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Economics paper 1 set 17 and marking guide

SECTION A (20 marks)

Answer all parts of this section

1. (a)(i) What is Possibility Frontier? (01mark)
(ii) Give any three causes of outward shift in the production possibility frontier. (03marks)
- (b)(i) Distinguish between vertical and horizontal merging of firms. (02marks)
(ii) Mention any two merits of merging of firms. (02marks)
- (c)(i) State the balanced growth theory (01marks)
(ii) Mention any three conditions necessary for the success of the balanced growth theory in an economy
- (d)(i) What is meant by monetary policy? (01marks)
(ii) State any three tools of monetary policy
- (e)(i) Distinguish between progressive tax and proportional tax. (02marks)
(ii) Give any two advantages of a progressive tax

SECTION B (80 MARKS)

Answer any four questions from this section

2. (a) Distinguish between price elasticity of demand and income elasticity of demand. (04marks)
(b) Explain the determinants of price elasticity of demand in an economy. (16marks)
3. (a) Describe the methods used to compute national income in an economy. (06marks)
(b) What measures may be adopted to increase the level of national income in an economy. (14marks)
4. (a) Distinguish between labour-intensive and capital intensive techniques of production. (04marks)
(b) Why should capital intensive techniques of production be adopted by developed countries? (16marks)
5. (a) Explain the Keynesian theory of unemployment. (08marks)
(b) What are the limitations of the Keynesian theory of unemployment in developing countries? (12marks)
6. (a) Account for the unfavorable terms of trade in developing countries. (10marks)
(b) Suggest measures that should be taken to improve the terms of trade in developing countries. (10marks)
7. (a) Describe the principle of economic development planning. (10 marks)
(b) What challenges do developing countries face when implementing development plans? (10marks)

SECTION A (20 marks)

Answer all parts of this section

1. (a)(i) What is Possibility Frontier? (01mark)

A production possibility frontier is a curve that shows all possible combinations of two commodities that can be maximally produced when all resources are fully and efficiently utilized / employed.

Or:

It is a locus of points showing all possible combinations of two commodities produced given the resources available to produce them

(ii) Give any three causes of outward shift in the production possibility frontier.(03marks)

- improved technology / technological progress
- Increased workers efficiency/ skills / increased training of labour
- Increase in Labour force
- Discovery of new natural resources
- Improved entrepreneurial abilities / skills
- Increase in capital inflow

(b)(i) Distinguish between vertical and horizontal merging of firms. (02marks)

Vertical integration is the merging or coming together of firms operating at different stages of production process within the same industry for example agricultural firm and a grocery

Horizontal integration is the merging or coming together of firms operating at the same stage of production process, producing related or similar products, e.g. merging of banks or supermarkets.

(ii) Mention any two merits of merging of firms. (02marks)

- Increased capital | Easy access to loans.
- Reduces the costs on advertising.
- Increased output / increased capacity utilization.
- increase skilled labour
- Sharing of risks
- Access to better technology
- Improved efficiency in management.
- Reduces stiff competition/Reduces competition for market / Widens Market/ Increased sales.
- Reduces duplication of goods and services
- Research is possible/ easy,
- Reduced prices due to reduced costs of production.

(c)(i) State the balanced growth theory (01marks)

A **balanced development theory** involves the simultaneous allocation of resources in all sectors of the economy so that all sectors grow at the same pace and complement each other in terms of market and supply of raw materials. It calls for a balance between consumer and capital goods, industry and agriculture, production for domestic markets and for exports etc.

(ii) Mention any three conditions necessary for the success of the balanced growth theory in an economy

- Availability of enough capital / sufficient / adequate capital.
- Availability of skilled labour /man power.
- Presence of entrepreneurial abilities/ skills
- Favourable political climate
- Favourable government policy on investment
- Existence of well-developed infrastructure.
- Low levels of conservatism.
- Existence of a large market
- Presence of a strong planning machinery.
- High level of accountability / Low level of corruption and embezzlement of public funds/ Transparency,
- Easy access to land.
- Presence of better technology.
- Existence of strong linkages between the sectors

(d)(i) What is meant by monetary policy? (01marks)

Monetary policy refers to the deliberate attempts/effort by the government through the central bank regulate/ control the amount of money in circulation / money supply in the economy so as to attain objective of development

(ii) State any three tools of monetary policy. (03marks)

- Bank rate
- Open Market Operations
- Legal Reserve requirement
- Margin requirement
- Moral suasion
- Selective credit control
- Variable reserve requirement cash ratio and liquidity ratio.
- Special deposit/ supplementary (Legal) reserve requirement
- Rationing of credit
- Currency reform

(e)(i) Distinguish between progressive tax and proportional tax. (02marks)

A progressive tax is one whose average rate of tax increases with increase in income / spending power of the tax payer

While

A proportional tax is one whose average rate of tax remains constant/ the same at all levels of income / spending power of the tax payer.

(ii) Give any two advantages of a progressive tax

- Reduces income inequality
- Increases government revenue
- Reduces social tension between the poor and the rich
- Encourage hard work
- Increases consumption of goods especially by the low income earners.

SECTION B (80 MARKS)

Answer any four questions from this section

2. (a) Distinguish between price elasticity of demand and income elasticity of demand. (04marks)

Price elasticity of demand is the measure of the degree of responsiveness of quantity demanded of a commodity to changes in the price of the commodity

Whereas

Income elasticity of demand is the measure of the degree of responsiveness of quantity demanded to changes in the consumer's income

(b) Explain the determinants of price elasticity of demand in an economy. (16marks)

- Availability of substitutes/ Degree of Substitutability
- Availability of complements / Degree of complementarity
- Degree of necessity of commodity
- Degree of addiction in the use of the commodity
- The level of income of the consumer
- The proportion of income spent on the commodity
- Number of uses of the commodity
- Time period i.e. short run or long run.
- Degree of durability of the commodity / Nature of the commodity
- Seasonal changes
- Possibility of postponement of the commodity
- Speculation/ expectation of price changes
- Level of advertisement / level of awareness of the availability cheaper goods

3. (a) Describe the methods used to compute national income in an economy. (06marks)

National income may be computed by one of the following methods

- **Income approach.** Here national income is obtained by adding up all incomes received by factors of production in a given period of time, usually a year. Such incomes include rent, salaries, wages, interest and profits.
- **The expenditure approach.** Here we add up expenditures on all final goods and services by all spending units of economy in a given time (year). Such expenditures include consumption, investment, government expenditure and net exports.
- **The product (output) approach.** It involves adding up the money value of final goods and services from all productive activities of an economy in a given time (year)

(b) What measures may be adopted to increase the level of national income in an economy.

(14marks)

- Increase the level of exploitation and utilization of national resource

- Expand/widen market for goods and services
- modernize/commercialize agriculture
- encourage further diversification of agriculture
- improve entrepreneurship skill through education/training
- encourage further privatization of public enterprises
- offer investment incentives to attract foreign investors
- ensure political stability
- ensure economic stability/control inflation
- liberalize economy
- undertake land reforms
- Offer cheap credit facilities.
- Control population growth
- Encourage labour training
- Improve infrastructure
- Ensure economic stability/control inflation

4. (a) Distinguish between labour-intensive and capital intensive techniques of production. (04marks)

Labour intensive technique of production refers to a production method that employs relatively more labour than other factors of production especially capital
While

Capital intensive technique of production refers to a method of production that employs relatively more capital than other factors of **production specially labour**

(b) Why should capital intensive techniques of production be adopted by developed countries? (16marks)

- **It leads to the production of better quality goods and services in the economy.** Such products are internationally competitive and fetch high prices on the world market hence better terms of trade for the country.
- **It increases the productivity and efficiency of other factors of production especially labour.** This leads to increase in output produced hence high rates of economic growth.
- **It facilitates the exploitation and utilization of the local resources.** This helps to improve on the productive capacities in the economy hence economic growth and development.
- **It enhances development of skills in the economy.** This is because it encourages research and development which leads to skill formation and management training.
- **It helps to modernize and standardize output especially from the agricultural sector.** This is in form of processing and better packaging of output necessary to meet international standards
- **It increases and stabilizes employment opportunities in the long run.** This is due to increased resource utilization and mass production which generates employment opportunities in other sectors of the economy through the multiplier process.
- **It facilitates the development of social and economic overheads.** Capital intensive technology promotes the development of the social and economic infrastructures in form of roads, schools, hospitals, financial institutions etc. so as to facilitate production and trade in the economy.

- **It facilitates technological development in the country.** Capital intensive technology encourages the use of modern production techniques through inventions, innovations and technology transfer. This increases efficiency in production.
- **It leads to better standards of living.** Capital intensive technology leads to the production of a variety of high quality goods and services in the economy. This widens the choice of consumers at reduced prices hence better standards of living.
- **It allows an economy to undertake heavy and complicated production where labour intensive technology cannot manage.** For example heavy engineering and manufacturing activities, mining etc.
- **It is appropriate in countries where labour is scarce and expensive.** This helps to minimize the wage bill and labour unrests.
- **It improves the balance of payment position of the country.** Capital intensive technology increases the production of high quality goods and services for exports through value addition. Such goods compete favorably on the world market hence increasing the export earnings of the country.
- **It encourages mass production in the economy.** This is because it makes it possible to achieve high rates of investment hence economic growth development.
- It is time saving as compared to labour intensive techniques of production, For example comparing the time taken to use a tractor to plough a given piece of land instead of using labour which is 'also difficult to supervise

5. (a) Explain the Keynesian theory of unemployment. (08marks)

The Keynesian theory states that **unemployment caused by a lack of aggregate demand in the economy**

Due to low demand for final products, firms reduce their output, income level fall, investment is discouraged and thus less labour and capital are employed.

(b) What are the limitations of the Keynesian theory of unemployment in developing countries? (12marks)

- **It is one sided.** it is mainly concerned with demand deficiency yet unemployment in LDCs is basically from supply side hence inapplicable.
- **It assumes full employment.** The theory is only applicable under conditions of full employment of resources, which condition do not exist in LDCs since there is excess capacity.
- **It considers industrialized economies.** The theory is mainly concerned with industrialized economies like Britain and yet LDCs are agrarian economies.
- **It can be inflationary.** As a solution to unemployment, Keynes prescribes policies, which raise the levels of aggregate demand such as increase in money supply which is always inflationary.
- **The theory is based on a highly monetized industrial economy.** LDCs are basically subsistence where production is intended for producer's own consumption.
- **The theory is drawn basing on the existence of a strong private sector** in LDCs is weak.

- **The theory is based on a well-functioning product, money and factor markets** which is not the case in LDCs.
- **The theory is based on assumption that firms respond quickly and effectively to change in demand.** Firms in LDCs due to structural difficulties tend not to respond quickly and effectively to demand.
- **Keynes based his theory on investment** multiplier as a major contributor to employment. In LDCs, it is export multiplier that contributes more employment than investment multiplier.
- **The theory of unemployment was based on a closed economy.** LDCs economies are open in that they have trade interactions with others.

6. (a) Account for the unfavorable terms of trade in developing countries. (10marks)

- **Production and exportation of similar products by developing countries.** This leads to excess supply on the world market hence low export prices as compared to import prices.
- **Discovery of synthetic substitutes by developed countries for exports from developing countries.** This has greatly reduced the demand for exports from developing countries hence low export prices.
- **Development of raw material saving technology by developed countries.** This has reduced the demand for raw materials from developing countries hence low export prices.
- **Production and exportation of cheap primary products (raw, materials) by developing countries.** Such products fetch low prices on the world market hence unfavorable terms of trade.
- **International commodity agreements favour developed countries by fixing low prices for exports** from developing countries and higher prices for exports from developed countries hence deteriorating terms of trade
- **Weak bargaining power among developing countries** due to limited economic integration leads to low prices for their exports.
- **Some developing countries (like Uganda) are land locked.** This leads to high costs of transport for their exports and imports. The high transport costs reduce the prices for their exports and increase the prices for their imports hence unfavorable terms of trade.
- **Protectionism by developed countries** against exports from developing countries in form of tariff and non-tariff barriers. This is aimed at protecting their economies as a way of achieving self-sufficiency and reliance. This has greatly reduced the demand for exports from developing countries hence unfavorable terms of trade.
- **Developing countries have a high marginal propensity to import.** This enables developed countries to fix high prices on their products hence unfavorable terms of trade.
- **Unfavorable exchange rate**
- Low quality exports due to poor technology

(b) Suggest measures that should be taken to improve the terms of trade in developing countries. (10marks)

- Promote export diversification including the production of industrial products so as to avoid over flooding of the world markets by similar products produced by developing countries. This helps to increase the export prices hence favourable terms of trade.

- Embrace regional integration and economic co-operation so as to promote trade among developing countries. This can help them to avoid being exploited by developed countries.
- Adopt technological development in order to improve on quality and quantity of exports. This can help to increase on the export prices.
- Formation of strong commodity associations so as to jointly bargain for fair prices for their exports on the world market. For example coffee producers Association (CPA).
- Adopt favorable policies like subsidization of local producers and privatization of the inefficient parastatals. This can help to improve on quality and quantity of their exports hence favourable terms of trade
- Carry out market research and advertisement as a way of improving on the marketability and prices of their exports.
- Adopt import substitution industrial strategy
- Stabilize exchange rate
- Negotiate for removal of trade barriers in export market

7. (a) Describe the principle of economic development planning. (10 marks)

- **Principle of comprehensiveness**- should cover the whole economy| all sectors of the economy.
- **Consistency**- should be in line with targets and objective of development
- **Sequencing** - implementation of projects should be done in an orderly manner / i.e. order of the implementation.
- **Compatibility** i.e. projects in the plan should be related to create / promote linkages
- **Simplicity** i.e. easy to understand by both formulators and implementer.
- **Proportionality in allocating resources/optimality in the use of resources**
- **Economic feasibility** i.e. should be achievable
- **Principle of acceptability** i.e. social. political and international
- Principle of continuity

(b) What challenges do developing countries face when implementing development plans?
(10marks)

- Inadequate funds / limited capital
- Inadequate/ limited necessary data information
- Limited good will by the people ,conservatism
- Natural calamities
- Presence of non-responsive private sector
- Poorly developed infrastructure
- Dependence on foreign aid which is inadequate, uncertain, inconsistent etc.
- Interference by politicians / government
- Political instability
- High rate of inflation
- inefficient/ weak implementation/ administrative machinery/ limited labour skills
- Low accountability ·
- Plans being too ambitious i.e. far beyond the means
- External / foreign interference

- High population growth rates
- Bureaucratic delays / red tape tendencies

Thank you

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