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## Economics paper 2 set 9 and marking guide

1(a) State the determinants of aggregate demand in your country (4marks)

- General price levels
- Availability of money in circulation
- Size of the population
- Availability of commodities
- Taxation and subsidization policy
- The existing capital stock
- Level of income
- Level of liquidity preference
- Level of advertising

(b)(i) Distinguish between partnership and a public limited company (2marks)

A **partnership** is an arrangement between two to 20 people to oversee business operations and share its **profits and liabilities**.

A Public Limited Company (PLC) designates **a company that has offered shares of stock to the general public with at least seven members**. The buyers of those shares have limited liability, meaning that they cannot be held responsible for any business losses in excess of the amount they paid for the shares.

(ii) State any two advantages of partnership in your country. (2marks)

- The members share risks and uncertainties
- More capital can be raised compared to sole proprietorship
- Easier to run and form compared to companies
- Enjoys privacy unlike public companies
- It attracts different talents and skills compared to sole trading
- Taxes paid by partnership are low compared to those of companies
- Partners withdraw funds and make business without formal meetings
- Members are not overworked compared to sole proprietorship
- Partnership, at times, offer bonuses to their members in bid to motivate them
- Specialization is possible unlike sole proprietorship

(c) (i) Differentiate between Gross National Product (GNP) and Gross Domestic Product (GDP) (2marks)

**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) Given GNP at factor cost, how would you derive GNP at market price? (2marks)

$$GDP_{FC} = GNP_{FC} - \text{net factor income from abroad}$$

$$GDP_{MP} = GNP_{FC} + \text{Net indirect taxes}$$

(d) State any four structural features of your country's economy.

Structural features of Uganda's economy is

- Dominated by agriculture
- Poorly developed infrastructure
- Unemployment and under employment
- Labour forces predominantly unskilled and mostly employed in the primary sector
- Mixed economy
- Small but growing industrial sector.

(e) (i) Define the term "under development".

**Underdevelopment** refers to the low level of development characterized by low real per capita income, wide-spread poverty, lower level of literacy, low technology, low life expectancy and underutilization of resources etc.

(ii) State any features of under development in your country

- Dominated by agriculture
- Low levels of income
- High population growth rate
- Low level of technology
- Existence of dualism
- Overdependence on external resource and trade
- High illiteracy rate
- Low life expectancy due to poor living conditions
- Low technology
- Wide spread poverty

(f) (i) Distinguish between imported inflation and bottleneck inflation. (2marks)

Imported inflation is the Increase in prices of domestically produced goods and services due to increase in the prices of imported fuels and raw materials for production

**Structural/bottleneck inflation:** this is caused by structural circumstances due to hindrances in the supply system or monetary inflation caused by too much money in the circulation.

(ii) Give any two causes of imported inflation in your country (2marks)

- **Rising prices in international market**
- **High cost of transport**
- **Shortage of foreign exchange** causes reduction in imports and scarcity of goods leads demand pull inflation
- **Frequent devaluation.** This leads to high costs of imports and import inflation.
- **Increasing prices of petroleum product**
- **Devaluation of domestic currency**
- **Changes in foreign exchange**

(g)(i) Define the term commercial policy (1 mark)

Commercial policy refers to the deliberate government strategies to influence, control and direct the volume and value of both internal and foreign trade in an economy.

(ii) State any three instrument of commercial policy in your country

- Devaluation
- Import quotas
- Import duties
- Quality controls
- Licensing
- Administrative regulation
- Subsidies and tax incentives

(h)(i) What is meant by liquidity preference (1mark)

Liquidity preference is the desire by individuals or firm to prefer holding or keeping their assets or wealth in money or cash form.

(ii) Give three factors which determine liquidity preference in your country. (3marks)

- The price level
- Level of speculation
- The degree of uncertainty
- Level of transaction in an economy
- Level of interest rate, low interest rates lead to high liquid preference
- Banking habits
- Level of monetization
- Time/season preference such as Christmas season people have high liquid preference.
- Precautionary motives
- Current prices of financial assets e.g. bills
- Level of saving
- Level of development of financial infrastructure

(i)(i) What are non-bank financial intermediaries? (2marks)

Non-bank financial intermediaries are non-bank financial institution that receive deposits from the public and advance loans out, but do not create new deposits/credit.

(ii) Give any two examples of non-financial intermediaries

- insurance firms,
- building societies
- development banks
- saving and credit schemes
- stock exchange
- housing finance co-operation
- hire purchase firm
- venture capitalists,
- currency exchanges,
- some microloan organizations,
- pawn shops

(j)(i) Differentiate between tax avoidance and tax evasion

**Tax avoidance** refers to a situation where by a tax payer exploits the loopholes within the tax system to pay less or no tax at all and it is illegal

**Tax evasion** is a deliberate refusal by a tax payer to pay a tax assesses on him/her and it is illegal

(ii) State any two reasons why people evade paying taxes in your country.

- Existence of loopholes in the tax system
- Political sabotage
- Unfairly high tax
- Low income levels of people
- Desire to retain all earnings especially by business people
- Low tax education
- Discontent about services provided by the government

## Section B

2. (a) Account for income inequality in your country

Reasons for income inequality in Uganda

- **Difference in talents** (natural ability) those who are naturally talented e.g. footballers, musicians usually earn higher incomes than their counterparts that are not talented.
- **Differences in resource endowment.** Places rich in productive resources usually earn more than others
- **Differences in opportunities:** people with good paying jobs earn more than others with low paying jobs
- **Level of education and training;** highly educated and well- trained people tend to earn more than those with low education and training e.g. Doctors versus nurses.
- **Differences in physical and mental abilities;** the mentally sound and physically strong tend to have ability and willingness to work and hence have higher incomes compared to those that are insane and physically weak
- **Differences in age, sex, tribe and race;** labour discrimination is based on these factors to determine individual income.
- **Inheritance;** those from rich families inherit and get rich unlike those from poor families.

- **Differences in wages;** some people earn higher wages compared to others
- **Differences in infrastructure distribution.** Area with even distribution of infrastructure tend to have high productivity hence higher incomes than others with under developed infrastructures
- **Differences in mobility of factors of production;** mobile factors of production can easily move from areas of low payment to areas of high wages unlike immobile factors of production.
- **Political stability;** areas that are politically stable attract investment than those that are unstable.
- **Influence of trade unions.** Strong and sound trade unions agitate for favorable conditions of work.
- **Government policy;** government tend to favor some parts of the country when allocating resources. These get higher incomes
- **Poor land tenure system;** land is not evenly distributed making those with land to produce and earn income than those without.
- **Globalization** – Lesser-skilled Ugandan workers have been losing ground in the face of competition from workers in Asia and neighboring countries.
- **Skills**– The rapid pace of progress in information technology has increased the relative demand for higher-skilled workers.
- **Social norms** –CEO pay is very much higher than a normal worker

(b) What policy measurements have been adopted to reduce income inequality in your country.

- **Adoption of progressive taxation.** High taxes should be imposed on the rich and the income earned from such taxes should be used to subsidize the poor.
- **Land reforms.** Land ownership and use should be changed from individual ownership to communal ownership system so that poor people can have access to productive land and generate income
- Price controls. Government should fix maximum prices to basic goods and services.
- **Setting and maintaining high minimum wages** to increase incomes of the employees.
- If the private market fails to provide enough jobs to achieve full employment, **the government must become the employer of last resort.**
- When growth is below capacity and the job market is slack, **apply fiscal and monetary policies aggressively to achieve full employment.**
- **Modernization of agriculture.** Agricultural sector should modernized to absorb unemployed educated people.
- **Infrastructural development throughout the whole** country to allow everybody to participate in productive activities.
- **Rural electrification schemes** to encourage rural development and curb rural-urban migration.
- **Education reforms** that encourage job makers rather than job seekers.
- **Fight corruption and embezzlement** through anticorruption agencies.
- Formation of credit scheme to provide initial capital to businesses.
- **Level the playing field for union elections** to bolster collective bargaining while avoiding, at the state-level, anti-union, so-called “right-to-work” laws.

3. Examine the merits and demerits of using capital intensive techniques of production in your country. (20marks)

**Merits of capital intensive techniques**

- It is associated with the production of high quality products which command high prices

- It is associated with mass production which accelerates the rate of economic growth
- It encourages the development of skills since it requires highly skilled labour hence encouraging research, innovation and invention
- It reduces the chances of labour unrest in form of strikes and demonstrations, since machines do not strike. Consequently, this increases production
- It improves on productivity and efficiency of labour due to constant research and training
- It encourages transfer of modern and efficient technology from MDCs to LDCs i.e. it brings about technological transfer
- It encourages exploitation of idle resources such as swamps, forest, minerals and leads to increased development
- It promotes industrialization and development of other infrastructure hence promoting the manufacturing sector.
- It saves time because a worker who employs a machine does his job in a short time and gets less exhausted than manual labour.
- It brings high profits for the entrepreneur because it reduces on the wage bills for labour.
- It encourages specialization and production of surplus at low cost and export to earn foreign exchange
- It increases assets in the country, which can be used as securities for getting loans.
- It encourages the use of modern method of farming e.g. use of tractors and fertilizers

#### **Demerits of capital intensive techniques**

- It is costly to buy machines. LDCs depend on foreign aid and loans to finance their budget, if they adopt this strategy for their development it will make them heavily indebted.
- It leads to technological unemployment, since more machines are preferred to abundant labour; this means that human beings will remain idle without jobs
- It leads to income inequality. The few highly skilled manpower will be employed to run machines and majority without skills will not be employed and as a result the income inequality gap widens
- Cost of maintenance in terms of repairs, replacements and depreciations are high
- It requires high expenditure of foreign exchange on raw materials, skilled labour and spare parts
- Machines are not applicable at some stages of production for example in printing books where sorting of printed paper is done manually.
- It encourages large-scale production which requires a big market for commodities, which may not be available
- It is not helpful in eradication of poverty since there would be a few people engaged in production.
- It encourages creation of monopolies that restrict output so as to charge high prices
- It is not always profitable in areas with land shortage considering use of tractors, chemicals, fertilizers which are normally costly
- It encourages rural-urban migration since it is used mainly in urban areas.

4. (a) Under what circumstances may a worker demand for higher wages? (10 marks)

- **Rising cost of living.** Workers agitate for higher wages so as to cope with rising cost of living.
- **In case of failure to pay the minimum wage.** When the employer refuses to pay wages set by government, workers agitate for that wage set to avoid exploitation.

- When there is **failure to implement the earlier wage increment agreed upon by the employer**, the workers agitate for higher wage again.
- When there is a **low labour supply**. When the demand for service or demand for worker exceeds the existing supply of workers, they demand for higher wages
- When there is an **increase in wages to workers of similar jobs in other firms**.
- When **the job is risky such as mining, workers** demand for higher wages.
- In case of **increased workload without wage adjustments**, workers ask for higher wages
- **When workers are feel exploited**, they will agitate for higher wages.
- **Increased profitability**. When the profit margin of the firm rises, all workers call for an increase in wages so as to benefit.
- In **case of improved productivity**. Workers demand for higher wages when their output level (output per unit of labour employed) has increased.
- In case of an increase in demand of for products; the worker demand for higher wages

(b) Examine the problems facing trade unions in your country. (10 marks)

- **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.
- **Limited/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 during strikes
- **Worker employed on probation and contract are reluctant** to join Trade Unions for fear of suspension.
- **Indifferent workers** do not care about Trade Unions.
- **Small membership**. Membership may too small to be significant.
- **Political influence**. Activities of trade unions may be hijacked by politicians for their selfish aims.

5.(a) Examine the causes of voluntary unemployment problems in your country (6marks)

Note : voluntary unemployment is a situation where the labour force is not willing to take up jobs at the ongoing wages rate and working conditions. Jobs are available but workers are not willing to work at ongoing wage rate

Reasons for voluntary unemployment are

- People having enough money and other means of self-support that makes reluctant to take up the jobs before the money is finished
- Lazy labour force that deliberately fail to take up jobs
- Over-qualification of labour force where people reject inferior jobs

- Expectation of better paying jobs
- Desire to retire. Labour force may choose to retire in order to get gratuity/pension benefits
- Unemployment benefits. Labour force may fail to take up jobs to get unemployment benefits
- Risky jobs. Labour may refrain from risky jobs such as mining.
- House wives may stay home to attend to domestic chores rather than a paid job
- Low wages/salaries force the labor force not to take up prevailing employment.
- When employment is located in unfavorable geographical location such as rural area.
- Early retirement from active work before the retirement age in order to get retirement benefits.

(b) Explain the policies being undertaken to solve unemployment problems in your country. (Uganda)

- **Ensuring political stability and crime reduction;** encourages investment and job creation.
- **Improvement of infrastructure;** several roads are being constructed and renovated to encourage investment and labour mobility.
- **Power generation and rural electrification** is being undertaken to encourage investment in rural area increasing job opportunities
- **Education reforms are being undertaken to** encourage vocational education; to provide people with employable skills.
- **Promotion of economic integration;** to expand market and investment and labour creation and mobility.
- Family planning is being encouraged to reduce population growth.
- **Privatization** of public enterprises increases efficiency and job creation.
- **Liberalization of economy.** Attract more potential investors
- **Development of financial institution** like banks to provide credit to local investors to boost production and hence job creation
- **Setting up investment institution** such Uganda investment authority (UIA) to promote investment and job creation.
- **Modernization of agricultural sector.** This reduces the rural under employment and encourages the population to engage in agriculture.
- **Advertising existing jobs.** Job centers are being created to provide job awareness.
- **Adopting land reforms** that increase land usage.
- **Diversification of Agriculture:** to increase profitability of agriculture.
- **More assistance to self-employed people:** with finances and technical training to grow and create employment.
- **Decentralization of industrial activity** in to spread employment across the country.
- **High rate of capital formation:** government should make investments leading high job creation

7. Assess the role of foreign capital investment in the development of your country. (20marks)

Positive contribution

- It closes the saving-investment gap; the foreign capital into the country increases the national saving ability which finally leads to improvement in investment.
- It bridges the technological gap; foreign capital investment leads to transfer of technologies into the country.
- Development of skills; foreign capital investment impart new skills to the existing labour force
- Acceleration of growth of industrial sector and increased output.
- Development of infrastructure; foreign capital investment may necessity improvement in existing infrastructures such as road network, electricity distribution and education facilities to much the growing investment
- Production of wide variety of quality products

- Promotes efficiency of the local firm due competition and research accompanying foreign capital investment.
- Promotes international co-operation
- Fills manpower gap; foreign capital investment to a country in form of manpower solves the problem of inadequate manpower in the country.
- It is a source of revenue to the country through taxation
- Provides employment to local people through job creation
- Fills the foreign exchange gap through increasing the volume of exports

#### Negative contribution

- Accelerated capital outflow; increased government payments abroad and profit or income repatriation by foreign investors.
- Worsens external dependence; on foreign investors
- Local firms are out competed cause loss of employment
- It may be expensive to the government through subsidies to the investors.
- Leads to rural-urban migration because most investors prefer to invest in urban areas.
- Worsen income inequality because production resource are controlled by a few people.
- Cause regional imbalance when investment is concentrated in developed areas the provide market to the outputs.

8.(a) Explain the term monetary policy (4marks)

Monetary policy is **a set of actions/guidelines/strategies to control a nation's overall money supply and achieve economic growth.**

(b) Examine the tools used by the central bank to regulate money supply in your country.

- **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 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 proportional 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.

Thank you

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