure easy linkage

   (v) ***Sequencing:*** planner should set up project step by step for example improvement of infrastructure must be done first before mining the area, a bottling company should be done before setting up beverage company

   (vi) ***Comprehensiveness;*** it should cover the entire or all section that is under plan or consideration. It should not leave any part of the section under plan uncovered. It is comprehensive and includes each and every aspect of the objectives.

   (vii) ***Participation;*** it should encourage massive participation in the implementation i.e. it should elicit people to actively participate and feel part and parcel of the plan

   (viii) ***Proportionality;*** planners should apportion the available resource to different development projects and sections according to priority. For example during the national budget, different ministries and departments get appropriate resource allocation

   (ix) ***Optimality;*** planners should ensure that there is full utilization of the planned resources so as to ensure maximum welfare

   (x) ***Relevancy:*** it should meet desired needs of the people. It should identify with people and ensure participation of the majority

   (xi) ***Acceptability;*** a plan should be socially, economically, and politically desirable in order to be implemented easily.

   (xii) It is Simple:
   A goods plan must be simple and comprehensive. When the plan is simple, all employees of the organisation can know its significance and it can be easily put into operation, which leads to achieve objective.

   (xiii) It is Flexible:

Planning should be flexible enough to incorporate any changes in the resources, if necessary. Additionally, it should be responsive to changed conditions so that if future events do not follow the anticipation, the same plan can be modified and adopted to the altered situation.

(xiv) It is Time-Bound:
The time period allowed for achieving goals should be reasonable even though planning is an attempt to anticipate the future. Long-range planning are more uncertain. Hence, the time period covered should be reasonable and reasonably stable.

10. Consider the view that developing countries should rely on taxation than on borrowing
The question should compare the advantages taxation and disadvantages of borrowing for the development of LDCs.

The importance of taxation to a country

- It helps in raising government revenue through direct and indirect taxes. This revenue helps the government to build infrastructures such as roads, hospitals and schools
- It helps in income distribution. This is done by mainly progressive tax system as well as using revenue raised to help poor
- It is a means of regulating and controlling monopoly power. This done by a way of taxing monopolies more than and using the revenue to finance or subsidize other weak starting projects
- Helps in protecting local producer and local infant industries by taxing heavily imports of similar products to the locally produced ones
- It helps in controlling the rate of inflation. This done by increasing the tax rates to reduce the amount of money in circulation
- It helps in allocation and regulation in scarce resources. This by way of taxing those with many resources and trying to develop one with fewer resources
- It insists in controlling production and consumption of undesirable goods by raising taxes to such goods.
- It helps in regulating the balance of payment position. This done by away of increasing import duties to reduce the volume of imports thereby reducing the total import expenditure
- It helps in boosting the levels of investments inn economy. This done by way of relaxing taxes on investors as well as taxes on raw materials and intermediate products
- It helps in strengthening trade relations especially in case of economic integration, member states are given tax concession and proves their economic and political relationship
- Taxes also help to protect people's health and consequently raise their life expectancy by levying duties on harmful consumptions of goods such as alcohol and cigarette.
- It discourages the production and importation of some goods especially luxury products that are not priority among the majority

Disadvantage of borrowing

- Public borrowing leads to foreign exchange outflow and consequently balance of payment deficits in long run during debt servicing
- Loans are public burdens because it is the public that will repay the loans through increased taxes to the government
- Borrowing encourages laziness among the nationals and consequently dependence on foreign nations. This retards the rate of economic growth.

- External borrowing leads to inflationary situation in economy. This is because externally borrowed funds are exchanged into local currency, which increase the amount of money in the circulation leading to demand push inflation
- Servicing external debt leads to reduced domestic saving, investment and low per capita accumulation in the country. This retards the rate of economic growth
- Borrowing encourages extravagancy. If a government borrows a lot of funds from external sources and spends these funds extravagantly, it reduces the sense of responsibility and this puts the nation into heavy debt burden for misuse of funds.
- In paying back the loan, the government has to cut down its expenditure on some services such as education, health, etc. and this reduces the standard of living.
- Unproductive long term loans shift the repayment to future generation that do not *necessarily* have benefited from such loans.
- At times borrowed funds are accompanied by expatriates who in most cases repatriate profit to their home countries. This also limits generations of employment opportunities for that nationals.
- Internal borrowing worsens income inequality. This is because the poor are asked to pay huge sum of money in form of taxes to repay the rich who often lend to the government. Thus the resources tend to flow from the poor to the rich
- In case the external debt s to be repaid in terms of goods and services, it deprives the citizen of a variety of the goods and services that would be locally consumed
- A heavy public debt (due to borrowing) can lead to selling off government property to pay off the debt. This property can however, be sold at a giveaway price which is a loss to the country.

Advantages of borrowing over taxation

- Borrowing is more reliable than taxation. A country can be certain about fund to be raised from borrowing unlike from taxation, which is affected by tax avoidance and evasion
- With borrowing, unlike taxation, revenue is obtained as lump sum. This is because tax revenue especially in LDCs, come in small bits which can hardly do any constructive economic activities.
- Borrowing has limited direct burden than taxation. This is a better option of raising funds without inflicting citizens with heavy tax burden
- Borrowing from external sources increases aggregate demand. This stimulates production and fast economic growth and development.
- Borrowing is cheaper than taxation in terms cost administration. It is worth noting that at times the cost of tax administration outweigh the tax revenue collected especially in direct taxes
- Borrowing is a better way of raising foreign exchange than taxation. External borrowing is important because it avails LDCs with scares foreign exchange.
- Debt financing/borrowing is a quicker means of funding projects unlike taxation, which involves a number of processes. Taxation revenue tends to pass through tedious stages.
- Borrowing strengthens the political ties between the lending and borrowing countries. This is important for co-existence as opposed to taxation
- Internal borrowing can be used to fight against inflation by withdrawing funds from the circuation

Thank you

Dr. Bbosa Science