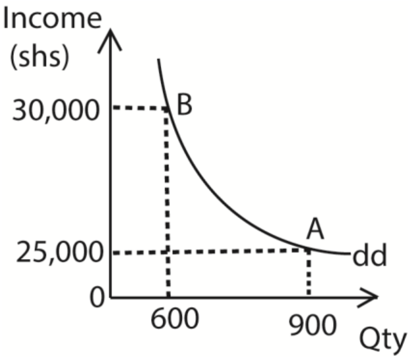
Economics paper 2 set 6 and marking guide

1(a) Study the figure below showing the consumer's level of income and the quantity demanded of good X and answer the questions which follow.



(i) Calculate the income elasticity of demand when consumer's income increases from A to B (3marks)

Yed = $\frac{600-900}{900} x \frac{25000}{30000-25000} = \frac{-300}{900} x \frac{25000}{5000} = -1.667(3dp)$

(ii) What type of good is X

X is an inferior good because as consumer's income increase, less of X is consumed.

(b)(i) What is meant by non-price competition?

It is a competitive strategy to attract customers and increasing sales by methods other than adjusting (lowering) prices.

(ii) Give three forms of non-price competition in your country

- Persuasive advertisement
- Product differentiation
- After sale service
- Offering gifts
- Sponsoring sport events
- Stocking a large varieties of goods and substitutes
- Offering free samples
- Improve quality of goods
- Use of appealing slogans, trade names and brand
- Provision of credit, instalment selling
- Organising raffles, draws and consumer games

(c) Distinguish between;

(i) overhead costs and prime costs

Overhead refers **to the fixed costs of running a business that are not directly related to producing a good or service**. They are the expenses the business incurs to stay in business, regardless of its success level

Examples of Overhead Costs

- Rent/property tax
- Administrative costs/salaries
- Government licenses
- Insurance.
- Repair and maintenance of motor vehicles and machinery.
- Depreciation of assets

Prime costs are the costs directly incurred to create a product or service such as cost of raw materials, wages directly involved in the production of a particular product, power, etc.

(ii) Average fixed costs and average variable costs

The average fixed cost (AFC) is the fixed cost per unit and is **calculated by dividing the total fixed cost by the output level**.

AFC = $\frac{TFC}{output}$

Average variable cost (AVC) is variable cost incurred while producing one unit of output.

It is calculated by dividing variable cost by the quantity produced.

AVC = $\frac{TVC}{output}$

(d)(i) What is meant by specificity of a factor of production?

Specificity a facto of production refers to the degree to which a factor of production is specialized in performing a given function in production..

(ii) How does the degree of specificity of a factor of production

The specificity and mobility of a factor of production are inversely related, i.e. the higher the degree of specificity of a factor of production, the lower the mobility and vice versa.

- Specific factors are occupationally immobile and geographically mobile.

(e) State four major development goals in your country.

- Attainment of full employment
- Achieving a high rate of economic growth
- Minimizing inflation
- Reducing income inequality and poverty
- Gender equity
- Balance of payment stability
- Reducing economic dependence
- Equality of regional development.

(f) (i) Explain the meaning of the following terms

(i) Industrial inertia

Industrial inertia refers to the tendency of an industry or industries to remain located in an area even after the advantage of its location in that area are no longer significant.

Or

Industrial inertia (geographical) describes **a situation in which an industry prefers to run in its former location although the main alluring factors are gone**. For example, the raw material source is depleted or an energy crisis has emerged.

(ii) Localization of industries

Localization of industries refers to concentration of industries in particular area such as industrial area or region such as capital city

(g)(i) What is meant by time-rate wage?

Time rate is a system of wages payment where labour is paid on the basis of time spent at work place.

Or

Time rates are used when employees are paid for the amount of time they spend at work. The usual form of time rate is the weekly wage or monthly salary.

(ii) State the socio-economic relationship between the level of occupational hazards and the wages in your country

The higher the occupational hazards, the higher the wages because people do not like such jobs.

(h)(i) Define voluntary unemployment

Voluntary unemployment is a situation where jobs are available but a person chooses not take up a job at the going wage rate.

Or

Voluntary unemployment is a situation in which someone chooses to not work, either because he/she will not take a job with low pay, or he is satisfied with the amount he/she receives from the government in benefits while not working.

(ii) State three causes of voluntary unemployment in your country

- High preference for leisure to work
- Poor attitude towards work
- Cultural factors
- Expectation of a better paying job in future
- Existence of past saving
- The unfavorable location of available job opportunities
- High risks to available jobs
- Over qualification for available jobs
- Availability of a person one depends on

(i)(i) Distinguish between cash ratio and liquid ratio

Cash ratio is the proportion or percentage of the commercial bank deposits kept in cash form to meet the day demands of their customers and other obligations which exclude lending out as loans to borrowers.

Liquid ratio refers to the proportion of the total deposits of commercial banks which is kept in cash form of in form of assets that can easily be converted into cash e.g. bank drafts, cheques, etc.

Liquid ratio = Liquid assets/total assets.

(ii) What factors influence the level of liquidity preference in your country?

- The price level
- Level of speculation

- The degree of uncertainty
- Level of transaction in an economy
- Level of interest rate, low interest rates lead to high liquid preference
- Banking habits
- Level of monetization
- Time/season preference such as Christmas season people have high liquid preference.
- Precautionary motives
- Current prices of financial assets e.g. bills
- Level of saving
- Level of development of financial infrastructure

(j)(i) What is meant by bank deposit multiplier?

The deposit multiplier is **the maximum amount of money that a bank can create for each unit of money it holds in reserves.**

Or

The deposit multiplier is the multiple by which banks can lend out deposited money based on the existing reserve requirement.

(ii) State three determinants of the bank deposit multiplier in your country.

- Reserve ratio
- Level of interest/bank rate
- Investment climate
- Liquid preference
- Level of cash ratio
- Public propensity to deposit
- Government policy on lending
- Level of credit worthiness

2 Account for the failure to establish the prices of

(a) Agricultural products

- **Long gestation period of agricultural products.** Agricultural products take long time to mature such that in case of high prices in short run, supply cannot be reduced in case of a predicted fall in price in long run.
- **Natural factors.** The occurrence of a factor such as bad weather, pest and disease, drought, floods affect the output causing high prices while disappearance of such factors increases output hence low price.
- **Perishability and difficulty of storage.** Agricultural products tend to go bad quickly and due to poor facilities, producers are forced to sell immediately at the existing price.
- **Weak bargaining position on the world market**. The price for agricultural products is only indicated by the developed countries and major buyers.
- **Bulkiness of the products.** Agricultural products are bulky which makes transportation from areas of low prices to areas of high prices difficult. Hence selling at existing prices.
- **The poorly planned production.** Most producers tend to relate the current output on the previous price and future output on the current prices (cobweb cycle) leading to price fluctuations.
- **Growing competition from synthetic substitutes.** Synthetic substitutes from developed economies have out competed the agricultural products from Uganda since they are of poor quality.
- **Divergence between planned and actual output levels.** Due to unavoidable factors, the actual output tends to vary from the planned output level causing price instability.

- **Technological development in developed economies.** The development in technology has promoted the raw material saving method of production, which require less of the raw material from LDCs, making planning output difficult hence price instability.
- **Agricultural products are used as mere inputs of industrial products.** They form a small part of final products making the absorption of excess supply difficult.
- **Poor surplus disposal machinery.** The poor infrastructure mostly in form of poor transport facilities make it difficult to get rid of surplus output from areas of low prices to those with high prices.
- **The price inelastic demand for agricultural products.** The demand for agricultural products tends to be inelastic such that a very wide change in price can cause a small change in quantity demanded.
- **Limited levels of diversification** because of the tendency to overspecialization in certain crops lead to fluctuation of prices of certain agricultural products.
- **Weak international commodity agreements** that have times failed to regulate quotas and prices of agricultural products from member countries.
- **Changes in cost of production.** When production costs increase, prices of agricultural product will increase.

(b) Consumer goods in your country.

- **Availability of consumer goods.** Scarcity of goods leads to high process and vice versa.
- **Trade liberalization.** Prices are determined by demand and supply.
- **Production cost.** High productions costs lead high costs of consumer goods
- Tastes preference. Goods with high tastes preference lead to high demand and high prices
- **Consumer's income;** increase in consumer's income lead to increase in demand and hence increase in prices.
- **Prices of imported goods** are determined by the costs of importation and import taxes.
- **Seasonal demand.** Seasonal changes determine demand and prices e.g. umbrella and rainy season.

3(a) What is the role of the private sector in the development of an economy

- Creation of employment
- Delivers good and services
- Undertakes investment
- Encourage capital inflow
- contributes to tax revenue
- Encourage diversification
- Increase the DGP of the economy
- Improves balance of payment
- Entrepreneurial development
- Improves quality and quantity of goods and service
- Lead to skill development
- Promotion of self-reliance
- Increase competition and efficiency

(b) Examine the policies that have been adopted to promote the private sector in your country.

- **Expansion of credit facilities.** Government has expanded and extended loan facilities through banking system and adoption of expansionary monetary policy.
- **Redistribution of income.** The government practice progressive tax in order to income and promote investment
- **Development of capital market** such as Kampala stock exchange markets to market shares and encourage investment.

- **The government has eased transaction through a number of platforms**, including ATMs, mobile money, borderless bank transfers etc.
- **Improvement of managerial**, entrepreneurship and book keeping skills through management training institutes and managerial courses at the universities.
- **Importation of technology** to boost production
- **Credit access through group formation** rather than securities such as SACCOs
- **Political stability** that encourage investment.
- **Improvement of infrastructures.** Such rural electrification and water distribution, roads etc.
- Export promotion to expand the market of goods and services.
- No minimum wages to encourage investment and expansion of infant industries.

4(a) Describe the structure of industry in your country. (8marks)

- Most industries process primary products , a few engage in the manufacturing and assembling parts e.g. Spear motors and BATA shoe firms
- Most industries are concentrated in urban areas especially, Kampala, Jinja, Mbale, Mbarara etc.
- The size of the industrial sector in Uganda is small but fast growing at fast rate. The small scale industries are widely spread i.e. urban and rural based e.g. agriculture processing industries like maize mill and sugar juggleries.
- Most of the industries in Uganda are engaged in the processing of primary products although some participate in finished goods due to low technology
- Most of the small and medium scale industries are privately owned while large scale industries are owned by foreigners and/or government.
- Most of the industrial products are locally consumed.
- The manufacturing industries contribute less than 10% to GDP.
- They provide employment to a few skilled and unskilled manpower because they are small scale production and capital intensive technology.
- Most of the industries operate at excess capacity due to limited market of the products.
- Most industries depend on agriculture and mineral products and others such as pharmaceutical industries depend on imported raw materials.
- Most of small scale industries tend to be labour intensive while large scale industries tend to be capital intensive.

(b) Examine the factors affecting the development of industrial sector in your country. (12marks)

- Low level of technology. Most industries in the country employ poor methods of production, mostly labour intensive that limits the capacity of production.
- Limited market both local and international.
- Stiff completion from cheap foreign products.
- Limited skilled manpower
- Poor infrastructures such as unstable electricity and transport network.
- Limited capital
- Unstable/ limited supply of raw materials that are influenced by climate changes
- Political instabilities in some parts of the country discourage investment.
- Political interference in management of private sector.
- Limited entrepreneurial skills
- Labour unrest/strikes

5(a) Examine the causes of open urban unemployment in your country.

Open unemployment is **the situation when a person is willing to work, is educated but is unable to get a job and work**

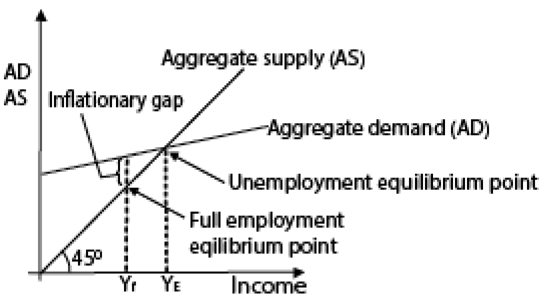
- Large number of job seekers in towns due to rural-urban migration
- Nature of education system that prepares students for “white collar jobs” which are few
- Export of unprocessed agricultural products creates few job opportunities
- Use of capital-intensive technologies like computers reduce employment opportunities
- Poor infrastructures such as electricity distribution in rural area leading to limited creation of rural employment
- Discrimination in the labour market due to corruption and nepotism.
- Low entrepreneurship skills leading to low rate of job creation
- Lack of relevant skills for the available employment

(b) What steps may be taken to minimize open urban employment.

- Rural-urban migration should be controlled through rural development, increasing wages for rural workers
- There is a need for manpower planning so that matches with labour demand.
- The government should extend credit to potential investor that they create more jobs
- Education system should provide skills for job creation rather than job seekers. It should be agricultural oriented since Uganda is an agricultural economy.
- The government should reduce corruption
- There is a need to adopt appropriate technology that can absorb all unemployed labour in urban area.
- There should be tight employment policy of foreign personnel to enable local labour force in town to get jobs.
- The government should encourage urban to rural migration through resettlement schemes.
- There is need to control population growth rate
- Support the expansion of the industrial sector by providing tax holidays and reduction of taxes to raw materials.
- Expanding domestic markets through economic integration.
- Increasing information about vacant jobs.
- Rural electrification programs to encourage industries in rural areas.
- Encouraging NGO that create jobs.

6(a) What is meant by inflationary gap

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 Yf to YE.

(b) Examine the policies adopted to curb inflation in your country.

- **Limited government expenditure.** By introducing cost sharing in healthy and education; hence controlling money supply in the country.
- **Adoption of monetary policy.** Like open market operations, selective credit control have helped to reduce money supply and hence controlling inflation.
- **Tight fiscal policy;** through progressive taxes to lower disposable income.
- **Improvement of transport network;** to facilitate movement of good and service and minimize scarcity conditions.
- Improvement of agricultural production; through land reforms and better production methods like use of better seed and extension of advisory service through National Agricultural Advisory Services(NAADS) to meet increasing demands
- Price controls policy; the government is trying to control maximum and minimum prices for essential goods.
- Encouragement of import to supplement local production
- Reduction of trade union influence; the government discourage trade unions from asking high wages to minimize the costs of production
- Discouragement of export of essential commodities such as sugar to curb scarcity
- Promotion of local industries to boost production
- Use of exchange rate policy boost capital inflow
- Adoption of privatization policy to boost efficiency and increase production
- Promotional of financial institution to avail credit to investors and boot production of goods and service.
- Promotion of political stability to encourage investment in the country
- Encouragement of investment through investment incentives to potential investor.
- Liberalization policy leading to increased production.

7(a) What is taxable capacity? (4marks)

Taxable capacity refers to the ability of the tax payer to pay the tax assessed to him and remain with enough disposable income to enable him enjoy his former standard of living.

(b) Why does your country depend more on indirect taxes. (16marks)

- Indirect taxes are cheap to collect
- Indirect taxes are difficult to evade
- Indirect taxes tend to form a major source of revenue.
- Indirect taxes can be used to discourage consumption of harmful goods to the society like tobacco.
- Indirect taxes are incentives to work harder so to afford basic necessities.
- Indirect taxes help in stabilization of economy e.g. high import duties improve balance of payment.
- Indirect taxes discourage dumping in the country thereby protecting domestic industries from unfair competitions.
- Indirect taxes are flexible can easily be altered to desired level.
- The government can use indirect taxes to encourage consumption of certain goods by reducing taxes on them.
- Indirect taxes can discourage production of certain goods and channel production resource towards essential goods and services.

8(a) Distinguish between "dead weight debt" and "reproductive debt"

Dead weight debt is money borrowed to finance unproductive activities or it is a debt which is not covered by any corresponding physical assets and whose repayment and interest have to be made from other sources.

Reproductive debt is money borrowed and used to purchase real assets and equipment intended for capital investment

(b) Examine the role of foreign capital in the economic development of your country.

Positive role of foreign capital

- It increases the flow of capital stock which helpful in breaking the vicious circle of poverty.
- It supplements domestic savings
- It is a source of capital for financing social overheads (SOC) or infrastructure and directly improve agricultural sector or industry
- In form of foreign investment, it is accompanied by inflow of skilled manpower and advanced technology that improves the quality of goods and services.
- It reduces unemployment through job creation
- It increases government revenues through taxes.
- Foreigners invest in exports increasing foreign exchange incomes
- Foreign investors encourage similar investments by local investors.
- Foreign investors lend money to the government by buying securities
- It increased cooperation among countries; the origin foreign investor and the receiving country.
- Foreign investors increase aggregate demand for consumer goods and services such as telephone, water and electricity.
- Foreign investors may give donation under privileged people such as disabled people.

The demerits of foreign capital

- Foreigners repatriate their profits reducing further investments
- Foreigners concentrate in urban areas leading to increased rural-urban gap
- Foreign investors may not be easily controlled by the government.
- Foreign investment use capital intensive production techniques leading to limited job creation.
- There is limited implementation of economic programs as it has unfavorable strings attached.
- It discourages domestic savings since government depend on the foreign capital
- It increases the degree of dependence to foreign investment/countries

Thank you

Dr. Bbosa Science