Economics paper 2 set 16 and marking guide

SECTION A (20 marks)

Answer all parts of this section

1. (a)(i) differentiate between effective demand and derived demand. (02marks)
   (ii) give nay two factors limiting effective demand for goods and services in Uganda (02marks
   (b)(i) Distinguish between commercial rent and economic rent. (02marks)
   (ii) Give any two determinants of economic rent in Uganda. (02marks)
   (c) State any four effects of young population on Uganda's economy. (04 marks)
   (d)(i) Define the term tax evasion (01marks)
   (ii) Mention three causes of tax evasion in Uganda (03marks)
   (e) (i) What is meant by balance of payments? (01marks)
   (ii) give any three ways of correcting a balance of payment deficit in Uganda. (03marks)

SECTION B

Answer any four questions from this section

2. (a) Describe the different forms of economic dependence in Uganda. (08marks)
   (b) what are the demerits of economic dependence in Uganda. (12marks)
3. (a) Analyze the factors that influence the rate of economic growth in Uganda. (10marks)
   (b)Explain the benefits of economic growth in Uganda
4. (a) why is there a need to modernize the agricultural sector in Uganda? (10marks)
   (b) Discuss factors limiting agricultural modernization in Uganda. (10marks)
5. (a) State the **Iron law of wages**. (04marks)
   (b) To what extent is the Iron law of wages applicable in the determination of wages in Uganda? (16marks)
6. (a) Describe the procedure of compiling the cost of living index. (08marks)
   (b) Explain the challenges faced when compiling price indices in Uganda. (12 marks)
7. (a) Differentiate between hyper-inflation and mild inflation. (04marks)
   (b) Describe measures being taken to control inflation in Uganda. (16marks)

Guide

SECTION A (20 marks)
Answer all parts of this section

1. (a)(i) Differentiate between effective demand and derived demand. (02marks)

Effective demand is the desire for / to possess or to acquire a good or service backed by the ability to pay for it.
OR:

The actual amount of good (s) /service(s) purchased by the consumer in a given time.
OR: The actual buying of goods and services at a given time.

While
Derived demand refers to the demand for a commodity / good due to the demand for what it helps to produce. (For example the demand for the factors of production.)

(ii) Give any two factors limiting effective demand for goods and services in Uganda (02marks

- High prices of goods and services / high price level.
- Low consumer(s) income.
- Unfavourable tastes and preferences / low quality of goods.
- Expectation of lower prices / fall in price in future.
- Unfavourable seasonal factors.
- Low level of advisement.
- High tax rates imposed on the goods and services / low subsidization of consumers (by government).
- High price of complements.
- Limited credit facilities.
- Small population (size).
- High degree of income inequality / unfair income distribution
- Large subsistence sector / production /output.

(b)(i) Distinguish between commercial rent and economic rent. (02marks)

Commercial rent refers to the payment made for the hire / use of a durable asset (which has many uses and the rent it earns reflects its opportunity cost). For example renting land, house, car.

While

Economic rent is the payment of a factor of production which is in excess of its transfer earning(s) / supply prices.

OR

Payment to a factor of production over and above what it would have earned in it next best occupation

(ii) Give any two determinants of economic rent in Uganda. (02marks)

- The elasticity of supply of the factor.
- The supply price of the factor.
- The elasticity of demand for the factor.
- The (degree of) substitutability of the factor.
- The demand for the factor.
- The supply of the factor.
- Time period.
- Specificity of the factor.
- The productivity of the factor

(c) State any four effects of young population on Uganda's economy. (04 marks)

- High dependency burden / low savings.
- Low effective demand.
- High government expenditure on provision of social services.
- Low labour supply /small size of labour force.
- Low labour productivity / low output.
- Available infrastructure is over strained.
- B.0 .P problem due to high import requirements to supplement domestic supply (of consumer goods)
- Government is awakened to its responsibility of providing necessary infrastructure and it leads to increase in output.
- Initiates effort to work harder to sustain predominantly dependent population.
- Promotes (increased) resources utilization.
- Increased the debt burden.
- It is encouraging investment.
- Leads to low government revenue.
- High taxation.

(d)(i) Define the term tax evasion (01marks)

Tax evasion is the refusal by the tax payer to pay a / the tax assessed / imposed on him / her.

(ii) Mention three causes of tax evasion in Uganda (03marks)

- The desire (by the tax payer) to retain or keep all income.
- Ignorance of the tax payers of the advantage of paying taxes.
- High level of corruption in tax administration
- Limit d I insufficient services provided to people by the government.
- Weak tax administration /ineffective enforcement of tax laws.
- .Unpopularity/inaccessibility of the government by tax payers/ political sabotage.
- Unfair tax assessment.
- High tax rates.

(e) (i) What is meant by balance of payments? (01marks)

Balance of payments refers to the difference between a1 country's receipts/ income from abroad and expenditure/payments abroad during a given time.

(ii) give any three ways of correcting a balance of payment deficit in Uganda. (03marks)

- Restricting trade to discourage imports.

- Promoting import substitution.
- Stabilize the political atmosphere.
- Diversification of export markets.
- Appealing for debt reference.
- Increasing volume of exports.
- Training manpower/providing skills to labour (to reduce dependence on expatiates)
- Improving quality of exports.
- Appealing for removal of trade restrictions in export market / should negotiate for trade preferences with trading partners.
- (Should) allow the local currency to depreciate.
- Strengthen commodity agreements.
- Restructure foreign mission and reduce foreign travels

SECTION B

Answer any four questions from this section

2. (a) Describe the different forms of economic dependence in Uganda. (08marks)

- Sectoral dependence.
- Trade dependence.
- External resource dependence.
- Direct economic dependence.

(b) What are the demerits of economic dependence in Uganda? (12marks)

- **It leads to capital out flow due to over dependence on foreign private investments**. Foreign investors repatriate profits back to their home countries leading to capital accumulation in the country.
- **It leads to unemployment due to heavy dependence** on foreign skilled manpower and over dependence on imported inappropriate technology.
- **It leads to neglect in the use of local resources and exploitation of local entrepreneurial skills**. This is due to over dependence on foreign resources and manpower
- **Direct economic dependence leads to development which is not in line with the social economic requirements of the country**. This is because economic .and political decisions are made externally without involving the participation of the people.
- **It worsens the balance of payment position.** This is due to heavy dependence on imports which leads to increased import expenditure.
- **It leads to imported inflation** due to heavy dependence on imports especially the petroleum products.
- **It leads to dumping.** This is due to heavy dependence on cheap imports and this retards the development of the industrial sector in the county.

- **It leads to fluctuations** in incomes and foreign exchange earnings due to over dependence on primary agriculture exports. This is because they experience price fluctuations on the world markets and they are affected natural conditions like bad weather.
- **It increases the debt burden on the future generation** in case the country heavily depends on loans from foreign countries.
- **Leads to cultural erosion**
- **Retards the development of local firms/industries**
- **Leads to political interference by foreigners**

3. (a) Analyze the factors that influence the rate of economic growth in Uganda. (10marks)

- the skills of labour
- the entrepreneur ability
- market size
- political atmosphere
- level of infrastructural development
- land tenure system
- rate of inflation
- existing (stock of) capital
- level of monetization of the economy
- population growth rate
- level of saving
- level of accountability
- attitude to work
- level of technological development
- level of conservatism/social factor

(b)Explain the benefits of economic growth in Uganda

- **It facilitates the exploitation and utilization of the idle local resources.** This increases the level of national income in the economy.
- **It increases government revenue through taxation.** Economic growth widens the tax b ase inform of numerous production activities set up hence generating mor e tax revenue to the government, The revenue realized is used to construct social and economic infrastructure like hospitals, roads, schools etc.
- **It leads to a fall in the general price level of goods and services hence improving the standards of living of the people.** As the economy grows, a variety of goods and services are produced and this results into a fall in the general price levels hence an increase in the volume of commodities consumed.
- **It facilitates technological development in the country.** Economic growth encourages the use of modem production techniques through inventions and innovations hence increasing efficiency in production.
- **It improves the balance of payment position of the country.** As the economy grows the production of

goods and services for both the domestic market and for exports increases. This helps the country to save and earn foreign exchange hence better balance of payment position.

- **It leads to an increase in employment opportunities.** This is in form of increased resource utilization and other economic activities set up. This increases the income of the people.
- **It leads to the development of social and economic infrastructure.** As the economy grows, there is development of social and economic infrastructures in form of roads, schools, hospitals, financial institutions etc. so as to facilitate trade in the economy.
- **It promotes urbanization and industrialization of the economy.** This is as a result of increased number of production and economic activities.
- **It reduces the dependence of the economy on other economies.** As the economy grows, per capita income raises and this leads to an increase in self-reliance and sustenance of the economy.
- **It improves the standards of living of the people.** This is due to increased production of a variety of goods and services at reduced prices in the economy. This increases consumption and utility maximization by the people.
- **It reduces income inequalities in the economy.** As the economy grows, it is possible for the government to redistribute part of the increased employment opportunities and income through the use of appropriate government policies like progressive taxation.
- **It increases the monetization of the economy.** This is because economic growth promotes trade and commerce in the economy.
- **It breaks the vicious circle of poverty**. As output expands, savings and incomes increase there by breaking the vicious circle of poverty .
- **It promotes social cultural transformation.** As the economy grows there is a change of life style of people as a result of increased incomes. This helps to break the remove the high levels of conservatism and backward cultures which are obstacles to development.
- **Promotes development of labour and entrepreneurial skills**
- **Widen consumers’ choice**

4. (a) Why is there a need to modernize the agricultural sector in Uganda? (10marks)

- To increase output / hence economic growth.
- To increase employment opportunities/to minimize seasonal unemployment.
- To reduce income inequality
- To increase economic activities in the country
- .To stabilize / increase producers income.
- To promote food security and ensure a healthy population.
- To generate (more) revenue for government.
- To control / minimize / solve (structural) inflation.
- To improve B .0 .P position /to increase foreign exchange earnings.
- To promote balance in Sectoral / regional development.

- To utilize (idle/ land) resources.
- To widen consumer choices.
- To promote infrastructural development.
- To promote industrial development / create sectoral link ages.
- To improve / increase labour skills.
- To promote entrepreneurship (skills).
- To increase quality of output.
- To promote technology development.

(b) Discuss factors limiting agricultural modernization in Uganda. (10marks)

- Under development infrastructures.
- Unfavourable/ unpredictable natural factors/ natural hazards.
- Limited labour skills.
- Small market (size)
- Unfavourable climate political climate
- Limited funds.
- Poor techniques of production.
- Poor land tenure system.
- Poor entrepreneurial ability.
- Low / fluctuating prices of agricultural products.
- Conservation (of most famers).
- Unfavourable / rugged topography.
- Low level of accountability

5. (a) State the **Iron law of wages**. (04marks)

Subsistence theory of wages (Iron law of wages). According to this theory, workers are given a wage which is just enough to enable them acquire the basic needs/necessities for example housing, clothes and food.

(b) To what extent is the Iron law of wages applicable in the determination of wages in Uganda? (16marks)

Application of the iron law of wages in Uganda

- Casual worker/unskilled labour are applied basing on the level of their subsistence needs.
- in the subsistence sectors of Uganda, reward to workers is based on basic needs
- entrepreneurs due to profit maximization goal pay workers' wages just enough to meet their basic needs
- Employers in a bid to retain cheap labour tend to pay wages which are just enough to cater for their subsistence needs
- cheap labour tend to pay wages which are just enough to cater for their subsistence needs

Limitations of the iron law of wages in Uganda

- the law/theory approaches the problem of wage determination entirely from supply side; it ignores the demand for labour entirely thus difficult to apply
- the theory relates wage rates to birth rates/population growth rate which is not the case in Uganda
- According to the theory all workers should be receive the same wage which is not the case in Uganda
- the theory does not consider the fact that the bare minimum need(s) varies from time to time depending on the price levels, economic conditions, etc.
- the theory is only applicable to the subsistence sector/subsistence level of living but not commercial sector.
- Trade Unions interference in wage determination is not taken into consideration
- contrary to the law, employees worker harder when paid higher wages than when paid low wages

6. (a) Describe the procedure of compiling the cost of living index. (08marks)

Procedure taken

- Define the objectives of calculating the price index e.g. wage determination.
- Choose an area where the data is to be collected
- Get the price for each good in a basket (A basket of commodities are a sample of goods consumed by most people)
- Choose a base year (a year when prices were relatively stable)
- Simple index of the base year should be given unit 100
- Attach weights to each good in the basket
- Obtain prices in the current year
- Calculation of price relative/for simple price index for each commodity in the basket using the formula

  Simple price index = $\frac{current\ year\ price}{base\ year\ price} x100$

- Compute the average simple price index from the formula

  Average simple price index = $\frac{\text{Total simple price index}}{\text{total number of commodities}}$

- Calculate weighted price index from the formula

  Weighted price index = simple price x weight

- Compute average weighted price index from the formula

  Average weighted price index = $\frac{\text{Total weighted price index}}{\text{total number of commodities}}$

(b) Explain the challenges faced when compiling price indices in Uganda. (12 marks)

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    - **Selection of base** year when prices were stable, it should be free from abnormal conditions like wars, famines, floods, political instability, etc.
    - **Selection of Commodities in a basket:** the items selected should be

      - representative of the tastes, habits and customs of the people.

      - be recognizable,

      - stable in quality over two different periods and places.

      -The economic and social importance of various items should be considered

    - **Unrepresentative results** due a few places sampled which do not cover the whole country.
    - **It is difficult to assign weight to different** because of differences in tastes and preferences.
    - **Difficult in choosing the representative families**, from where necessary data has to be collected.
    - **Difficult to find a base year with stable prices since prices vary with seasons**
    - **Choice of the prices** to be collected whether wholesale prices or retail prices
    - **Different methods:** whether simple index number or weighted index number give different values
    - **Inadequate skilled** labour to collect information
    - **Price changes from one region to another**
    - **Lack of standard units for sale of the basic needs across the country**
    - **Inadequate funds for the process of compilation of data** for instance money for transport and stationery
    - **Individual income may change consumption patterns**
    - **Wrong information from interviewee.**
    - **Data collection is a tedious exercise**
    - **Unstable taste and preferences of interviewees**.
    - **Unrepresentative basket of goods due to different income groups**
    - **Price discrimination** may make it difficult to choose a price of a commodity.
    - **Food basket may change when a new commodity enters market**

7. (a) Differentiate between hyper-inflation and mild inflation. (04marks)

   Hyperinflation is a persistent increase in the general price levels at high/fast rate (i.e. over 10% per annum)
   Mild inflation is persistent increase in price level at a slow rate (i.e. less than 10%)

   (b) Describe measures being taken to control inflation in Uganda. (16marks)

- **Selling government securities to the public.** This is aimed at reducing money supply and aggregate demand in the economy as a way of controlling inflation.
- **Increasing direct taxes.** This helps to reduce the disposable incomes of the individuals and to check on aggregate demand.

- **Reducing government expenditure** for example through retrenchment so as to reduce on money supply and aggregate demand in the economy.
- **Maintaining political stability and security by the government through democratic governance and use of amnesty act**. This helps to create a favorable investment climate hence increasing the supply of goods and services in the economy.
- **Use of import and export policies.** Policies aimed at restricting the exportation of scarce commodities and importation of commodities which are scarce in the economy should be promoted. This helps to increase on the availability of commodities in the economy.
- **Controlling the importation of goods and raw materials from countries experiencing inflation.** This is done by the government adopting import substitution development strategy to produce commodities formerly imported. This helps to check on imported inflation.
- **Use of population control measures.** This is aimed at reducing population growth rates through the use of appropriate family planning methods. This helps to check on excessive demand. For goods and services.
- **Construction of social and economic infrastructure.** For example construction of roads, rehabilitation of production units etc. This helps to facilitate the distribution of goods and services from rural to urban areas hence controlling inflation.
- **Reducing government borrowing from the central bank for deficit financing.** This helps to reduce excessive money supply in the economy.
- **Use of price control measures for example use of maximum price legislation, rationing etc**. to check on inflation.
- **Use of wage freeze policies.** These are aimed at controlling wages of workers through the use of wage freeze and restraint. This helps to check on the disposable incomes of individuals hence reducing money supply and aggregate demand.
- **Providing investment incentives.** There is need for the government to create a conducive investment climate by providing investment incentives to both foreign and local investors in form of subsidization and granting tax holidays. This helps to increase production of goods and services in the economy.
- **Use of currency reforms in case the level of inflation is very high**. This helps to reduce money supply in the economy.
- **Use of privatization policy.** This helps the private individuals to get involved in production hence increasing the supply of goods and services in the economy
- **Liberalization of the economy.** This allows for a number of individuals to get involved in exchange of goods and services with limited unnecessary government intervention

Thank you

Dr. Bbosa Science