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Economics paper 1 set 12 and marking guide

SECTION A

Answer all parts of this question.

1. (a) (i) Define the term "effective demand" (01 mark)
(ii) Give any **three** factors that limits effective demand in an economy (03marks)
- (b) (i) Distinguish between producers' surplus and consumers' surplus. (02 marks)
(ii) Given that the market price of a commodity is Uganda Shs 65,000, calculate the producer's surplus in the table below:

Price Ugshs.	30,000	35,000	40,000	45,000	50,000	55,000	60,000	65,000
Supply	1	2	3	4	5	6	7	8

- (c) (i) Differentiate between casual and residual unemployment (02marks)
(ii) State any two effects of unemployment in an economy (02marks)
- (d) (i) What is meant by the term "marginal propensity to import". (01 mark)
(ii) Give three effects of high marginal propensity to import in an economy. (03marks)
- (e) (i) Distinguish between a reproductive debt and a dead weight debt. (02marks)
(ii) State any two ways in which a public debt can be redeemed. (02marks)

SECTION B (80 MARKS)

Answer any **four** questions from this section.

2. (a) How does a firm in monopolistic competition market determine output price and profit in the long run? (06marks)
(b) Explain the merits and demerits of monopolistic competitions (14marks)
3. (a) Why may a country adopt an export promotion strategy of industrial development? (10 marks)
(b) Explain the limitations of the export promotion strategy of industrial development. (10 marks)
4. (a) Distinguish between labour supply and labour force. (04 marks)
(b) Explain the factors that determine labour supply in an economy. (16 marks)
5. (a) Given that the volume of money in an economy is £ 20 billion; total level of transaction is £ 250 million and transaction velocity is 20. Calculate the general price level in the economy. (04 marks)
(b) Explain the limitations of Irving Fisher's quantity theory of money. (16 marks)

6. (a) Differentiate between mild inflation and hyperinflation (04 marks)
 (b) Explain the effects of hyperinflation in an economy (16 marks)
7. (a) Differentiate between taxation financing and debt financing (04 marks)
 (b) Why may a government rely more on debt financing than taxation financing? (16 marks)

Guides

SECTION A

Answer all parts of this question.

1. (a) (i) Define the term "effective demand" (01 mark)
 Effective demand is the desire to acquire/possess a commodity backed by ability to pay for it.
 Or
 It is the actual amount of goods/services purchased / bought by the consumer at a given price and at a given time.
 OR
 It is the actual buying of a product / goods and services at a particular time.
- (ii) Give any **three** factors that limit effective demand in an economy (03 marks)
- High prices for goods and services.
 - Low levels of consumers income
 - Unfavorable tastes and preferences
 - High prices of complementary goods
 - Low prices of substitute goods
 - Expectation of a fall in future prices
 - unfavorable seasons / end of season
 - Limited credit facilities
 - Low levels of advertising
 - Uneven distribution of income
 - Small population size
 - Government policy against consumption of commodity i.e. high taxation/low subsidization
- (b) (i) Distinguish between producers' surplus and consumers' surplus. (02 marks)
Producer's surplus is the excess earnings between what the producer was willing to charge for a commodity and what he/she actually receives after selling it.
Consumers' surplus is the difference between what the consumer is willing to pay and what he actually pays for a commodity.

(ii) Given that the market price of a commodity is Uganda Shs 65,000, calculate the producer's surplus in the table below:

Price Ugshs.	30,000	35,000	40,000	45,000	50,000	55,000	60,000	65,000
Supply	1	2	3	4	5	6	7	8

Producer's surplus = actual revenue - expected revenue

Expected revenue = 30,000 + 35,000 + 40,000 + 45,000 + 50,000 + 55,000 + 60,000 + 65,000

= 380,000

Actual revenue = 65,000 x 8 = 520,000

Producers surplus = Shs. 520,000 – Shs. 380,000 = Shs. 140,000

(c) (i) Differentiate between casual and residual unemployment (02marks)

Casual Unemployment refers to a situation where workers are employed on temporary basis and as soon as their contract (work /season is over, they become unemployed.

While

Residual unemployment is one which results from physical or mental handicaps making one fail to get a job or work.

(ii) State any two effects of unemployment in an economy. (02marks)

- It increases the dependence burden of the unemployed on the employed.
- It leads to low government tax revenue
- It worsens income and wealth inequalities.
- It leads to rural - urban migration with its associated adverse effects.
- It leads to high government expenditure on the unemployed on provision of social services
- It leads to brain drain
- It results in low aggregate demand for goods and services.
- It leads to low production / low GDP /Low economic growth
- It leads to underutilization of productive resources/wastage of resources
- It leads to low **standard** of living and misery among the unemployed/poverty
- It leads to social evils such as alcoholism, prostitution etc. among the unemployed.
- It creates political tension /unrest
- It leads to a decline in the acquired skills
- It discourages investment in education.

(d) (i) What is meant by the term "marginal propensity to import". (01 mark)

Marginal propensity to import is the proportion/percentage/fraction of additional income that is spent on imports.

Or

Marginal propensity to import is the ratio of change in import expenditure to change in income.

(ii) Give three effects of high marginal propensity to import in an economy. (03marks)

- High outflow of foreign exchange
- Unfavourable balance of payment position/increases public debts
- Limited growth of local industries
- Unemployment problem
- Increased dependence on other economies
- Limited innovations and inventions
- Leads to imported inflation
- It leads to underutilization of local resources.
- It leads to erosion of social - cultural values
- It increases government tax revenue
- Provision of a variety of goods.

(e) (i) Distinguish between a reproductive debt and a dead weight debt. (02marks)

A reproductive debt is one where the borrowed money is used to purchase real assets/finance productive projects which bring in returns used to pay back the loan i.e. self-

liquidating debt.

While

A dead weight debt is one where the borrowed money is used to finance unproductive projects.

(ii) State any two ways in which a public debt can be redeemed. (02marks)

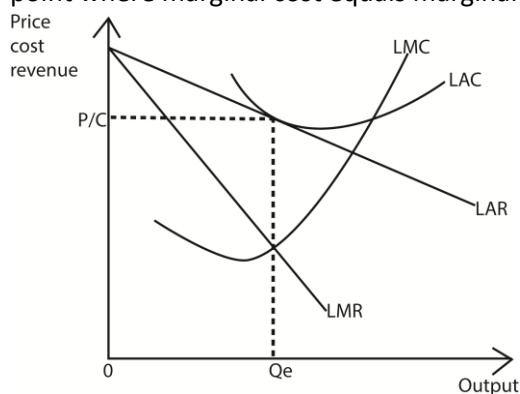
- Through borrowing from a cheaper source to pay a due debt / debt conversion
- Through debt rescheduling i.e. asking for an extension in the time / date of repayment / terms.
- Through debt repudiation i.e. outright refusal to repay the debt.
- Through disinvestment / privatization
- Through debt relief/ cancellation
- Creating a sinking fund.
- Drawing a surplus budget
- Drawing on foreign reserves/sale of Gold reserves
- Use of gifts and grants
- Use of profit
- Through government securities to the public
- Through taxation
- Borrowing from central bank/printing more money/financial accommodation.

SECTION B (80 MARKS)

Answer any four questions from this section.

2. (a) How does a firm in monopolistic competition market determine output price and profit in the long run? (06marks)

In the long run a firm in a monopolistic competitive market determines output and price at a point where marginal cost equals marginal revenue (LMC = LMR)



- Price is determined where output line meets the LAR/DD curve, the LAR is tangential to LAC.
- In the long run the firm earns normal profits (zero profits) since the LAR = LAC.

(b) Explain the merits and demerits of monopolistic competitions (14marks)

- A variety of products is produced due to product differentiation.
- High quality products are produced due to competition of production unit.
- Abnormal profits earned in the short run can be used for expansion
- Promotes innovations and inventions
- Low prices are charged due to competition
- Persuasive advertisement enables firms to expand market for their products,

- High output is produced due to presence of many firms
- Source of revenue for the government through taxation.
- Provision of employment

Demerits of monopolistic competition.

- Underutilization of resources because of producing at excess capacity.
- Limited research since firms earn normal profit in the long run.
- Duplication of activities/service hence wastage of resources
- High cost of production e.g. on advertising and product differentiation.
- Limited market share because of the many firms in monopolistic competition.
- Persuasive advertisement disturbs consumer choices.
- Prices charged are higher compared to perfect competition and this leads to/ consumer exploitation.
- Leads to unemployment due to exit of firms in the long run.

3. (a) Why may a country adopt an export promotion strategy of industrial development?

(10 marks)

- To increase foreign exchange earnings
- To improve the country's balance of payments position.
- To diversify the economy
- To widen the tax base of the country.
- To expand market for the country's goods and services
- To create more employment opportunities
- To facilitate the exploitation and utilization of resources
- To reduce the dominance of subsistence production and hence promote commercial production
- To increase economic growth
- To promote growth of the industrial sector
- To promote technological development
- To promote international co-operation
- To develop entrepreneurship
- To improve on quality of products produced.
- To promote infrastructural development

(b) Explain the limitations of the export promotion strategy of industrial development.

(10 marks)

- Low quality products that cannot compete favourably in foreign markets
- Inadequate capital to set up industries.
- Limited skilled manpower to employ in the industries.
- Limited entrepreneurial skills
- Limited local natural resources / shortage of raw materials
- Poor infrastructure (irregular power supply /poor transport)
- Low level of technological development.
- Protectionist policies of developed countries.
- Political instabilities
- Limited market among LDCs due to production of similar products.
- Production of expensive products due to high cost of Production. Firms are usually high cost producers.
- High cost of advertising, market research

- Limited export promotion facilities /institutions
- Corruption and embezzlement
- poor land tenure system

4. (a) Distinguish between labour supply and labour force. (04 marks)

Labour supply is the number of people willing and able to work at a given wage rate

Or

Labour force is the total number of people of a working age group available for employment at a given time i.e. it includes all those employed and unemployed.

(b) Explain the factors that determine labour supply in an economy. (16 marks)

- The population size
- The health conditions of the worker/mental and physical abilities.
- The age composition of the population
- The working conditions
- Nature of the jobs i.e. risky or not risky
- The level of skills required in a particular job / Training period education levels
- Attitude of the worker towards work.
- Political climate
- The influence of trade unions
- The level of labour mobility, both geographically and occupationally.
- The rates of migration of labour i.e. immigration and emigration.
- Legal working age
- The wage rate
- The sex composition of the population
- The number of hours worked
- Level of discrimination in the labour market

5. (a) Given that the volume of money in an economy is £ 20 billion; total level of transaction is £ 250 million and transaction velocity is 20. Calculate the general price level in the economy. (04 marks)

$$P = \frac{MV}{T} = \frac{20,000,000,000 \times 20}{250,000,000} = \text{£}1,600$$

(b) Explain the limitations of Irving Fisher's quantity theory of money. (16 marks)

- There is no general price level but rather a series of price levels.
- The theory only attempts to explain changes in the value of money but not how the value of money is determined.
- It ignores the influence of the rate of interest.
- It does not take into account the demand for money but only looks at money supply.
- An increase in money supply may result into saving, more so if the MPS is high, this reduces the velocity of circulation and price may fall.
- Haggling between buyers and sellers to reach an agreeable price is not taken into account.
- It ignores price control by the government.
- It ignores other causes of price increase (inflation) e.g. cost push, demand pull etc.
- It is just a truism which merely shows that M, V, P and T are related.
- It ignores barter trade
- It considers only the transaction motive and ignores other motives for holding money like precautionary, speculative etc.
- The four variables M, V, P and T are not independent of one another because a change in

one induces change in others.

- The theory assumes that velocity of circulation and the level of transaction are constant but this is not the case in real life.
- Where a country has many idle/unused resources, an increase in money supply leads to an increase in production of goods and services which makes prices fall or not change at all.

6. (a) Differentiate between mild inflation and hyperinflation (04 marks)

Mild inflation is one which is characterized by a slow rise in the general price level, usually less than 10%.

While

Hyperinflation is one which is characterized by a rapid rise in the general price level usually exceeding 10% (per annum).

(b) Explain the effects of hyperinflation in an economy (16 marks)

- Discourages savings due to the constant loss of money value/ fall in the value of money. It leads to loss of Confidence in the country's currency.
- It worsens the balance of payments position
- Encourages capital outflow.
- It leads to unemployment as some firms close down.
- It promotes speculation in the economy.
- It makes government planning difficult
- It leads to industrial unrest due to constant demand for higher wages
- It leads to brain drain
- People are strained in an attempt to cope with the rising cost of living.
- It worsens the problem of income inequality
- Fixed income earners lose due to a fall in money value.
- The government becomes unpopular.
- It discourages local and foreign investors
- It encourages illegal activities such as corruption and smuggling etc.
- It leads to production and consumption of poor quality/inferior goods/ leads to low standards of living

7. (a) Differentiate between taxation financing and debt financing (04 marks)

Debt financing is where government borrows money to finance its expenditure that may not be covered by the tax revenue.

While

Taxation financing is where government uses revenue from taxes to finance its expenditure

(b) Why may a government rely more on debt financing than taxation financing? (16 marks)

- Debt financing does not have negative political effects compared to taxes that may cost the government political popularity.
- It is easier to borrow money than to tax.
- Debt financing helps to realize a lump sum of money compared to taxation which is slow in bringing in money.
- Debt financing tends to augment/supplement tax revenue that is always low due to a narrow tax base
- Debt financing makes use of both local and foreign sources of revenue compared to taxation which is only internal.
- Debt financing does not have adverse effects on consumption compared to taxation that

reduces the disposable income of the people.

- Debt financing does not involve costly methods of collection compared to taxation.
- Debt financing does not discourage production by increasing the costs of production unlike taxation which increases the cost of production.
- Debt financing does not discourage savings and investment as compared to taxation.
- Debt financing increases foreign reserves of the country and encourages foreign investment as compared to taxation which discourages potential foreign investors.
- The burden of borrowing can be postponed to the future generations than taxation whose burden is felt by the present generation.
- Borrowing can be used to fight inflation, especially internal borrowing as compared to taxation, which causes cost push inflation
- Borrowing is a quicker method of raising money than taxation.

Thank you

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