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## Economics paper 1 set 16 and marking guide

### SECTION A (20 marks)

Answer all parts of this section

1. (a)(i) What are public goods? (01mark)  
(ii) Outline any three challenges faced by your country when providing public goods. (03marks)
- (b)(i) State the law of diminishing returns (01marks)  
(ii) Give any three assumptions of the law of diminishing returns. (03marks)
- (c)(i) State the Big-push theory of economic growth (01mark)  
(ii) Mention any three benefits of adopting the Big-push theory in developing countries (03marks)
- (d) (i) Define the term credit multiplier. (01mark)  
(ii) given an initial deposit of Shs. 750,000 and cash ratio of 20%, calculate the total credit formed. (03marks)
- (e)(i) What is meant by trade diversion? (01marks)  
(ii) Examine any three effects of trade diversion in an economy. (03marks)

### SECTION B (80 MARKS)

Answer any four questions from this section

2. (a) Why may government impose price control in an economy? (10marks)  
(b) Examine the implications of price controls in an economy. (10 marks)
3. (a) Given that in two sector economy; marginal propensity to consume = 0.75, investment = USD 5billion, Income USD 250billion.  
(i) Calculate the value of multiplier (02marks)  
(ii) If investment increases by USD 1billion, determine the new equilibrium level of National income  
  
(b) Assess the factors that determine the level of national income in an economy. (16marks)
4. (a) Why is there a need for industrialization in less developed countries? (10marks)  
(b) Explain the problems faced by the industrial sector in less developed countries. (10marks)
5. (a) Distinguish between over-population and optimum population. (04marks)  
(b) Assess the implications of over population in an economy. (16marks)
6. (a) Explain the causes of open-urban unemployment in an economy. (10marks)

- (b) Suggest measures that can be adopted to reduce open-urban unemployment in an economy. (10marks)
7. (a) What is the role of National Budget in an economy? (10marks)
- (b) Suggest measures that should be taken to control budgetary deficits in developing countries. (10marks)

Guide

**SECTION A (20 marks)**

Answer all parts of this section

1. (a)(i) What are public goods? (01mark)
- Public goods** are goods provided by the government (state) and they are collectively owned by the members of society in such a way that their consumption by an individual does not reduce the amount available to other individuals at the same time. For example public roads, hospitals, defense etc.

(ii) Outline any three challenges faced by your country when providing public goods.

(03marks)

- Inadequate funds/capital
- Corruption and embezzlement of funds by public officials.
- Poor infrastructure.
- Political instability.
- Limited political commitment.
- Political interference in management.
- Inadequate skills.
- High rates of inflation
- Poor technology
- Poor land tenure system.
- Occurrence of natural calamities making it difficult to provide and maintain public goods
- Poor management skills.
- High level of bureaucracy/ red tape.
- Foreigner interference

(b)(i) State the law of diminishing returns (01marks)

The law states that as

more and more units of variable factor (labour) are added to fixed factor (land), marginal product first increases reaches the maximum beyond which it diminishes.

(ii) Give any three assumptions of the law of diminishing returns. (03marks)

- It assumes a short run period
- It assumes existence of a variable factor
- It assumes existence of a fixed factor
- It assumes constant technology
- All units of a variable factor are homogeneous
- Assumes that all factors of production are divisible and they are easy to change in proportions in which they are combined:
- It assumes that factors of production are equally efficient in the production process. That is, they have the same skills, level of education etc.

- It assumes constant factor prices.

(c)(i) State the Big-push theory of economic growth (01mark)

**The Big-push theory** states that, for a backward economy (Le. LCD) to take off into a **self-sustained growth a massive investment** program in industries and economic infrastructure is required.

(ii) Mention any three benefits of adopting the Big-push theory in developing countries (03marks)

- Increased employment opportunities.
- Promotes economic diversification.
- Development of infrastructure
- Increased government revenue.
- Improved balance of payments position.
- Increased exploitation and utilization of resources.
- Promotes linkages/ widens market
- Reduces economic dependence / encourage self-reliance
- Facilitates technological transfer and development
- increased GDP/ economic growth.
- Improved terms of trade.
- Improvement of local skills.
- Increased variety of products | widens consumer choice.

(d) (i) Define the term credit multiplier. (01mark)

Credit multiplier (M) is the number of times the initial bank deposits multiply to give the final bank deposits

$$\text{Credit multiplier (M)} = \frac{\text{Total final deposits}}{\text{Total initial deposits}} = \frac{1}{\text{Cash ratio}}$$

(ii) given an initial deposit of Shs. 750,000 and cash ratio of 20%, calculate the total credit formed. (03markks)

$$\text{Total credit} = \text{Initial deposit} \times \frac{1}{\text{cash ratio}} = 750,000 \times \frac{1}{0.2} = \text{Shs. } 3750,000$$

(e)(i) What is meant by trade diversion? (01marks)

**Trade diversion** is a situation where as a result of economic integration, a country shifts from the importation of goods from low cost non-member state to high cost member state.

(ii) Examine any three effects of trade diversion in an economy. (03marks)

- low quality products due to low competition
- high prices leading to low demand
- High prices leading to high production
- limited variety/choice of goods and services
- increased self-reliance in the region
- growth of infant industries
- loss of export and import revenue
- smuggling of cheaper commodities from nonmember countries
- poor terms of trade

## SECTION B (80 MARKS)

**Answer any four questions from this section**

2. (a) Why may government impose price control in an economy? (10marks)

- To protect consumers from exploitation.
- To protect producers from exploitation.
- To maintain price stability/ control inflation.
- To increase production/ output/ economic growth
- To make commodities available to all groups of people in the economy.
- To establish industrial peace where price/reduce labour unrest/strike.
- To control / monopoly power.
- To enable producers, realize stable incomes i.e. minimum price.
- To control the production and consumption of undesirable products I harmful products.
- To reduce income inequality / wage differential
- To win political support from the masses
- To help the economy off-set (recover from) an economic depression.

(b) Examine the implications of price controls in an economy. (10 marks)

### **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 mal-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 of goods and** services 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) Given that in two sector economy; marginal propensity to consume = 0.75, investment = USD 5billion, Income USD 250billion.
- (i) Calculate the value of multiplier (02marks)  
 The value of the multiplier  

$$k = \frac{1}{1-MPC} = \frac{1}{1-0.75} = \frac{1}{0.25} = 4$$
- (ii) If investment increases by USD 1billion, determine the new equilibrium level of National income  

$$\Delta y(\text{increase in income}) = k \times \text{increase in investment}$$

$$= 4 \times 1,000,000,000$$

$$= 4 \text{ billion}$$
 New equilibrium level of income = original income + change in income  

$$= 250 \text{ billion} + 4 \text{ billion}$$

$$= \text{USD } 254 \text{ billion}$$

(b) Assess the factors that determine the level of national income in an economy. (16marks)

- **The level of investment both domestically and externally.** The higher the level of investment, the higher the level of national income but a low level of investment discourages the production of goods and services hence low levels of national income.
- **The level of exploitation and utilization of the available natural resources.** The higher the level of utilization of natural resources like minerals and water resources in the economy, the higher the level of national income and the lower the level of utilization of natural resources, the lower the level of national income.
- **The size and quality of the labour force (working population).** Presence of a big and skilled labour force increases production of goods of services which leads to an increase in national income. On the other hand, a small-unskilled labour force discourages production hence low levels of income
- **Level of capital stock.** Availability of capital in form of machinery and equipment increases the level of output and national income while presence of limited capital stock limits production hence low level of National Income.
- **The level of technological progress.** Use of better and improved technology increases production at reduced average costs hence giving a bigger size of national income. On the other hand, uses of poor production techniques reduce output hence low level of national income.
- **Degree of political stability.** Political stability encourages investment and growth of national income while political instability leads to break down in production by discouraging investment hence a small size of national income.
- **Market size within and outside the country.** The large market encourages investors which lead to the production of more goods and services hence increasing national income. But a small market discourages investment and production hence low level of national income.
- **The level of monetization of the economy.** The higher the level of monetization of the economy, the higher the level of national income. But a large subsistence sector discourages production and exchange hence low levels of income.
- **Level of specialization in production.** The higher the level of specialization in the economy, the higher the level of national income and the lower the level of specialization, the lower the level of national income

- **The level of entrepreneurial ability.** Presence of individuals who can organize and mobilize other factors of production leads to an increase in production hence an increase in national income and absence of entrepreneurial skills discourages production hence low levels of national income.
- **Degree of economic stability.** A country which is economically stable in form of stable prices of goods and services encourages investments hence increase in the level of national income. But existence of high levels of inflation discourages investments hence low levels of national income.
- **Level of saving**
- **Land tenure system**

4. (a) Why is there a need for industrialization in less developed countries? (10marks)

- To create jobs/employment in the country
- To promote innovation, and technological advancement
- To develop of infrastructures such as roads and power distribution.
- Promotes scientific research
- To provide of a wide range of commodities. The existence of both processing and manufacturing industries tend to produce diversity of products
- To increase government revenue through taxed to the firm and salaries of employees.
- To encourage development of skills such as managerial and entrepreneurship skills.
- To minimize rural—urban migrations especially those located in rural areas.
- To get foreign exchange from exports
- To provision markets to raw materials especially agricultural produces.
- To strengthen international relations due to free participation of foreigners.
- To diversify economy
- To promote self-reliance

(b) Explain the problems faced by the industrial sector in less developed countries. (10marks)

- Limited capital stock/ funds.
- Poor infrastructure.
- Limited entrepreneurial skills.
- Limited skilled manpower.
- Limited domestic and foreign markets, high MPM / competitor imports.
- Under developed capital markets.
- Poor technology.
- High level of taxation.
- High level of corruption in the sector.
- Political instability.
- Limited supply of raw materials.
- Poor land tenure system.
- High capital out flow/ income and profit repatriation.
- Economic instabilities such as high inflation, unstable foreign exchange rate, etc.

5. (a) Distinguish between over-population and optimum population. (04marks)
- (b) Assess the implications of over population in an economy. (16marks)

### **Benefits of over population**

- It increases the size of the domestic market for both the manufactured and agricultural products.
- Encourages investment
- It stimulates rapid economic growth. This is due to the expansion of investments as a result of increase in market size. .
- It increases labour supply and mobility in the country. This increases output hence economic
- Encourages hard work to sustain the population.
- Encourages innovation and invention
- The big population puts pressure on the government to provide social services so as to meet the basic needs of people.

### **Disadvantages/disadvantages of over population**

- It leads to low standards of living. This is due to high cost of living and low per capita income.
- It leads to over straining of the available social amenities like water supply, medical services, electricity, roads etc.
- It leads to food shortage in the economy. This results in famine and malnutrition hence poor health conditions.
- It leads to excessive demand for goods and services in the economy hence demand pull inflation.
- It leads to balance of payment problems. This is due to increased importation of commodities in the country.
- It encourages rural urban migration with its associated problems. This is because people leave the rural areas to come and enjoy the better services in urban areas.
- It increases the levels of unemployment and under employment in the economy as a result of excess population.
- It leads to over exploitation of natural resources hence environmental degradation in form of pollution.
- It reduces government tax revenue in case the majority of the people are poor.
- It encourages political instabilities in form of civil wars due to the excessive pressure on the government for social
- It increases dependence burdens in the economy. This discourages savings and investments due to high consumption expenditure.
- Leads to brain drain
- Limited domestic market due to low income

6. (a) Explain the causes of open-urban unemployment in an economy. (10marks)

- Rural to urban migration.
- High population growth ratio.



- Poor education system which prepares people for white collar jobs.
- Technological advisement.
- Limited skills among job seekers.
- Discrimination in the labour market.
- Structural adjustment programs e.g. retrenchment of the workers.
- Poor land tenure system.
- Political instability in some parts of the country.
- Decline in demand for goods and services /Limited market.
- Low rate of industrialization in urban areas
- Localization of industries in urban areas.
- Lack of information about existing jobs.
- Changing/ switching jobs by labour.

(b) Suggest measures that can be adopted to reduce open-urban unemployment in an economy. (10marks)

- Advertise / publish the available jobs.
- Widen markets.
- Population control to reduce high population growth rate,
- Education reform/ proper man power planning.
- Under take land reforms.
- Encourage use of appropriate technology.
- Under take agriculture modernization.
- Under take economic diversification.
- Promote economic stability in all part of the country.
- Liberation of the economy.
- It prom0te political stability in all parts of the country.
- Promote industrialization /delocalization of industries.
- Provide credit facilities to local investors.
- Under take infrastructural development.
- Provide investment incentive to encourage production.
- Privatization.

7. (a) What is the role of National Budget in an economy? (10marks)

- Creation of employment opportunities
- Attains price stability/ controls inflation.
- Protection of infant industries.
- Reducing income inequality / ensures equitable distribution of income.
- Discourages production and consumption of undesirable / harmful products.
- It is used to mobilize resource, both local and foreign/soliciting foreign aid.
- Raising revenue to finance development through taxation. . .
- Promotion of economic growth.
- Influencing resources allocation/investment.
- Promoting regional balanced development.
- Helps the government in ,management of public debt
- Reducing economic dependence/ attaining self-reliance. .
- Regulating government expenditure.

- Improving balance of payments position.
- It is used to solicit for political support by government / mobilization of the masses.

(b) Suggest measures that should be taken to control budgetary deficits in developing countries. (10marks)

- Control population growth rate .
- Privatize loss making state enterprises / disinvestment.
- Minimize I reduce borrowing I tmrrow from :-:--· · cheaper sources.
- Promote political stability.
- Fight corruption.
- Develop infrastructure.
- Widen the market base.
- Liberalization the economy.
- Increase on taxable sources/ diversification of the economy.
- Reduce the civil/public services staff.
- Reduce administrative units i.e. reduce on local government units , cabinet, parliament.
- Encourage income generating activities by creating a favourable economic climate.
- Restructure / reduce foreign mission and other external government agencies.
- Proper planning by government to reduce on unnecessary expenditure /avoid over ambitious planning.
- Encourage cost sharing .
- Strengthening tax administration

Thank you

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