



Dr. Blosa Science

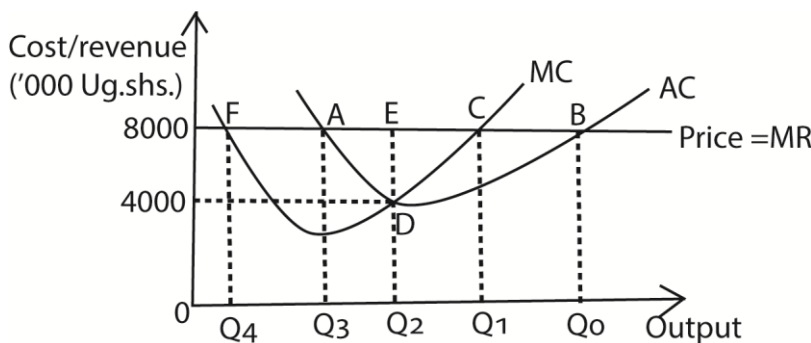
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## Economics paper 2 set 4 and marking guide

1(a) Study the figure below showing the cost and revenue of a firm under perfect competition and answer the questions that follow.



(i) State the

- Optimum size of the firm  
The optimum size of the firm is point B because the highest output  $OQ_2$  is produced at the lowest cost (4000, 000/=)
- The shutdown point of a firm  
The shutdown point of a firm is point A because below this point, the firm cannot cover the average variable cost
- Average revenue of the firm when the output  $OQ_2$  is produced.  
Average revenue =  $\frac{TR}{output} = \frac{P \times Q_0}{Q_0} = P$   
= shs. 4000,000 (since the price is in '000U.shs.)

(ii) Why do costs increase beyond output  $OQ_2$ ?

Costs increase beyond output level  $OQ_2$  because of diseconomies of scale whereby output increases with increase in average variable costs.

(b) With examples, distinguish between derived demand and composite demand.

**Derived Demand** is demand for a good or service that arises as a result of demand for another related good or service. Thus the demand for labour is a derived demand from the demand for goods and services. For example, if the demand for a good such as vehicles increases, then this leads to an increase in the demand for labour, as well as demand for other factors of production such as steel.

**Composite demand** happens when there are multiple uses for a single product. For example, **corn can be used as animal feed, ethanol and food in its whole form.** The rise

in demand for any of these products leads to a shortage in supply for the others. This shortage can lead to a rise in price

(c) Explain the difference between;

(i) Real economies and pecuniary economies of scale

**Real economies of scale** are benefits accruing to a firm operating on large scale in terms of saving on the quantity of inputs leading to falling average costs of production. Or **Real economies of scale** occurs when more units of a good or service can be produced on a larger scale with (on average) fewer input costs

Whereas **Pecuniary economies of scale** are those which accrue to large size firms from discounts available to them due to large purchases of raw materials, large scale acquisition of external finance at lower rate of interest from central banks.

Or **Pecuniary Economies of Scale** can be defined as a situation when lower prices are paid for the factors used in the production and distribution of the product, due to bulk-buying by the firm as its size increases.

(ii) Internal and external diseconomies of scale

**Internal diseconomies** imply to all factors which raise the cost of production from within a particular firm as a result of expansion of its scale of production. These can be technical issues of production or organizational issues within the structure of a firm or industry.

**External diseconomies of scale** refers to external forces imposed by the environment within which a firm or industry operates leading to increase in average costs of production. Causes external diseconomies of scale may includes

- Intense competition among the firms raises the cost of raw material.
- The scarcity of electricity, water, finance, and other factors of production raises the price.
- Local roads become congested and so the transportation cost begins to rise.
- Local labour becomes scarce and firms have to offer higher wages to attract new workers.
- Land and factories become scarce and rent begin to rise.
- The localization of an industry in a specific region leads to pollution. This adversely affects their health. The social cost of production rises.

(d) State the:

(i) conceptual problems of measuring national income in your country

- **Calculation of incomes:** In underdeveloped countries, people are not specialized in a particular occupation. They work in one occupation at one season and another occupation in another season. Hence it is difficult to calculate the national income.
- difficult to calculate the value goods that are to be sold but are used for self-consumption.
- Difficult to make a clear distinction between primary, intermediate and final goods.
- Illegal activities
- Problems of valuing inventories and work in progress
- Existence of large subsistence output
- Valuing of unpaid service e.g. House wives.

(ii) Statistical problems of measuring national income in your country

- Inadequate data/information
- Problem of double counting/transfer payment
- Difficulty in valuing government services
- Unpaid services
- Difficulty in calculating depreciation of capital
- Difficulty in valuing of subsistence output
- Price changes/instability

(e) Distinguish between:

(i) Gross National Product (GNP) and Gross Domestic Product (GDP)

**Gross national product (GNP)** refers to the money value of all final goods and services produced by nationals of a country (living within and abroad) during a given period of time.

**Gross domestic product (GDP)** refers to money or market value of all final goods and services produced within the geographical boundaries of a country by the nationals and foreigners living in a country during a period of one year.

(ii) GDP at factor cost and GDP at market price

GDP at factor cost refers to the value of goods and services valued at what factor of production are paid in production process in a given year.

GDP at market price refers to the value of goods and service valued at what is paid for final commodities and services in the market in a given period of time normally one year.

(f)(i) What is meant by “take off stage” in economics?

Take –off stage is the third stage of Rostov’s economic growth model where a country attains a self-steady and self-sustained growth. Industrialization increases with workers switching from the agricultural sector to the manufacturing sector. Growth is concentrated in a few regions of the country and within one or two manufacturing industries. The level of investment reaches over 10% of GNP.

Or

The take-off is defined as the interval during which the rate of investment increases in such a way that real output per capita rises and this initial increase carries with it radical changes in production techniques and the disposition of income flows which perpetuates the new scale of investment and perpetuate thereby the rising trend in per capita output

(ii) Give three conditions necessary for the take-off stage

- Arise in the rate of productive investment from over 10%-15% of national income
- The development of one or more leading manufacturing sectors with high rate of growth.
- Emergency of cultural frame work that exploits the impulses to expansion in modern sector.
- High levels of employment
- A large monetary sector with a fading role of subsistence sector

- Expansion of markets
- Innovations and inventions take place.

(g)(i) Define the term land tenure system

Land tenure system refers to the right of ownership and use of land in a particular society.

(ii) How has agricultural production been affected by the land tenure system in your country?

Land tenure system have affected agricultural productivity in the following ways

- Communal ownership of land has encouraged subsistence farming leading to low production.
- Has led to production of poor quality products
- There is absence of specialization
- There is dependence on nature
- There is limited credit facilities
- Limited mechanization due to peasantry holding system

(h)(i) Differentiate between nominal wage and real wage

**Nominal wage** refers to payment or reward for labour in monetary terms whereas **real wage** refers to the purchasing power of the nominal wage. It is expressed in terms of basket of goods and services bought out from nominal wage.

(ii) Give two modes of paying workers in your country.

- Piece rate system
- Time rate system
- Profit sharing system
- Sliding scale
- Bank system of paying

(i) Distinguish trade creation and trade diversion

**Trade creation** refers to a situation where as a result of economic integration, a country shifts the consumption of goods from high cost non-member countries to low cost member country.

**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.

(j) What is the economic relationship between cash ratio, bank deposits and credit creation?

A low cash ratio will have a small effect on bank deposit and therefore greater credit will be created whereas on the other hand, high cash ratio will reduce on the bank deposits leading to low credit creation

## SECTION B

2(a) Distinguish between aggregate money demand and aggregate demand.

**Aggregate money demand** refers to the total sum of money demanded by the economy to finance its expenditure

**Aggregate demand** refers to the total demand of finished goods and service produced in an economy by both households and firms.

(b) Examine the factors which affect the level of aggregate demand in your country

- The general price levels in the country: when the general price levels of goods and services are high, aggregate demand lowers and when the general price level is low aggregate demand increases.
- The general level of incomes: when the incomes of households and firms in a country are high, the demand for goods and services are high and vice versa.
- The amount of money supply in an economy: the high supply of money in the country increases the purchasing power of the households and firm raising the aggregate demand.
- The level of aggregate money demand in a country. High level of aggregate money demand reduces the purchasing power of consumers reducing aggregate demand and the vice versa.
- The supply of consumer goods and service. A limited supply of good and services force prices to increase and reduces the aggregate demand and vice versa.
- The distribution mechanism of good and services: When the distribution of goods and services is poor, the level of aggregate demand will be low and vice versa.
- The size of the population: high population increase purchasing power and aggregate demand and vice versa.
- The tastes and preferences. If the tastes and preferences are positive for particular goods and service, the purchasing power increases leading to increase in aggregate demand.
- The political climate in the country. A stable conducive political climate increase the purchasing power leading to increase in aggregate demand
- Economic climate. Stable economic climate such as stable prices increase purchasing power and therefore increase aggregate demand.
- Levels of development of the commercial sector. A well-developed commercial sector implies high levels of income leads to an increase in aggregate demand.
- Government policy on taxation. When the tax rates in the country are high, this reduces the income of consumers leading to low purchasing power thus reducing aggregate demand.
- The expectation of inflation:- If the consumer expects high inflation in the future then the demand rises in the present such that the aggregate demand curve shifts rightward.

3(a) Account for poor performance of agricultural sector in your country

- Unfavourable climatic factors. The unpredictable climate; draught and floods in Uganda lead to low output in agriculture
- Pest and disease to plants and animals lead to low output.
- Poor soils leading to low yield
- Insufficient access to extension services remains a key barrier to farmers' uptake and use of productivity-enhancing technologies.
- Poor land tenure system prevent potential farmer without land not the produce. Secondary land fragmentations prevent commercial agricultural investments.
- A big proportional of agriculture is subsistence mainly for women and children
- Poor attitude towards agriculture. Many Ugandans have low opinion about agricultural investment.
- Inadequate markets for agricultural output.
- Inadequate capital to invest in agriculture
- Political instability discourages farmers.
- Poor infrastructure such as road enable faster transport of agriculture output to the markets
- Limited research in agriculture and failure to product high yield breeds of plants and animals.

- Relying on a few traditional cash crops such as coffee, tobacco, cotton, tea.
- Price fluctuations discourage farmers
- Few agro-based industries to process and add value to agricultural outputs before they are exported.

(b) What are steps being taken to improve performance of agricultural sector?

Policy measures to improve agricultural sector in Uganda.

- Encourage diversification to increase on the farmer's revenue.
- Governments provide high yield seeds and crossbreed animals to the farmer
- Discouraging land fragmentation
- Funding of research through National agricultural research organisation (NARO)
- Improvement of extension service through the national agriculture extension services through NAADS
- Training manpower for agriculture at various universities and colleges
- Encouraging investment in agriculture such as cooler trucks for milk.
- Modernization of agriculture through providing tractors and irrigation schemes
- Increase allocation of funds to agricultural sector.
- Encouraging private sector to invest in agriculture
- Removal of taxes on agriculture inputs and exports
- Liberalization of agricultural exports breaking monopoly of marketing boards.
- Extending credit to farmers.
- Addressing gender balance

4(a) Explain the difference between export promotion and import substitution strategies of industrial development.

**Export promotion** refers to government policy and strategies of expanding the volumes of output destined for export.

**Import substitution** refers to establishment of industries to produce goods and services that were formerly imported into the country with the aim of reducing foreign exchange expenditure on imports.

(b) Examine the limitations of import substitution strategy in your country.

- Limited domestic market to sustain development of industries.
- Import substitution requires a lot of protection and subsidies rarely affordable by government.
- Lack of competition make infant domestic industries leading to poor quality goods and services
- Industries to produce import substitutes require very high capital not affordable by local investors
- Low technology and skilled manpower fail to produce import substitutes
- Import substitution industries in urban area because of availability of market lead to rural-urban migration
- Decrease in government revenue to reduce import duties
- Import substitution encourages foreign investors resulting in profit repatriation
- It requires stable political environment to attract foreign investors.

5 (a) What are the functions of a Trade Union?

- negotiate agreements with employers on pay and conditions
- discuss major changes to the workplace such as large scale redundancy
- discuss members' concerns with employers
- accompany members in disciplinary and grievance meetings
- provide members with legal and financial advice
- provide education facilities and certain consumer benefits such as discounted insurance
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(b) What problems trade unions face in your country?

- Government interference: the government is the major employer but usually interferes with decision made by trade unions e.g. it may refuse to give high wages as anti-inflationary measure
- Poor leadership. Worker lack adequate leadership skills to organize successful trade unions.
- Inadequate funds to Union's activities especially in crisis such as in case of strike.
- Weak industrial sector. Most people are employed in agricultural sector where workers are scared and cannot easily be organized into Trade Unions
- Corruption: members of Trade Unions administration are corrupt to push members' interests.
- There is a problem of labour mobility. Workers are continuously changing jobs leading the problem of permanent membership and goals Of Trade Unions.
- Weak bargaining powers since Trade Unions form a small percentage of the total labour force.
- Open unemployment in economy scares Trade Union members. In case they strike, they can easily be fired.
- Ignorance of the benefits of Trade Unions by most worker who do not mind their working conditions.
- Poor communication network among Trade Union members
- Worker employed on probation and contracts are reluctant to join Trade Unions.
- Indifferent workers do not care about Trade Unions.

6(a) What are the features of an economic Union

- Free movement of goods and services
- Common policies on product regulation
- Common external polity and external tariff structure.
- Free movements of capital and factors of production,
- Trans-borders infrastructure such roads, postal service, railways.
- Economic unions integrate monetary and fiscal policy. Member countries coordinate and harmonize government policy, taxation, and spending
- Supranational institution are required to regulate commerce within the union of the rules
- Same geographical locations
- All members adopt a uniform set of policies when trading with non-members

(b) Examine the factors that may encourage the formation of an economic union in Eastern Africa.

- **Interest in a wider market.** Cooperating countries must be interested in widening market for their nationals
- **Geographical accessibility.** All member states should be geographically near each other to minimize transport costs and avoid trade barriers in international trade.
- **Development level.** All member states must be of the same levels of development otherwise resources will flow from less developed to the more developed ones in the cooperation.
- **Common political ideology.** All member countries should have the same political ideologies say capitalism or not.
- **Different resource endowment.** This promotes interdependency leading to mutual benefits by each country.
- **Infrastructure.** There must be a good transport network connecting all the countries in the region to facilitate easy movement of goods and services and factors of production.
- **Political interest.** The leaders of the integrating countries should be interested in implementing the terms and conditions of economic integration.

7(a) Explain the various tools of monetary policy

- **Open market operation,** this is the sale and purchase of government securities, bonds and treasury bills with the aim of regulating money in circulation. When the central bank buys securities, it adds cash to the banks' reserves. That gives them more money to lend. When the central bank sells the securities, it places them on the banks' balance sheets and reduces its cash holdings. The bank now has less to lend.
- **Legal reserve requirements/Cash Reserve Ratio (CRR):** This is the proportion of the bank's total deposits that commercial banks are required by law to keep in the central bank. Low reserve requirement allows banks to lend more of their deposits and thus increase money in circulation. It's expansionary because it creates credit.
- **Special deposits,** the central bank can require commercial banks to have supplementary reserves over and above the legal reserve requirements. This limits the amount of money in circulation. If the central bank wishes to restrict the amount of money available for lending to the public, it increases supplementary reserves but if it wishes to increase money in circulation, it reduces the supplementary reserve.
- **The bank rate/discount rate,** this is the rate at which the central bank lends to commercial banks. When the bank rate is high, commercial banks will not borrow much from the central bank and this reduces the amount of money available to commercial banks for lending and vice versa.
- **Marginal requirements,** this refers to the difference between the value of the collateral security and the amount of money advanced as security and the money advanced as a loan. If commercial banks increase marginal requirements, little money is lent to the public hence little money in circulation and vice versa.
- **Statutory Liquidity Ratio (SLR)/Reserve ratio;** this is the proportion of a bank's total deposits that must be kept in liquid/cash form to cater for the cash demands of customers. If the cash ratio is raised, then there is little money left for lending out and this reduces the amount of money in the circulation and vice versa.
- **Credit Ceiling/Selective credit control;** here, the central bank issues directive to commercial banks to extend credit up to a certain amount to priority sectors as outlined in the development programs of economy. This also reduces the amount of money in circulation since it encourages certain activities at the expense of others.

- **Moral suasion;** this relies on the power of the central bank to persuade commercial banks either to restrict or extend money credit to the public.

(b) Examine the limitations of the monetary policy in your country

- **Unstable money multiplier;** this makes it rather difficult to predict the amount of money in the circulation. This is due to inability to predict money supply accurately. This instability in money multipliers is mainly due to varying behaviour of public towards the banking sector.
- **Underdeveloped money and capital markets;** interest rate in these markets is so low that together with high rates of inflation, individuals and companies prefer to invest elsewhere other than securities and thus money policy has limited effects.
- **High levels of liquidity held by commercial banks especially those owned by foreigners.** They can easily get more liquid from their abroad to neutralize the restrictive monetary policy.
- **Ignorance about open market operations makes the instrument inefficiency.** People still prefer holding their wealth in cash form or other assets such as land, cows, buildings etc. therefore even if the Central Bank wishes to use monetary instruments, people are still ignorant about their operations.
- **Large subsistence sector;** the tools of monetary policy operate in monetary economy. Therefore monetary policy fails to influence this large segment of the economy where there is barter trade.
- **There is lack of independence of the Central Bank from government.** This results into incredibility of the Central Bank and hence inadequate in executing its monetary policy.
- **There is corruption, mismanagement and inefficiency** that discourage people from buying securities.
- **Lack of banking facilities/concentration of commercial banks in urban** areas resulting in failure to mobilize idle savings from rural areas.
- **Disequilibrium in Balance of Payments:** In less developed countries like Uganda, monetary expansion generally leads to increased imports and unfavorable balance of payments. This puts a limitation on the monetary policy.
- **Lack of Integrated Interest Rate Structure:** The various types of interest rates prevalent in the money market do not bear any definite relationship with the bank rate of the country. Any changes affected in the bank rate do not produce proportional changes in the other interest rates. The result is that the central bank of the country is unable to control the money market in an effective manner and monetary policy fails in its operation.
- **Proportion of Credit to Money:** The proportion of credit to money in the monetized sector is very small. Nearly 70-75% money supply consists of currency in active circulation. The bank deposits in such an economy form only a small and insignificant portion of the total money supply. This seriously limits the working of monetary policy.
- **Shortage of Real Factors:** Another problem in developing countries exists that there is a shortage of real factors like capital, entrepreneurial ability etc., therefore, monetary policy can do nothing about it.
- **Existence of Inflation:** A developing economy is highly sensitive to inflationary pressures. Government incurs huge expenditure on various types of development projects. It increases the effective demand much more than the output of consumer goods. The result is a sharp

rise in the internal price level. Moreover during the course of hyperinflation, tools of monetary policy fail to work properly.

- **Black Money:** large quantity of black money exists due to political and economic factors. Black money is used for activities such as hoarding and speculative motives etc. As a result, it hinders the true spirit of the various objectives of monetary policy.
- **Non-Banking Financial Institutions:** According to Gurley and Shaw, non-banking financial institutions like “Life Insurance Corporation, State Financial Institutions and other Credit Financial Institutions, greatly hamper to achieve the objectives of monetary policy in a less developed country.
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- **Deficit Financing:** In the modern world, deficit financing is the main source of financing development activities. But heavy doses of deficit financing have proved inoperative to achieve the objectives of monetary policy. For example, monetary authority wants to check the supply of money while deficit financing helps to increase its supply. Thus how both factors can operate simultaneously?
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8(a) What is budget deficit?

A budget deficit occurs when expenses exceed revenue of a country

(b) What are steps being taken to minimize budget deficits in your country

(i) increasing tax revenue through the following measures

- Increasing the tax base through industrialization and operation of value added tax (VAT).
- Reducing smuggling by harmonizing tax rates with those of neighbouring countries.
- Increase the tax capacity of tax payers by availing credit.
- Encouraging domestic and foreign investors through tax holidays and provision of infrastructures
- Strengthening revenue authority
- Easing means of payment of tax i.e. through banks and mobile money means.
- Reducing tax exemptions
- Reducing corruptions.

(ii) Reducing government expenditure by.

- Advocating for political stability
- Reducing high administration posts.
- Checking population growth through family planning strategies
- Cost shearing in health and education institutions
- Automation to reduce government staffing
- Fight inflation
- Reducing internal debt by selling less treasury bills.
- Privatize inefficient government enterprises.
- Reducing corruption and embezzlements.

**Thank you**

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