CHAPTER ONE

INTRODUCTION AND PRICE THEORY

Question.1 (a) Examine the features of command economic system.

(b) What are the merits and demerits of command economic system?

A. Command economic system is a system of economic organization in which the allocation of resources in an economy is done by the state through a central planning authority. It is sometimes referred to as planned or socialist economic system.

Features.

- **No profit incentives by producers**. The purpose of production is to promote the general welfare of society rather than maximization of profit.
- All means of production or resources are owned by the state.
- There is no personal income derived from the ownership of resources.
- The economy is managed by the state as a single big firm. The central planning authority makes all the economic decisions and imposes on the population.
- The means of distribution is controlled by the state ie there is rationing of goods.
- Prices of goods and services are fixed by the state and made uniform throughout the economy.
- Production is controlled by appointed central authority.

Merits.

- **Minimizes income inequality.** Since all resources are owned by the state the government will ensure equitable distribution of income.
- **Promotes proper utilization of resources.** Government will allocate resources in the production of essential goods and services. This minimizes resource wastage.

Minimizes stratification. The classification of society into landlords, capitalists and workers which is characteristic of free enterprise economy is not found in a command economy.

- Minimizes consumer exploitation by instituting maximum price control.
- Avoid unnecessary expenditure in the economy for instance wasteful expenditure on advertisement is avoided.
- Ensures availability of factors of production to every one in society.

Demerit.

- **It is difficult to accurately determine people's wants in advance.** This leads to under or over estimation of wants leading to resource wastages.
- **Associated with lack of democratic institution.** All economic decisions are made by the state and imposed on the population. Thus there is high degree of state dictatorship.

- Co-ordination and management of large-scale economic plans are difficult because of enormous task involved.
- **Imposes high costs and burden on the state.** Sustaining all production and distribution is a very expensive venture.
- State ownership and control reduces workers' incentives hence killing their initiatives, effort and productivity.
- Reduces consumer's sovereignty ie consumer's freedom to make choice is violated.
- Promotes inefficiency and delays in decision making due to bureaucratic tendencies.
- Low output of goods and services due to lack of profit drive.
- Under utilization of resources due to inefficiency and lack of initiatives.

2. (a) Explain the features of market economic system.

(b) Examine the merits and demerits of market economy.

Market economic system is a system of economic organization in which the allocation of resources is done by private individuals and companies with limited or no government role.

Features.

- **Reliance on invisible market forces of demand and supply**. Allocation of resources is controlled by the operation of market mechanism ie forces of demand and supply determine price, and price in turn determines how, what and for whom to produce.
- **Limited or no role of government**. Economic decisions on what to produce, how to produce and for whom to produce is done by private individuals. The government participation in the affairs of the economy is very minimal and merely regulatory.
- **Profit motive is the driving force**. Producers are guided by the profit motive ie it is the desire to make profits that drive individuals to engage in economic activities.
- **Promotion of self interest**. Producers take part in production because they want to satisfy their selfish interest. The society only benefits indirectly.
- **Operation of perfect competition**. It operates on the basis of perfect competition where there are many buyers and sellers producing homogeneous products.
- **Freedom of enterprise**. An individual is free to produce commodity of his/her interest and sell in the market of his/her choice .
- **Freedom of choice**. An individual is free to choose what he wants to produce or consume. Workers are also free to decide on their own profession.
- **Institution of private property**. Free market is characterized by private ownership of resources. Individuals have the right to own, control or sell property.

Merits.

- **Provides incentives to hard work.** The desire to make more profits will motivate people to work harder, hence increased output.

- **Promotes efficient allocation of resources.** Resources are only allocated in production of goods and services demanded by consumers. This minimizes resources wastage.
- **Encourages competition.** Since there are no restrictions to entry into production, many firms will engage in production. The competition among these firms will ensure high quality goods and services,
- **Promotes economies of scale in the industry.** The desire for high profits induces firms to undertake large scale production. Thus advantages of large scale production are enjoyed.
- **Encourages production of a variety of goods and services.** Due to freedom of enterprise producers will come up with wide variety of goods and services which increase consumer choice.
- **Reduces cost and burden on the government.** Since allocation of resources is done by free invisible forces of demand and supply there is no body directly employed to oversee how allocation of resources takes place.
- **Leads to reduced prices**. Due to competition producers cut prices. Thus consumers buy high quality goods and services at low prices.
- **Promotes consumer's sovereignty**. The consumer is regarded a king and influences what is produced through casting a vote ie it is only those goods demanded by the consumers that will be produced.

Demerits.

- **Economic instabilities.** Free market is characterized by constant economic instabilities such as inflation, recession, depression etc.
- **Encourages growth of monopolies**. The competition that characterizes free market lead to inefficient firms being out competed. The efficient firms will in the long-run gain monopoly power and exploit consumers.
- **Promotes inequalities in distribution of incomes and wealth.** The harder working will accumulate more wealth than the rest in society.
- **Inadequate provision of public and merit goods**. There are goods that are vital for the society but do not generate profits. These goods include roads and services such as education, security, defense etc. These will not be adequately provided by free market.
- **Preference for private gains at the expense of public gains.** Since free market is characterized by self interest, producers will pursue their goals of profit maximization but may impose social cost on society e.g. pollution, over exploitation of resources etc.
- **Encourages misallocation of resources.** Resources will be allocated in producing the luxuries of the rich who can pay high prices at expense of the basic necessities of the poor.
- **Inability to cope with rapid structural changes.** When there is need to attain faster rate of growth and development, there is desire for adequate infrastructure such as roads, power etc.

These cannot be provided by the free market. In addition it fails to cope with unforeseen circumstances e.g. during times of war, floods, famine etc.

- **Unemployment of labour and other resources**. Due to competition inefficient firms close down and their workers become unemployed. In addition employers may prefer to use capital intensive rather than labour intensive techniques of production.
- Encourages consumer exploitation due to consumer ignorance associated with the imperfections in the market.

Question 3 (a) what is meant by the term price mechanism?

(b) Examine the merits and demerits of price mechanism in a free enterprise economy.

Price mechanism is a system of economic organization in which price plays a central role in influencing the activities of consumers, producers and the general patterns of resource allocation in a free enterprise economy. Forces of demand and supply determine the price, and price in turn influences fundamental economic decisions like what, how, when and for whom to produce.

Merits of price mechanism

- **Promotes incentives to hard work**. The prospect of high profits stimulates effort leading to efficiency in production by promoting innovations and inventions.
- **Leads to efficient allocation of resources**. Producers will direct more resources in production of goods and services demanded by the consumers. Thus resource wastage is minimized.
- **Encourages consumer's sovereignty**. By buying a commodity, the consumer casts a vote for the production of more of that commodity. Producers switch resources from production of other commodities to producing more of that commodity demanded by the consumers. In this way the consumer is regarded a king as far as allocation of resources is concerned.
- **Encourages competition.** Due to freedom of enterprise, many firms engage in production. This leads to high quality goods and services, thus improved welfare of the consumers.
- **Makes available wide variety of goods and services**. Due to freedom of enterprise, many firms will come up with wide range of goods and services, thus increasing consumer choice.
- **Reduces administration cost**. Since the government does not intervene to direct resource allocation, administration costs are minimized. Allocation of resources is directed by free market forces of supply and demand without any one employed to oversee the process.
- **Leads to low prices**. Due to competition and economies of scale, producers cut prices. This benefits consumers because they purchase high quality goods at low prices.
- **More employment opportunities are created**. Due to freedom of enterprise, many firms are established leading to creation of more job opportunities.
- **Leads to increased government revenue**. Government imposes taxes on the many

enterprises and their workers, hence increased revenue.

- **Promotes increased utilization of resources**. Due to large number of firms, the would be idle resources are put to use.

Demerits of price mechanism

- **Gives rise to monopoly power**. The more efficient firms will out compete the less efficient ones. In the long run the most efficient firm will gain monopoly status leading to exploitation of consumers.
- **Leads to unemployment**. Due to competition, inefficient firms close down rendering the workers unemployed.
- **Associated with market imperfections**

  Consumers are always ignorant of market conditions which cannot allow effective reliance on market forces.
- **Leads to Income inequality**

  The more hardworking will accumulate more wealth than the less fortunate in society. This widens income disparities in the country.
- **Leads to divergence between private benefits and social costs**

  In the pursuit of private profit, private investors tend to impose social costs on the society for example noise, air and water pollution.
- **Leads to economic instability and unemployment**

  Price mechanism is associated with economic instability such as depression, recession, unemployment etc. due to price fluctuations.
- **Leads to neglect of public and merit goods**

  These goods are very vital for the society but unfortunately, they do not generate adequate profits. In addition public goods like roads have the characteristic of non excludability in consumption
- **Encourages inflationary tendencies**

  It leads to inflationary tendencies due to constant changes in prices caused by changes in demand and supply conditions.
- **Leads to duplication of activities**

  Competition leads to setting up similar activities which leads to wastage of scarce resources.
- **Inability to cope with rapid structural changes.**

  It does not cope easily with structural changes in the economy, e.g. it cannot be depended upon to solve problems in periods of war and famine

Question 4(a) Explain what is meant by the term consumer sovereignty.

(b) Examine the roles of price mechanism in a free enterprise economy.

Consumer's sovereignty is a situation in a free enterprise economy where the consumer is regarded a king as far as allocation of resources is concerned. The producers will allocate resources only in production of those goods demanded by the consumers. The consumers indicate their preference for the commodity by their willingness to offer higher prices. Producers switch resources from production of commodities which are less demanded and lowly priced to those which are more demanded and highly priced.

Roles of price mechanism

Determines techniques of production: Prices provide indicators to producers when choosing method of production to use. They will choose to use either capital or labour intensive method, whichever of the two is cheaper.

Determines how much and for whom to produce: Price mechanism influences resource allocation. It guides producers in determining how much and for whom to produce. They will produce according to the size of the market or level of demand. For whom to produce, they will produce for those who can pay the highest price.

Provides incentives for increased output: The prospect for high profits will attract entry of new firms in production leading to increased output.

Provides employment opportunity: The desire to make profits will drive entrepreneurs to increase the level of investment. The demand for factors of production including labour will increase leading to increased employment opportunities.

Determines income distribution: The household which own the factor services receive income from the sale of their services. In turn they spend that income to buy goods and services produced by firms. In this way income is redistributed in the economy.

Encourages resource exploitation: The desire for profits will encourage increased use of a country's resources leading to their efficient utilization.

Ensures increased competition: The entry of many firms lead to increased competition in the economy. This leads to improved quality of goods and services produced thus, reduced prices.

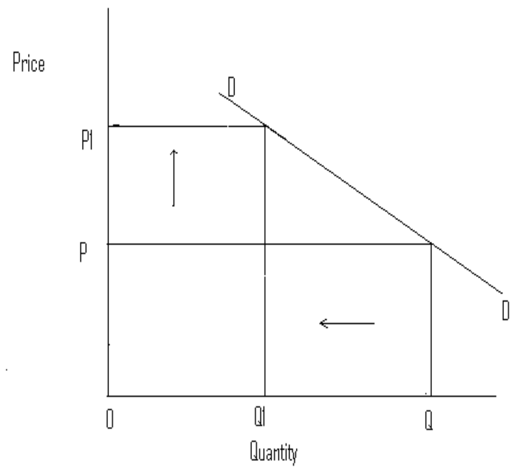
Makes automatic adjustment between demand and supply: price mechanism helps to establish equilibrium price where quantity of goods supplied will be adjusted to level of demand through the medium of equilibrium price

Harmonizes profits and utility maximization goal: Price mechanism helps to reconcile the utility maximization goal of consumers who wish to buy at low prices and profit maximization goal of producers by adjusting supply to the level of demand

Question 5 a) Explain the law of demand

b) Explain why normal demand curves have negative slope

The law of demand states that other factors remaining constant; more of a commodity is demanded at a lower price than at a higher price.



If the price of the commodity increases from OP to OP1 the quantity demanded will fall from OQ to OQ1 thus satisfying the law of demand.

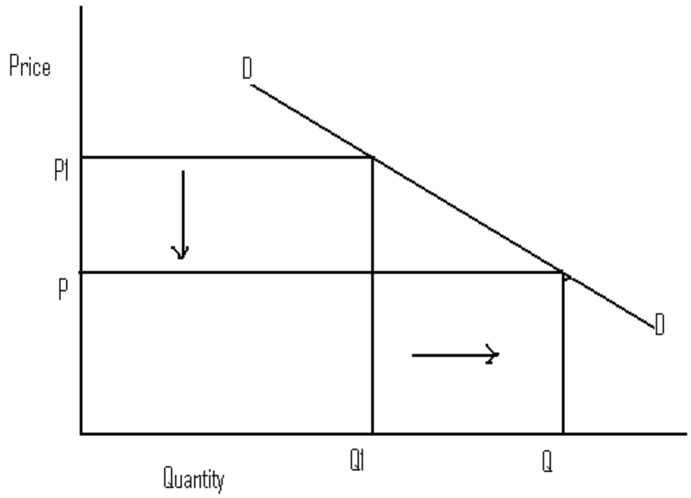
b) Why demand curves have negative slope:

The effect of diminishing marginal utility: According to the law of diminishing marginal utility, which states that the satisfaction derived from each additional unit of a commodity consumed will fall as total consumption increases, thus as marginal utility falls the consumer is willing to pay less and less causing the curve to slope negatively.

Effect of low income earners: When the price of a commodity falls it becomes cheaper and the poor who could not previously afford will begin to buy causing the increase in quantity demanded hence a negative slope.

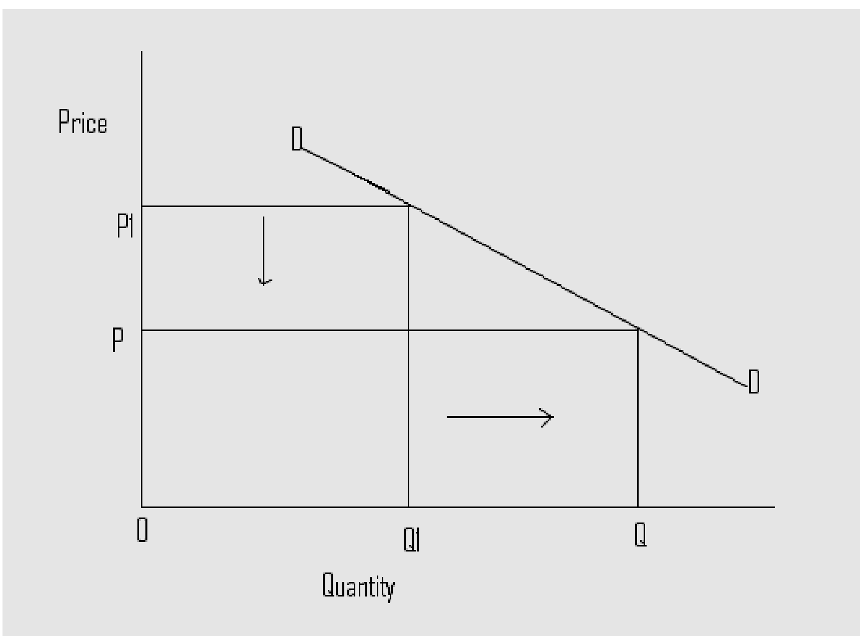
A fall in price of a commodity from OP1 to OP will result into an increase in quantity demanded of the commodity from OQ1 to OQ because the commodity has become cheaper.

Price effect: According to the law of demand, which states that as the price falls more of that commodity is demanded other factors remaining constant this causes a negative sloping of the demand curve.



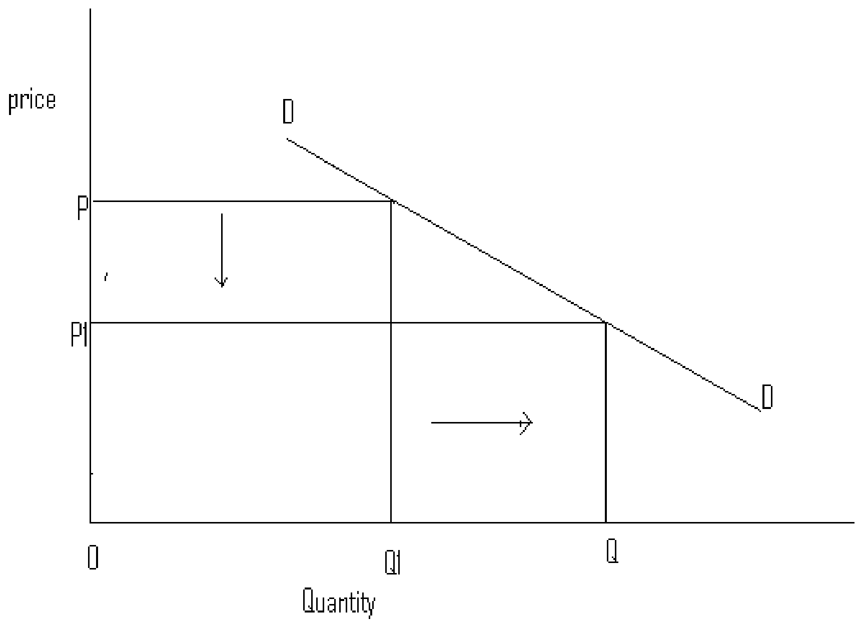
If a price of commodity falls from OP1 to OP the quantity demanded increases from OQ1 to OQ causing a demand curve to slope negatively.

Substitution effect: When price of a commodity falls relative to its substitutes consumers will move away from other commodities to concentrate on the commodity whose price has fallen.



A fall in price from OP1 to OP leads to increase in quantity demanded of a commodity from OQ1 to OQ. This is because commodity x has become cheaper relative to the substitute.

Real income effect: When the price of a commodity falls the real income of a consumer increases and with given money income, he/she is able to buy more goods as price falls.



As price of commodity falls from OP1 to OP the real income of a consumer increases and is able to buy more of the commodity from OQ1 to OQ causing the negative slope of demand

Question.6 a) Distinguish between price elasticity of demand and income elasticity of demand

b) Examine the importance of the concept of elasticity of demand to:

i) Producer

ii) Government

iii) Consumer.

Price elasticity of demand refers to the measure of degree of responsiveness of change in quantity demanded to changes in that commodity's own price

i.e. $PED = \frac{proportionate\ change\ in\ quantity\ demanded}{proportionte\ change\ in\ price}$

Whereas,

Income elasticity of demand refers to the degree of responsiveness of demand for a commodity to changes in consumer's income.

i.e. YED $= YED = \frac{Proportionte\ change\ in\ quantity\ demanded}{proportionte\ change\ in\ income}$

Importance of price elasticity of demand

(i) Producer:

Helps producer in determination of prices: While fixing the price of his/her products, a producer puts into consideration the elasticity of demand for that product. In order to maximize profits, he fixes high price for commodities with inelastic demand and low price for commodities with elastic demand.

Assists monopolist in the practice of price discrimination: He/she charges high prices in the market with inelastic demand and low prices in the market with elastic demand.

Helps in determination of cost of joint products: Where it is difficult to determine separate production cost of joint products, the one with inelastic demand is charged high price while the one with elastic demand is charged low price.

Helps in determination of prices of public utilities: Services with inelastic demand are charged high price and those with elastic demand are charged low prices.

Basis for promotional advertisement: Advertising makes the consumer to develop strong liking for the commodity as he becomes familiar with it. The addiction makes the demand to be inelastic such that the producer will be assured of a market and can even raise the price without risk of losing customers.

(ii) Government:

Helps government when formulating protectionist policies: Greater protection is usually offered to local industries producing goods with elastic demand because they cannot recover the high initial costs by increasing price of their products. It becomes ineffective for commodities with inelastic demand.

Helps when imposing taxes to raise revenue: High revenue is realized when indirect taxes are imposed on commodities which have inelastic demand than those with elastic demand. This is because the consumer will not significantly reduce quantity demanded in response to increase in price caused by the tax.

Helps explain the persistence of poverty in LDCs amidst plenty: In agricultural economy, farmers get less income when there is good harvest because agricultural products have inelastic demand. A good harvest leads to excess supply resulting in fall in the market price. Thus, when farmers get a good harvest, they receive less income.

Useful when carrying out devaluation: Devaluation is a deliberate policy to reduce the value of home currency in terms of other currencies in order to correct BOP problem. Devaluation is effective in correcting B.O.P deficit if the demand for both imports and exports are price elastic.

Helps in determining the incidence of a tax: Tax incidence refers to who finally bears the burden of tax. Price elasticity of demand helps to determine how the incidence of a tax is shared between the producer and the consumer. For goods with inelastic demand, greater incidence is on the consumer and for those with elastic demand it is on the producer.

Helps in determining the benefits of subsidies: When extending subsidies to consumers and producers elasticity of demand is important. Greater subsidies will be extended to producers of commodities with elastic demand because the producers cannot recover the cost by increasing the price.

(iii) Consumer:

Elasticity of demand is useful to a consumer when allocating his/her income among different commodities. He/she will allocate more income to goods with inelastic demand.

Question7 a) Distinguish between Arc elasticity of demand and point elasticity of demand

b) Examine factors that influence price elasticity of demand.

Arc elasticity of demand is the average value of elasticity of demand over a segment of the curve. It is calculated by; ED = $\frac{\Delta Q}{Q} / \frac{\Delta P}{P}$

Whereas,

Point elasticity is the value of elasticity at any one point on the demand curve.

It is calculated by: ED = $\frac{-\Delta Q}{Q} / \frac{\Delta P}{P}$

b) Factors that influence elasticity of demand

The ease of substitution: The greater the number of substitutes available for a product, the greater will be its elasticity of demand. Commodities with many substitutes tend to have elastic demand because a slight increase in price leads to big fall in quantity demanded as customers switch to cheaper substitutes whose prices have not changed. On the other hand commodities without substitutes have inelastic demand because consumers have no substitute to it.

The degree of necessity: Elasticity may be determined by whether or not a product is a necessity. Necessities tend to have low elasticity of demand because consumers may demand them in fixed quantities regardless of changes in price. Non necessities on the other hand have high elasticity of demand because consumers can do without.

Habit in the use of the commodity: There are some commodities which are habit forming such as cigarettes. A habitual smoker may not significantly reduce the number of sticks smoked in response to rise in price. Such commodities have inelastic demand.

The number of uses a commodity can be put to: The greater the number of uses to which the commodity can be put to, the greater it's elasticity of demand. This is because if the product has many uses then there are many different markets on which price changes can exert their effect. There is, therefore, a greater possibility that in some markets substitutes may be readily available. Electricity for example has many uses heating, lighting, cooking, etc. A rise in the price of electricity might cause people not only to make economies in all these areas but also to substitute other fuel for some uses.

The proportion of consumers income spent on the commodity: The greater the proportion of income which the price of the product represents the greater its elasticity of demand will tend to be. Commodities such as match box which takes very small proportion of consumer's income tend to have inelastic demand. If the price of match box increases by 50 percent it may not affect the quantity bought because that price takes insignificant proportion of consumer's income. On the other hand expensive commodities have elastic demand.

Durability of the commodity: The greater the durability of a product, the greater elasticity of demand will tend to be. Durable commodities such as furniture, etc. have inelastic demand because once one has acquired them; he/she may not buy for along time. Less durable commodities have high elasticity of demand because they are replaced often.

Price of other commodities: An increase or decrease of demand by a constant price leaves elasticity unchanged. But a right ward shift of the curve by specific amount reduced elasticity.

Time: The period of time under consideration has effect on elasticity. For change in price, elasticity of demand will tend to be greater in the long-run than in the short-run. If price of meat rises disproportionately to other foods, eating habits built over years will be slow to change but if price remains high, people will begin to consume substitutes. Hence elasticity of demand is low in the short-run and high in the long-run.

Seasonal factors: There are some commodities which are demanded seasonally such commodities will have inelastic demand during the season and elastic demand during off season.

Future expectations: If people expect scarcity, elasticity of demand will be inelastic. People will buy even when prices are rising in order to build their stock. On the other hand, if people are expecting prices to fall elasticity will be high as they wait to buy more at the lowest price.

Question 8 a) Define elasticity of supply

b) Examine the factors which influence price elasticity of supply.

Elasticity of supply refers to the measure of degree of responsiveness of supply to change in factors that affect supply.

$$ES = \frac{Proportionate\ change\ in\ quantity\ supplied}{Proportionate\ change\ in\ factors\ that\ influence\ supply}$$ Or

$$\text{ES} = \frac{\%\ change\ in\ quantity\ supplied}{\%change\ in\ factors\ affecting\ supply}$$

Factor s which influence price elasticity of supply

Gestation period. When a commodity has a short gestation period, its supply is price elastic and if it has a long gestation period, it has inelastic supply. This is because producers can not expand quantity supplied immediately in response to change in price. In agriculture the period between planting and harvesting is long.

Nature of the commodity. Durable commodities have elastic supply whereas perishable commodities tend to have inelastic supply.

Cost and availability of factors of production. When the cost of producion is low and factors of production are readily available, supply of the commodity will be elastic and when factors of production are not available and cost of production is high, then supply will be inelastic other factors remaining constant.

The plant capacity. When the firm is operating below optimum capacity (excess capacity), supply will be elastic because the firm can increase supply in response to increase in demand. At full capacity supply is inelastic other factors remaining constant.

Full employment situation. The supply of most goods and services will be inelastic in full employment situation other factors remaining constant.

Time factor. In the long-run, elasticity of supply is high because the time is long enough for producers to adjust both fixed and variable factors of production in order to create supply.

The amount of stock kept in store. When producers are holding a large stock of commodities in their stores, the supply of the commodities will be elastic. A small increase in price will induce them to sell out of stock.

Price expectations. When producers expect price changes to be temporary, they hesitate to adjust production and supply remains inelastic.

State of technology. Commodities which can be produced with simple technology have elastic supply other factors remaining constant.

Freedom of entry into industry. When new firms are restricted from entering the industry, the supply of commodities is likely to be inelastic, other factors remaining constant.

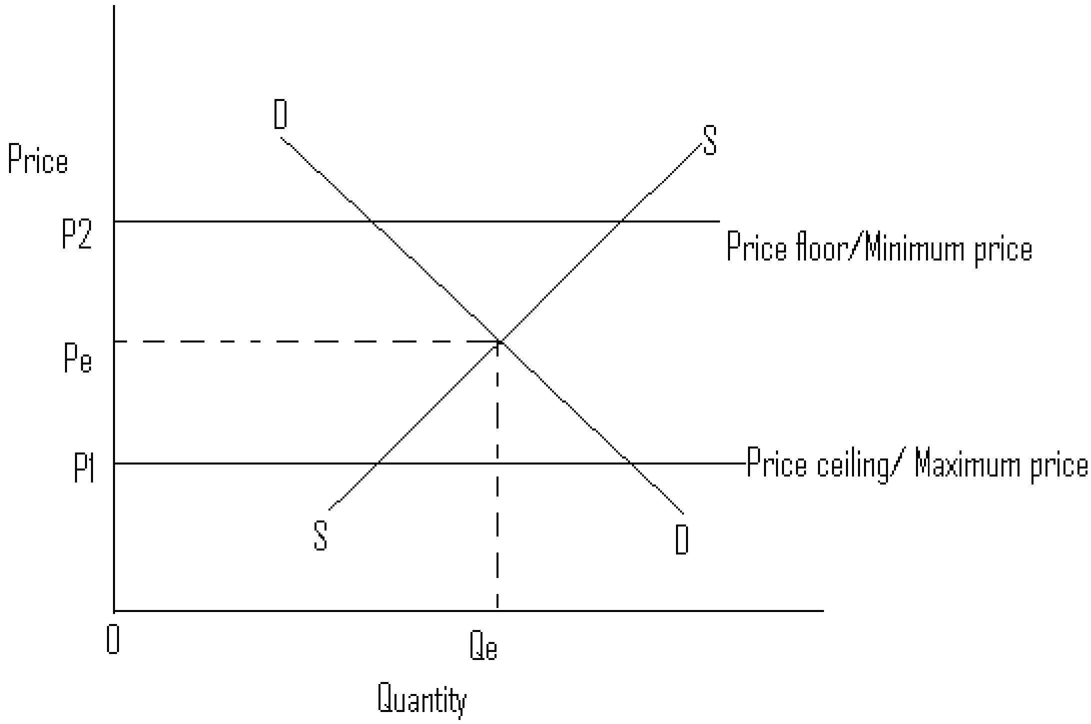
Question 9 a) Distinguish between price ceiling and price floor

b) What are the implications of government price control?

Price ceiling is a situation where the government fixes price below equilibrium price and it becomes illegal to buy or sell above that price.

Whereas,

Price floor is a situation where the government fixes price above equilibrium price and it becomes illegal to sell below that price.



(b) Positive implications of government price control.

Maximum price/ price ceiling maintains price stability. Where prices are fixed below equilibrium price, unnecessary price increases are curtailed.

Maximum price/price ceiling helps control monopoly power. The ability of the monopolist to use monopoly power to exploit consumers is checked. His ability to discriminate price is also reduced because the firm cannot charge above the legislated price.

Maximum price control protects consumers against exploitation by producers. Since it is illegal for sellers to sell above the legislated price, the welfare of the consumers is safe guarded.

Minimum price control leads to increased output. Many producers will be motivated by the high prices to enter production. In this way more employment opportunities will be created.

Minimum price control protects producers from exploitation by consumers. Since the legislated price is high, producers' income can be maintained.

Maximum price control helps to maintain industrial peace: where prices of product and wages are controlled, workers will not be justified to demand for wage rise above the set wage.

Minimum price control discourages consumption of harmful commodities. By raising the prices of such undesirable commodities, consumers are discouraged and consumption of such commodities is reduced.

Minimum price control helps motivate producers to produce more. Minimum price means producers will get more profits. Thus they will be encouraged to produce more.

Minimum price may help an economy to offset an economic depression or recession. In a depression incomes are low, aggregate demand falls, and investment discouraged causing unemployment. Minimum price control can help to lift the economy out of such a situation.

Minimum price helps to achieve equitable distribution of income/reduces income inequality. The incomes of all producers of such a commodity will raise thus reducing income inequality.

Maximum price helps to make commodities available to all groups of people in the economy. Even the low income earners will be able to afford these commodities thus increasing the general welfare in the society.

Negative implications

Minimum price leads to production of unmanageable surplus. Many producers will be attracted to enter production, thus excess supply over demand.

Maximum price reduces incentives for private initiatives. Potential investors are discouraged thus retarding growth by discouraging investment.

Maximum price leads to unemployment. Due to reduced investment in the economy less employment opportunities will be generated.

Maximum price leads to shortages in supply. Since producers are discouraged by the low price, there will be less supply leading to excess demand.

Price control interferes with the benefits of price mechanism. The invisible forces of supply and demand no longer direct resource allocation and the benefits of such mechanism are lost.

Maximum price control leads to trade malpractice. It encourages illegal activities like hoarding, black marketeering, smuggling etc. this causes artificial shortages in the market.

Minimum price leads to increased cost of production. The cost of wages and other inputs whose prices are controlled will rise forcing producers to increase prices.

Minimum price leads to reduction in social welfare. Due to high cost of living, the prices of basic necessities increase forcing consumers to reduce consumption thus reduced welfare.

Maximum price leads to production at excess capacity/under utilization of resources. Producers are discouraged by the low prices and may cut down output and employment.

Maximum price control limits consumers from consuming the quantities they want due to rationing.

Question 10 a) Explain why prices of agricultural products fluctuate more severely than those of industrial products.

b) What measures should your country take to stabilize prices in the agricultural sector?

The biggest problem facing the agricultural sector is the instability in the prices. Unlike in the manufacturing sector where the prices are relatively stable, in agriculture the prices fluctuate severely, thus affecting the incomes of farmers. There are several causes of this phenomenon.

Supply rigidities/bottlenecks. Agriculture depends on weather and other natural factors, which are beyond the control of farmers. In case of unfavorable weather conditions, there is low supply leading to increase in price. On the other hand favourable weather condition leads to a bumper harvest leading to fall in prices.

Time lag and long gestation period. The time between planting and harvesting is long. Once planting has been done, it is difficult to increase or reduce supply in response to changes in price. If the price in this season is low, a farmer can only adjust his output in the next season.

Perishability: most agricultural products are perishable and can not be stored for long. During harvesting season a farmer is forced to dispose his products at low prices because he/she cannot store and wait for rise in price. Thus, instability of agricultural prices in the downward trend.

Agricultural products are bulky: this makes it difficult to transport from areas where the stock is plenty and cheap to areas of scarcity and prices are high.

Many people carry out agriculture: this makes out put to be persistently in excess of demand. This is because it does not require high skills like in the manufacturing sector. Thus, downward instability in price.

Forms small proportion of the manufactured goods: in cases where agricultural products are used as components of the manufactured goods, it forms a very minor proportion of the total cost of the product. For example rubber is used in manufacture of tyres. Tyres however form minor proportion of the cost of the car and price of rubber and tyres can increase or fall without affecting the price of the car.

Production of similar products: there are too many countries producing agricultural products. Majority of them produce similar commodities. Thus increased competition for market causing prices to fall.

Discovery of new technology: the users of agricultural raw materials are continuously discovering new and modern technology that is raw material saving. This causes fall in the demand for agricultural products of LDCs, thus falling prices.

Inelastic demand for agricultural products: Agricultural products have inelastic demand. Any small variation in supply causes wide oscillations in price.

Protectionist policies of developed countries: The MDCs, which are the major users of agricultural products from LDCs, restrict the entry of these products into their markets through high tariffs and quality standards. This reduces market for agricultural products of LDCs.

Production of low quality products: Agricultural products of LDCs are of low quality thus fetch low prices in the international market.

Weak commodity agreements: Commodity agreements for agricultural products have weak bargaining power. Thus low prices for their products

Low-income elasticity of demand: As incomes raise people prefer to consume industrial products relative to agricultural goods, thus instability of agricultural prices in the downward trend as income raise.

Poor transport network in LDCs: Due to poor transport network, it makes it difficult to move agricultural products from areas of plenty to areas of scarcity.

Producer ignorance: Producers are often ignorant of the output and price relations and the market trend. They continue producing the same commodity inspite of very low prices.

Low industrialization: LDCs do not process raw materials to finished goods. Thus the MDCs that buy the primary raw materials dictate very low prices.

Divergence between planned and actual output: This has resulted into poor planning capacity of farmers. When the planned output is less than the actual output, prices go up thus causing instability in prices.

Measures to stabilize prices in agriculture

Government price legislation: The government should fix minimum price legislation so that buyers do not exploit farmers.

Improvement in technology: Instead of the sector being left to the mercy of nature, modern techniques like irrigation should be adopted to stabilize the supply and price.

Improvement in transport: government should rehabilitate the transport network and build new ones to make arbitrage easy by moving goods from one area of plenty to another, which is experiencing scarcity.

Provide education to farmers: In agriculture farmers do not learn from experience due to ignorance. Therefore the government should equip the farmers with the simple planning skills needed to regulate output in order to stabilize prices.

Improvement in research: the government should undertake research to help shorten the gestation period by introducing fast yielding varieties to enable stable supply, which ensures stable prices.

Processing of agricultural products: The government should establish agro-based industries to add value, and stabilize prices.

Formation of agricultural movements: The farmers should organize themselves to form co-operative societies to help regulate output and strengthen the bargaining power of the member farmers.

Entering commodity agreements: The government of Uganda should join international commodity agreements to be able to bargain for favourable prices for farmers' products in the world market.

Provide storage facilities: The government should provide storage facilities like refrigerators so that farmers can store their products in periods of low prices and sell when prices are high.

SECTION A

1a) (i) Attempt the definition of Economics.

(ii) Identify any two fundamental economic problems.

A(i) Economics is a social science which studies the relationship between unlimited human wants and scarce means which have many alternative uses.

(ii) **Fundamental economic problems:**

- Scarcity, which means limited supply of resources.
- Choice, which means selecting the best out of many competing alternative.

2a) **Explain the relationship between scarcity choice and opportunity cost.**

A Due to scarcity ie limited availability of resources, consumers are forced to make choice ie selecting the best out of many competing alternative after choice has been made some alternatives are foregone and these are known as opportunity costs. Therefore, scarcity leads to choice and choice leads to opportunity cost.

3 (i) Define the term 'opportunity cost".

(ii) State three circumstances under which opportunity cost principle can be applied in economics.

A (i) Opportunity cost refers to the second best alternative foregone after choice has been made. Or The second best alternative foregone

(ii) Circumstances under which it can be applied:

- It can be applied when determining price of a commodity.
- When determining factor prices and resource allocation.
- When producers are making production decisions such as what to produce, how to produce, for whom to produce etc.
- When deciding on the patterns of consumption and public expenditure.
- When forming basis for specialization among countries based on comparative advantages.

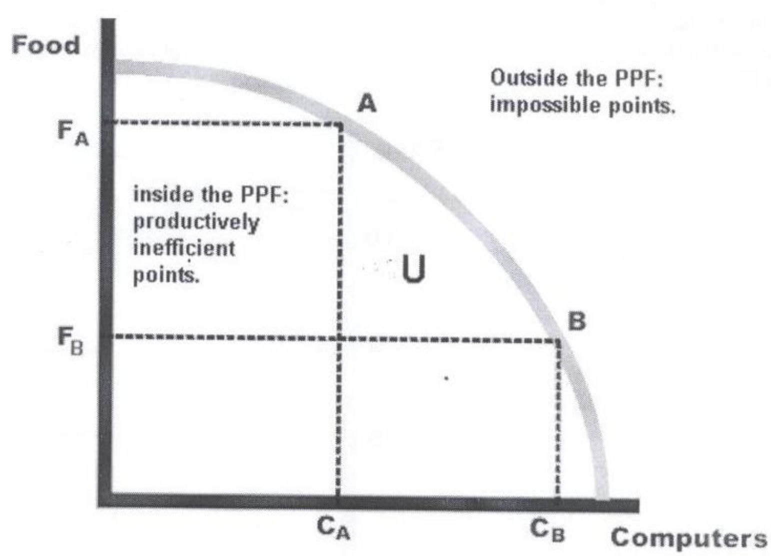
4. Give any four limitations of opportunity cost principle.

- It is not applicable to factors of production which are fixed in supply and whose use is specific.
- If factors are immobile, then their prices do not reflect opportunity cost because their use doe not impose sacrifice.
- It is difficult to establish the difference between individual and social cost.
- Sometimes the alternatives foregone cannot easily be established e.g. the acquisition of a durable capital asset which may not have opportunity cost over the time its use is spread

5a) (i) What is transformation curve?

(ii) Give two causes of outward shift of transformation curve.

A (i) Transformation curve is a locus points showing all combinations of two commodities say X and Y that can be maximally produced when all resources are fully and efficiently utilized. It is also known as production possibility frontier curve or opportunity cost curve.



All points on the curve are points of maximum productive efficiency; all points inside the frontier are feasible but productively inefficient; all points outside the curve are infeasible for given resource.

(ii) **Causes of outward shift of transformation curve**.

- Improvement in technology.
- Use of improved seeds.
- Discovery of new sources of raw materials.
- Foreign capital/resource inflow/capital accumulation.
- Improvement in labour skills.

- Improvement in entrepreneurial skills
- Increase in labour force.

6. **Give any four uses of production possibility frontier.**

- Illustrates opportunity cost i.e. the alternative which is sacrificed when production takes place.
- Illustrates scarcity. ie indicates the limit beyond which production is not possible.
- Illustrates choice. ie indicates the various sets of commodity combination options available to the producer along the PPF.
- Illustrates the efficiency in production ie shows points of optimum output along the curve.
- Illustrates economic growth. Outward shift in PPF indicates economic growth.

7. **Distinguish between the following concepts.**

(i) Micro economic and Macro- economics.

(ii) Positive statement and normative statements.

A(i) Micro-economics is a branch of economics that deals with individual economic units such as the household, firm etc and their interactions to determine price

(ii) Macro-economics is a branch of economics that handles problems which affect the whole economy eg inflation, unemployment, national income etc.

(ii) Positive statements are those statements which deal with facts. Positive statements are either true or false and are concerned with what is.

Whereas

Normative statements are statements which reflect individual value judgment. They are concerned with what 'ought to be."

8. (i) What is meant by Command Economic System.

(ii) Give any three features of a command economy.

A. (i) A command economic system is a system of economic organization where allocation of resources is done by the state through a central planning authority. It is also known as planned or socialist economic system.

(ii) **Features of a command economy**.

- All means of production are owned by the state.
- No personal income is derived from ownership of resources.
- The economy is managed by the state ie there is rationing of goods in the economy.
- Prices of goods and service are fixed by the state.
- No class stratification

9.Give any two merits and two demerits of command economic system.

Merits

- Minimizes income inequality/promotes equitable distribution of income.
- Promotes effective and proper utilization of resources.
- Ensures availability of means of production to all.
- Minimizes exploitation of consumers through price control.
- Minimizes wasteful expenditure in the economy
- Minimizes classification/stratification of society.

Demerits

- Imposes high costs and burden to the state.
- It is difficult to ascertain people's wants in advance, thus leading to resource wastage.
- Coordination and management of large scale economic plans is difficult due to enormous tasks involved.
- Public ownership and control reduces the incentives of workers thus killing their initiatives, effort and productivity.
- Reduces consumer's sovereignty/violates consumers' freedom of choice.
- Promotes inefficiency due to bureaucratic tendencies.
- Associated with dictatorship/lack of democratic institutions.
- Low output due to lack of profit drive.
- Under utilization of resources due to inefficiency.

10. (i) What is a market economic system.

(ii) Give any three features of a market economic system.

A. (i) Market economic system is a type of economic organization where allocation and ownership of resources is in the hands of private individuals and companies with limited or no government interference. It is also known as free enterprise or laissez faire or capitalist economic system.

(ii) **Features of a market economic system**.

- Institution of private property/private ownership of resource.
- Freedom of enterprise.
- Freedom of choice.
- Operation of profit motive.
- Promotion of self interest.
- Operation of perfect competition.

- Reliance on market forces of demand and supply.
- Limited or no role of the government.

11. Give any two merits and two demerits of market economy.

A**. Merits**.

- Provides incentives to hard work.
- Promotes efficient allocation of resources.
- Promotes consumer's sovereignty.
- Encourages competition which improves the quality of products.
- Promotes economies of scale in the industry.
- Encourages production of a variety of goods and services.
- Reduces the burden of administration on government.

Demerits

- Associated with economic instabilities like inflation and recession.
- Encourages growth of monopolies.
- Promotes wealth and income inequalities.
- Encourages preference of private gains at the expense of public benefits eg over exploitation of resources.
- Encourages misallocation of scarce resources.
- Inability to cope with rapid structural changes.
- Leads to unemployment problems.
- Encourages consumer exploitation due to consumer ignorance.

12. (i) Define free goods.

(ii) Give any three characteristics of free goods.

A. (i) Free goods are type of goods supplied by nature and exist in natural abundance and one's desire for them is satisfied at zero cost eg air in the atmosphere, rain water etc.

Features/characteristics of free goods

- Exist in natural abundance.
- Consumed at zero price/free of charge.
- Non-excludability in consumption.
- Cannot be exhausted.

13. (i) Distinguish between personal wealth and social wealth.

(ii) Give any three characteristics of wealth.

A. (i) Personal wealth is the stock of economic goods that belong to an individual eg books, clothes, cars etc.

Whereas

Social wealth is the stock of economic goods which are collectively owned by the society. It includes property owned by the state or local authorities such as lakes, government forest reserves etc.

(ii) Characteristics of wealth.

- Must possess utility.
- Have money value.
- Have opportunity cost.
- Scarce/limited in supply.
- Have transferable ownership.

14. (i) What is meant by the term price.

(ii) Give any three methods of price determination in your country.

A. (i) Price is the relative value of a commodity expressed in monetary terms.

(ii) **Methods of price determination.**

- By haggling/bargaining between buyers and sellers.
- Through auctioning/bidding.
- Through Government price legislation/state control.
- Resale price maintenance.
- By signing treaties/agreements.
- By market forces of demand and supply.
- Through price leadership in the oligopoly industry.
- The production costs.

15. (i) Define economic goods.

(ii) Give any three characteristics of economic goods.

A. (i) Economic goods are goods which arise out of scarcity and are consumed at a price/cost.

(ii) **Characteristics.**

- They are scarce relative to people's demand for them.
- They possess utility/satisfaction.
- Have money value.

- Have opportunity cost.

16. (i) Distinguish between public goods and merit goods.

(ii) Give any two features of public goods.

A. (i) Public goods are those goods which are provided by the state to the whole society for consumption without exclusion e.g. roads.

Whereas

Merit goods are those goods provided by the state to individuals or groups of individuals who satisfy certain conditions but the benefit is to the whole society e,g. education, health services etc.

(ii) **Features of public goods**.

- Non excludability in consumption.
- Payment is made indirectly through taxation.
- Non exhaustibility.
- Non appriopriability/equally available to every one.

17. What is meant by the following terms?

(i) Private goods.

(ii) Intermediate goods.

(iii) Final goods.

(iv) Quasi-public goods.

A. (i) Private goods are those goods whose consumption is exclusive right of the person who owns them and has the right to exclude others from consuming them at the same time eg private cars, house, land etc.

(ii) Intermediate goods are those goods used in the process of producing other goods e.g. raw materials.

(iii) Final goods are those goods which are ready for consumption.

Or

Goods which are at the end of the production process and are ready for use.

(iv) Quasi – public goods are those goods whose consumption depends on the ability to meet conditions set for their consumption and when they are consumed by an individual, the whole society benefits. They are also known as merit goods.

18. Give any four uses of price in an economy.

- Guides producers on what to produce.
- Used to measure the value of goods.
- Helps in making adjustments between demand and supply.

- Used to determine income distribution.
- Helps consumers to make the consumption plans.
- Guides producers on how to produce.
- Guides producers on where to produce.

19. (i) Define reserve price.

(ii) Give any three factors that determine the reserve price.

A. (i) Reserve price is the minimum price below which a seller is not willing to sell his commodity during haggling process.

(ii) Factors that determine the reserve price.

- Durability of the commodity.
- Liquidity preference of the seller.
- Expectations of future demand.
- Storage costs.
- Durability of storage.
- Expectation of future changes in price.
- Expectation of future changes in production cost.

20. (i) What is price mechanism.

(ii) Identify the merits and demerits of price mechanism.

A. (i) Price mechanism is a system of economic organization in which price plays a central role in influencing allocation of resources in a free enterprise economy.

Merits

- Encourages consumer's sovereignty.
- Promotes incentives to hard work.
- Encourages competition leading to improved quality and quantity of output.
- Leads to efficient allocation of resources.
- Leads to charging lower prices due to competition and economies of scale.
- Reduces cost of administration due to limited government role.
- Provides wide variety of goods and services thus increases consumer choice.

Demerits

- Market imperfections due to consumer ignorance.
- Encourages income inequality.
- Promotes growth of monopoly power.

- Divergence between private benefits and social costs e.g. pollution.
- Encourages inflationary tendencies.
- Encourages duplication of activities thus resource wastage.
- Inadequate provision of merit and public goods.
    - Economic instability and unemployment due to price fluctuations

21. Give any four roles of price mechanism in a free market economy.

- Determines resource allocation, that is, what to produce, when to produce, how to produce etc.
- Encourages increased exploitation of resources due to desire to make more profits.
- Provides employment opportunities.
- Determines techniques of production.
- Ensures competition thus, improved quality.
- Determines income distribution.
- Makes automatic adjustment between demand and supply.
- Harmonizes profits and utility maximization objectives.

22. Define the following terms as used in economics.

(i) Diamond water paradox.

(ii) Effective demand.

(iii) Total utility.

(iv) Marginal utility.

A. (i) Diamond water paradox is a theory which helps to explain why scarce commodities are sold more expensively even when they are less useful than the commodities which are in plenty but more useful.

(ii) Effective demand is the desire for commodity backed by the ability to pay the price charged.

(iii) Total utility is the combined amount of satisfaction received from all the units consumed over a given period of time.

(iv) Marginal utility is the satisfaction derived from each additional unit of a commodity consumed in a given period of time.

23. (i) State the law of diminishing marginal utility.

(ii) Give any three application of the law of diminishing marginal utility.

A. (i) The law states that 'as more successive units of a commodity are consumed the extra satisfaction derived from each additional unit diminishes as total consumption increases'.

(ii) **Application of the law.**

- Forms basis of consumption theories eg law of demand and concept of consumer's surplus is based on this law.
- The law influences changes in design and packaging of commodities etc.
- The law explains why the price of a commodity falls when its supply increases.
- It explains the 'diamond – water paradox'.
- The law helps in taxation by the government ie government imposes high tax on the rich whose marginal utility of money falls, and less on the poor whose marginal utility of money is high.

24. Give any four limitations of the law of diminishing marginal utility.

- The law cannot work if a consumer is consuming a commodity of heterogeneous units.
- The law cannot work if the consumer changes his/her taste, habit, custom etc.
- The law cannot apply if the commodity is consumed at random and marginal utility may increase instead of diminishing.
- The law only works when the commodity is consumed in a suitable size e.g. giving water to a thirsty person using a tea spoon only increases marginal utility for subsequent spoons.
- The law only works if price of the different units of substitutes of the commodity remains the same.
- The law cannot work if the commodities are indivisible.
- The law does not work if the consumer behaves irrationally.
- The law does not apply to precious commodities.
- The law does not apply to money because marginal utility of money does not become zero.

25 (i) What is 'consumer's surplus.'

(ii) Explain the relationship between marginal utility and consumer's surplus.

A (i) Consumer's surplus is the extra utility that a consumer enjoys without paying for because the market price is lower than the price he/she was willing to pay. OR the difference between what the consumer was prepared to pay for the commodity and what he/she pays.

(ii) The relationship between marginal utility and consumer's surplus is that the higher the marginal utility the higher the consumer's surplus. This means when the marginal utility is high the consumer's surplus is also high and when it is low the consumer's surplus is also low.

26. What is meant by the following terms?

(i) Derived demand.

(ii) Giffen paradox.

(iii) Joint demand.

(iv) Marginal rate of substitution.

A. (i) Derived demand is the demand for a commodity not for its own sake but due to demand for something else. For example demand for raw material is derived from the demand for the final product that raw material produces.

(ii) Giffen paradox is the tendency by the low income earners to buy more of a particular commodity as its price rises. It is displayed on the demand for giffen goods.

(iii) Joint demand is the demand for commodities which are used together e.g. demand for car and fuel, gun and bullet etc.

(iv) Marginal rate of substitution is the rate at which a consumer substitutes one commodity for another in order to maintain same level of satisfaction. It is the slope of the indifference curve.

27. (i) Differentiate between change in demand and change in quantity demanded.

(ii) State two factors which lead to change in demand.

A.(i) Change in demand refers to the increase or decrease in demand due to change in other factors that affect demand price remaining constant.

Whereas

A change in quantity demanded is the increase or decrease in quantity demanded due to change in price other factors affecting demand remaining constant.

(ii) **Factors which lead to change in demand**

- Change in population size
- Change in consumers' tastes and preferences
- Change in price of other goods
- Change in consumers' income
- Change in income distribution
- Change in future expectation
- Change in government policy

28. (i) Distinguish nominal income and real income.

(ii) Give any two determinants of real income in Uganda.

A. (i) Nominal income is the income expressed in monetary terms. It is also known as money income.

Whereas

Real income is income expressed in terms of goods and services nominal income can buy. Or, it is the purchasing power of nominal/ money income.

(ii) **Determinants of real income.**

- The level of taxation/disposable income.
- The price level/cost of living/rate of inflation.
- The size of money income /nominal income.
- The size of monetary/subsistence sector.
- Quantity of goods available.

29. Distinguish between substitution and income effect of price change.

A When price falls there are two effects.

(i) The commodity becomes cheaper (price effect).

(ii) The consumer is left with income to spend on other goods (income effect).

When price of Y falls relative to X the consumer will reduce amount of X and buy more of Y, thus moving from point A to point B along indifference curve. I_1 (substitution effect).

When price falls the real income of the consumer increases. He/she is now able to buy more of X and Y than before, thus he/she is on a higher level of satisfaction I_2. (Income effect).

30. (i) Distinguish between normal price and market price.

(ii) Give two ways of price determination.

A. (i) Normal price is that price which is obtained where demand and supply are equal in the long-run period/long-run equilibrium.

While

Market price is any price determined by buyers and sellers in the market in the short period.

Or

The ruling price in the market at a particular time.

(ii**) Ways of price determination.**

- Interaction of market forces of demand and supply.
- Price leadership under oligopoly.
- Fixing by treaty/collusion/agreement.
- Sales by auction.
- Haggling or bargaining between buyers and sellers.
- Government legislation/fixing.
- Resale price maintenance.

31. Study the table below showing the price and quantity purchased of commodity X and answer questions that follow.

Price consumers are willing to pay	Units purchased
300	1
250	2
200	3
150	4
100	5
50	6

i) What is meant by consumer's surplus?

(ii) Calculate consumer's surplus if four units of the commodity were purchased at Shs. 150 per unit.

(iii) What is the relationship between consumer's surplus and diminishing marginal utility?

A. (i) Consumer's surplus is the extra utility consumer derives without paying for.

Or

The difference between what the consumer was prepared to pay and what he actually pays for the commodity.

(ii) If four units were purchased consumer's surplus will be:

(300 – 150) + (250 – 150) + (200 – 150) + (150 - 150)

150 + 100 + 50 + 0

= 300 shs.

(iii) Diminishing marginal utility is the decline in satisfaction due to increase in consumption by one unit. The relationship between the two is that, the higher the marginal utility, the higher the consumer' surplus. As consumption increases marginal utility diminishes and so is the consumer's surplus.

32. State four reasons why a consumer buys less of a commodity when its price falls?

- When the consumer associates fall in price with fall in quality/poor quality.
- When the consumer expects further fall in price in the future.
- If the commodity is a giffen good.
- When the economy is in depression and incomes are falling.

- When the commodity is a good of ostentation and consumed for prestige.
- When the price of substitutes have fall even more.
- When consumer's taste for the commodity has fallen.

33. State any four determinants of aggregate demand in your country.

- The general price level.
- The quantity of money in supply.
- Income levels.
- The size of population.
- The existing stock of capital.
- Taxation and subsidization policies.
- Political factors.
- The availability of stock of consumer goods and services.

34. (i) Distinguish income elasticity of demand and price elasticity of demand.

(ii) State any two uses of the concept of price elasticity of demand in your country.

A. (i) Income elasticity of demand is the measure of the degree of responsiveness of quantity demanded of a commodity to change in consumer's income.

$$YED = \frac{proportionate\ change\ in\ demand}{Proportionate\ change\ in\ income}$$

Whereas

Price elasticity of demand is the measure of degree of responsiveness of quantity demanded of a commodity to change in the commodity's own price.

$$YED = \frac{proportionate\ change\ in\ quantity\ demanded}{Proportionate\ change\ in\ price}$$

Uses of the concept of price elasticity of demand.

- Helps a producer when determining price of his product in order to maximize revenue.
- Important to a monopolist when carrying out price discrimination.
- Helps producers/firms when carrying out persuasive advertisement.
- Helps producers when determining wages of employees.
- Helps in explaining why agricultural economies are poor.
- Important to government when carrying out policy o devaluation.
- Helps government when imposing indirect taxes.
- Helps government when designing protectionist policy.
- Helps government when designing subsidization policy.

- Important when fixing price of public utilities.
- Important when determining the incidence of a tax.

35. State any four factors that affect elasticity of demand.

- The size of consumer's income.
- The ease of substitution of the commodity for others.
- The degree of necessity of the commodity.
- Proportion of consumer's income spent on the commodity.
- Consumer's habit in the use of the commodity.
- Number of uses the commodity can be put to.
- Durability of the commodity.
- Time period available for adjustment.
- Seasonal changes.

36. (i) Define the term "income elasticity of demand".

(ii) Given that an individual's income increased from Shs. 50,000 to Shs. 80,000 per month and this led to an increase in demand by 10%.Calculate the income elasticity of demand.

A. (i) Income elasticity of demand refers to the degree of responsiveness of demand for a commodity due to change in consumer's income.

(ii) $$Income\ elastity\ of\ demand = \frac{Proportionate\ change\ in\ demand}{Proportionate\ change\ in\ income}$$

$$YED = \frac{Prop\Delta Q}{Prop\Delta Y}$$

$$YED = \frac{NQ-OQ}{OQ} / \frac{NY-OY}{OY}$$

$$= \frac{\Delta Q}{\Delta Y} \cdot \frac{Y}{Q}$$

$$= \frac{10\%}{80{,}000-50{,}000/_{50{,}000}} X100$$

$$= \frac{10\%}{60\%}$$

$$\text{YED} = \frac{1}{6}$$

37. Study the table below showing income and quantity demanded of a commodity X and answer the questions that follow.

Income (Ug.Shs)	Quantity demanded of commodity X (Kg)
10,000	50
30,000	20

(i) Calculate the income elasticity of demand for commodity X

(ii) What type of commodity is X? Give reasons for your answer.

A. (i) $Income\ elasticity\ of\ demand = \frac{proportinate\ change\ in\ quantity\ of\ X}{Proportionate\ change\ in\ Income}$

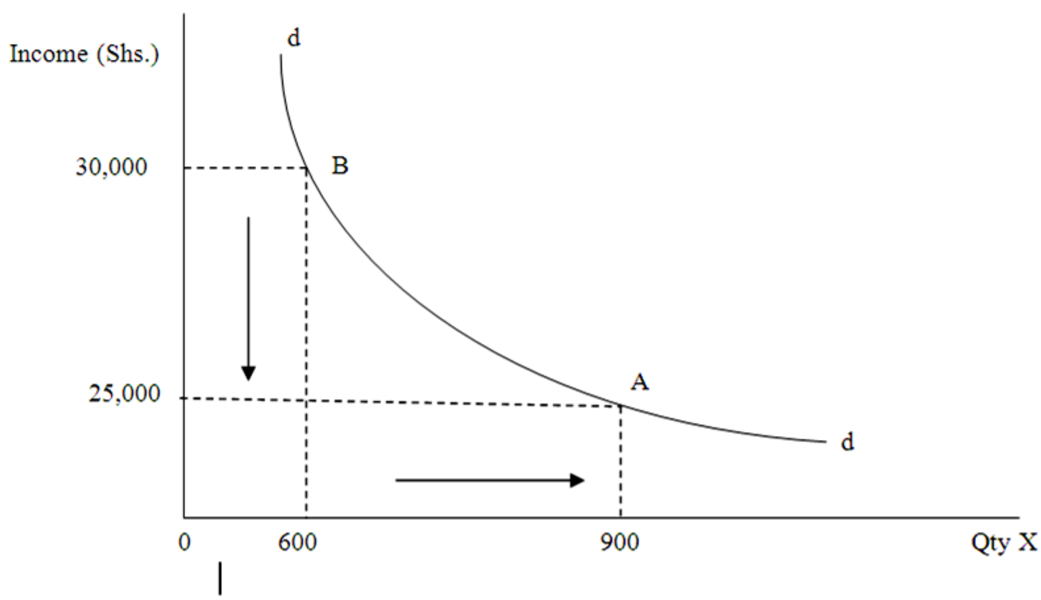
$$\text{YED} = \frac{Prop.\Delta Qx}{Prop.\Delta Y}$$

$$\text{YED} = \frac{20-50}{50} / \frac{30{,}000-10{,}000}{10{,}000}$$

$$= \frac{-3}{5}\ X\ \frac{1}{2} = -0.3$$

(ii) Commodity X is an inferior good because value of income elasticity is negative i.e. As income increases, quantity demanded falls.

38. Study figure 1 below showing the consumer's level of income and the quantity demanded of good X and answer the questions which follow:



(i) Calculate the income elasticity of demand when consumer's income increased from A to B.

(ii) What type of good is X?

A. (i) $Income\ elasticity\ of\ demand = \frac{prop.change\ in\ quantity\ demanded}{prop.change\ in\ income}$

$$YED = \frac{NQ-OQ}{OQ} / \frac{NY-OY}{OY}$$

$$YED = \frac{\Delta Qx}{\Delta Y} . \frac{Y}{Qx}$$

$$\text{YED} = \frac{600-900}{900} / \frac{30{,}000-25{,}000}{25{,}000}$$

$$YED = \frac{-300}{900} / \frac{5000}{25{,}000} = \frac{-3}{9}\ X\ \frac{25}{5} = \frac{-5}{3}$$

= -1.67

(ii) X is an inferior good because of negative value of income elasticity of demand.

39. (i) Define cross elasticity of demand.

(ii) Calculate the cross elasticity of demand for commodity Y in the table below.

iii) State the relationship between commodities X and Y.

Year	**Price of commodity X**	**Quantity demanded of commodity Y**
1998	**12,000**	**300,000**
2008	**10,000**	**500,000**

A. (i) Cross elasticity of demand is the degree of responsiveness of demand for one commodity say X due to change in price of another commodity say Y.

(ii) Cross elasticity of demand for Y.

$$= \frac{\%change\ in\ Qty\ of\ Y}{\%change\ in\ price\ of\ X}$$

$$= \frac{\%\Delta Qy}{\%\Delta Px} \text{ or } \frac{\Delta Qy}{\Delta Px}\ \text{X}\ \frac{Px}{Qy}$$

$$= \frac{500{,}000-300{,}000}{300{,}000} / \frac{10{,}000-12{,}000}{12{,}000}$$

$$= \frac{2/3}{-1/6}$$

= -0.167

(iii) X and Y are complementary goods.

40. What is the importance of elasticity of demand to a producer?

- Helps a producer in determining price of his product. He/she will fix high prices for commodities with inelastic demand and low prices for those with elastic demand.

- Helps monopolist when carrying out price discrimination.
- Assists a producer when fixing wages of his employees.
- Helps in determining cost of joint products.
- Basis for promotional advertisement.

41. (i) Given that the price of a commodity X decreased from shs. 15,000 to Shs. 10,000 and quantity demanded of a related commodity Z increased from 400,000 Kg to 600,000 Kg. Calculate cross elasticity of demand for commodity Z.

(ii) State the relationship between commodities X and Z

A. (i) Cross elasticity of demand $= \frac{Proportionate\ change\ in\ quantity\ of\ Z}{Proportionate\ change\ in\ Price\ of\ X}$

$$= \frac{\Delta Qz}{\Delta Px} \cdot \frac{Px}{Qz}$$

$$= \frac{600{,}000-400{,}000}{10{,}000-15{,}000} \text{ X } \frac{15{,}000}{400{,}000}$$

$$= \frac{200{,}000}{-5{,}000} \text{ X } \frac{15}{400}$$

$$= \frac{3}{-2} = -1\frac{1}{2}$$

(ii) Commodities X and Z are complements due to negative value of income elasticity of demand.

41. (i) Calculate the cross elasticity of demand if the price of commodity P falls from Ug Shs. 1000 to Shs. 800 per unit and quantity demanded of commodity Q increases from 20 to 30 units per day.

(ii) What is the relationship between commodity P and Q.

A. (i) Cross elasticity of demand $= \frac{Proportionate\ change\ in\ quantity\ of\ Q}{Proportionate\ change\ in\ Price\ of\ P}$

$$\text{CED} = \frac{\Delta Q}{\Delta P} \cdot \frac{P}{Q}$$

$$CED = \frac{30-20}{800-1000} \cdot \frac{1000}{20}$$

$$\text{CED} = \frac{10}{-200} \cdot \frac{1000}{20}$$

$$CED = \frac{10}{-4} = -2\frac{1}{2} \ or -2.5$$

(ii) P and Q are complements because of negative value of cross elasticity of demand.

42. Give four reasons why labour supply curve may be regressive.

- When workers prefer leisure at high wages.
- If the work force is dominated by target workers who abandon work after achieving what they want.
- If there is a progressive tax system.

- When employers substitute labour with capital as wages rise.
- If the work is unpleasant and working for long hours may affect the health of workers.

43. (i) State the law of diminishing marginal utility.

(ii) Give three limitations of the law of diminishing marginal utility.

A. (i) The law states that as successive units of a commodity is consumed the satisfaction derived from each additional unit diminishes as total consumption increases.

(ii**) Limitations of the law:**

- Cannot apply if a consumer is consuming commodity of heterogeneous units.
- Cannot work if a consumer changes his/her tastes, habit etc.
- Cannot work if the commodity is consumed at random and may instead increase.
- The law cannot work when the commodity is consumed in suitable size.
- The law cannot apply if the price of substitutes has changed.
- The law cannot apply if the commodities are indivisible.
- The law does not work if the consumer behaves irrationally.
- The law cannot apply to money because marginal utility of money increases rather than diminish.

44. Explain why leisure is an economic good.

- Yields utility/satisfaction to the person enjoying it.
- Has opportunity cost i.e enjoying leisure involves foregoing work.
- Leisure has money value i.e it is obtained at a cost.
- Leisure time is scarce.

CHAPTER 2: **PRODUCTION**

Question 11 a) What is meant by efficiency of labour

b) Examine factors that influence efficiency of labour.

Efficiency of labour refers to quantity and quality of goods and services that a unit of labour can produce in a given period of time. It is also known as productivity of labour.

Factors that influence labour efficiency

- **Level of remuneration/wages:** A worker who is well paid is likely to be more committed to work than the other who is less paid.
- **Degree of specialization/division of labour.** A worker who concentrates on a single task is likely to become extremely proficient at that particular operation than his/her counterpart who is a jerk of all trades but a master of none.

- **Level of management or supervision:** A worker performing under close supervision in terms of performance appraisals will be more productive than a worker under "Laissez faire" system. Where a worker is his own boss productivity falls because he/she will work at his/her own pace.
- **Level of education:** A worker who is educated and better trained is likely to be more efficient than the other counterparts who are less educated. This is particularly in skilled jobs.
- **Labour's own attitude:** A worker who loves her/his work will be self motivated and self driven to perform the task. He/she will be more efficient than a worker who is biased and has negative attitude towards the work he/she is doing.
- **Level of experience:** A worker who has worked for long and attained experience will be more efficient than the worker who has just entered the field of work.
- **Level of job security:** A worker who is employed on permanent basis will be less efficient because he/she is assured of job security and monthly pay regardless of how much he/she has worked. A worker on contract basis will be more efficient to impress employers to renew the contract.
- **Time worked:** Other factors remaining constant a worker who spends more hours at work will be more efficient and productive than his/her counterpart who works for fewer hours.
- **The health condition of the worker:** A worker who is physically fit and in good health condition will be more productive than those whose health is in bad conditions or physically impaired.
- **Level of technology:** A worker using advanced technology will produce more and better quality products than those using old technology.
- **The cost of living:** When the cost of living is high, the worker will lead a deprived life. Such a worker will become less enthusiastic at work and his/her productivity falls. When the cost of living is low, the worker will enjoy high standard of living and will be more interested in work.
- **Availability and efficiency of co-operant factors:** The quality of the tools with which labour works, has important influence on labour productivity. A worker using better tools is likely to be more productive than those using poor tools.
- **The working conditions:** A worker performing his/her task under attractive environment will be more cheerful, and more productive than those working in a gloomy dull environment. Such environment considers things like ventilation, play grounds etc.
- **The nutritional standards:** A worker who is well fed is likely to be more productive than those who are poorly fed.
- **The level of motivation:** A worker who is cheered, and given additional rewards will be more interested in his/her work than those who are often rebuked or harassed.
- **Housing conditions:** A worker accommodated in a good house will be more productive than those housed in noisy and congested environment. Rest and relaxation after work

requires a worker to be better housed.

Question 12 a) Distinguish between occupational and geographical mobility of labour

b) Explain the factors that limit free mobility of labour in your country.

Occupational mobility of labour is the ease with which labour as a factor of production can move from one occupation to another.

Whereas,

Geographical mobility of labour is the ease with which labour as a factor of production can move from one geographical location to another.

Barriers to geographical mobility of labour

- **The high cost of movement:** The cost of moving the family together with their belongings presents a very big obstacle to labour movement from one work place to another especially if the areas are far part.
- **Lack of suitable accommodation in some areas:** difficulties in getting suitable accommodation elsewhere sometimes also prevent labour from changing to such areas of work.
- **Family attachments:** Sometimes labour is held by family ties or commitments or responsibilities in a particular place e.g. children's education, commitment to spouses etc.
- **Social ties:** Many people are reluctant to leave behind friends, church members, and club members and face the task of establishing new social relationships in a new place.
- **Imperfect knowledge of other places:** Some people are reluctant to move to places they are not familiar with or lack adequate knowledge about. Thus the fear of adventurism makes labour immobile geographically.
- **Prejudice against certain places:** Some people tend to develop negative attitudes and feelings towards certain places. Thus there are some people who are not prepared to work in certain parts of the country because of prejudice.
- **Barriers to occupational mobility of labour:**
- **Lack of natural ability.** Certain jobs require natural ability like natural intelligence which is only possessed by few individuals.
- **Training limitations.** Occupations which require lengthy and costly training prevent many people from joining due to inability to cope with the costs and other demands of the training.
- **Professional regulations.** Some trade unions/professional associations prevent labour from joining the profession until certain conditions are fulfilled.
- **Old age of the worker.** Workers who are too old to learn new skills find it difficult to change occupations thereby ending up remaining in their old professions that require their old skills.
- **Capital constraints.** Certain occupations require certain minimum amount of capital in

order to join. The inability to provide capital makes it hard for labour to join such occupations.

- **Discrimination in the labour market**. Discrimination based on sex, religion, social classes, experience etc prevent people from joining such occupations.
- **Ignorance of the worker.** The ignorance of workers about certain occupations prevents them from joining such occupations.
- **Specificity of labour.** Labour which is highly specialized is immobile since it is not possible for such labour to change its function.
- **Personal considerations.** Sometimes workers may prefer to stay unemployed rather than accept wage below a recognized minimum in an alternative occupation.

Question 13a) Distinguish between a firm and an industry.

(b)Account for survival of small firms along side large ones in your country.

A firm is a production unit under unified control and management. Or production unit that employs factors of production in order to produce goods and services that are sold to households, other firms and the government.

Whereas

An industry is a combination of two or more firms.

Reasons for the survival of small firms.

- **Capital limitations.** Expanding the size of the firm requires injecting additional capital. Some firms have problems of raising capital thus find it hard to expand, hence continue operating as small firms.
- **Market limitations.** Where firms produce for small markets, such firms will operate on small scale.
- **Geographical limitations.** The existence of small firms may be to due to geographical confinement. Where the industry is producing bulky goods which may not be easy to transport to other locations. If the demand in that location is small, the firm will remain small.
- **Price limitations.** Firms which produce very expensive commodity for few rich people such as jewellaries are small firms.
- **Personal services.** Firms rendering services that require special attention to customers will always operate on small scale such as law firms, medical clinics, beauty saloons etc.
- **Demand for variety.** A firm that produces a commodity where consumers demand a variety of styles, fashions etc cannot specialize and must remain small because demand changes every time.
- **Fear to pay tax.** A firm may continue to operate on small scale because the owner fears to pay taxes to the government. He may be dodging taxes which will be difficult if he/she operates on large scale.

- **Fear of diseconomies of scale.** The owner may fear the challenges of managing large firms and may chose to remain small to avoid such risks.
- **Disintegration of the industry.** Specialization of process with many small firms concentrating in the production process. In such situation the firms remain small because their market is controlled by industry that uses their products.
- **Desire for independence.** Some people prefer to be self employed without any external control. Such firms will remain small despite advantages of large firms.
- **Government limitation.** The government may pass a law preventing the merging of firms as anti monopoly measure. Thus, survival of small firms.
- **Raw material limitations.** If the raw material used by the firm is small, the firm remains small.
- **Skilled manpower constraint.** If the firm cannot get the required skilled manpower, it remains small.

14a) .Distnguish between division of labour and specialization.

(b) Examine the merits and demerits of division of labour.

Division of labour refers to the splitting of economic task into a large number of repetitive individual operations and each operation is the responsibility of a particular worker and the whole work is completed by different workers.

Whereas

Specialization is the concentration of a worker on one particular task which he/she can do best. Division of labour therefore leads to specialization in the long run after the worker has performed the same task repeatedly.

Merits of division of labour.

- **Increases skills and dexterity.** A person who spends all his/her time performing the same simple task becomes extremely proficient at that particular operation. The constant repetition of tasks means that they can be done more expertly as most people would say; ‘practice makes perfect’.
- **Time saving.** No time is wasted moving from one task to another. The necessity of moving from one station to another, or putting down one tool and picking another is eliminated.
- **Saves time in training skills.** A worker can be trained quickly for the performance of a single operation. If for example, a person has to be trained as an all round doctor it would take many years, but can quickly be trained to fulfill one operation in the medical field.
- **Increased output.** Overtime evidence indicate that by carrying out some degree of specialization the total output of any group was much higher than the sum of individual outputs of independent producers. Since a worker concentrates of a particular task, the productivity of the worker increases thus high output.

- **Personal liking/individual aptitude.** Specialization means that different occupations are created, each one of which calls for some particular aptitude. It is possible therefore, for each worker to specialize in the job for which he is best suited.
- **Permits greater use of machinery.** When complex process has been broken down into a series of separate, simple processes it is possible to devise machinery to carry out each individual operation. This further saves time.
- **Encourages team spirit.** Since work is completed by different workers, each contributing a small part of the work, cooperation among the workers is encouraged.
- **Economies of scale are enjoyed.** Division of labour and specialization is associated with large output. This leads to advantages of lower average costs and high profitability to the firm.

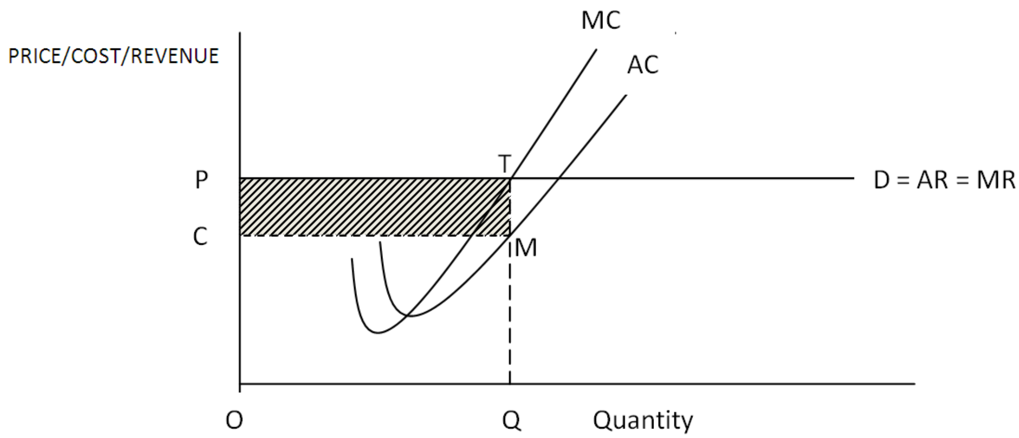
Demerits of division of labour.

- **Leads to monotony and boredom.** A cycle of simple movements which is repeated every few minutes makes a worker bored. There is no opportunity for a worker to exercise initiatives, judgment or manual skills. This has negative impact on labour productivity.
- **Promotes interdependency.** A specialized system of production increases the extent to which different sectors of the economy depend upon one another. Most large industries consist of many small firms each concentrating on the production of one or very few components which are brought together in an assembly line as in motor car industry. This is every efficient, low cost method of production, but is extremely vulnerable to a break down in any one of the large number of links in the chain. Delay in the supply of anyone of components may cause massive hold-ups through out the industry.
- **Leads to dislocation.** Due to interdependency, the possibility for dislocation is very great. For example; strike by a key group of workers such as the miners can bring the whole country to a halt.
- **Increased risk of unemployment.** Specialization means that for many people their training and experience is narrow. This means that if that particular skill is no longer required, it is very difficult for the worker to get alternative work.
- **Loss of craftsmanship.** Specialization is associated with increased use of machinery. Basic skills are transferred from the hands of the worker to the machines; it is the machine which now controls the design, the quantity and quality, and not the person tending the machine. The pride derived from making something is lost to the machines.
- **Loss of sense of responsibility.** Since no one is directly responsible for the final product, it is not possible to hold any worker personally accountable for the poor quality of the final product. The sense of care required of a worker is therefore sacrificed when a worker is just responsible for a small component of the work.
- **Leads to mass production.** Specialization and use of machinery is associated with large output that can be limited by market. This causes surplus production.

Question 15.a) Explain how a firm under perfect competition determines output, price and profit in the; (i) short run (ii) Long-run.

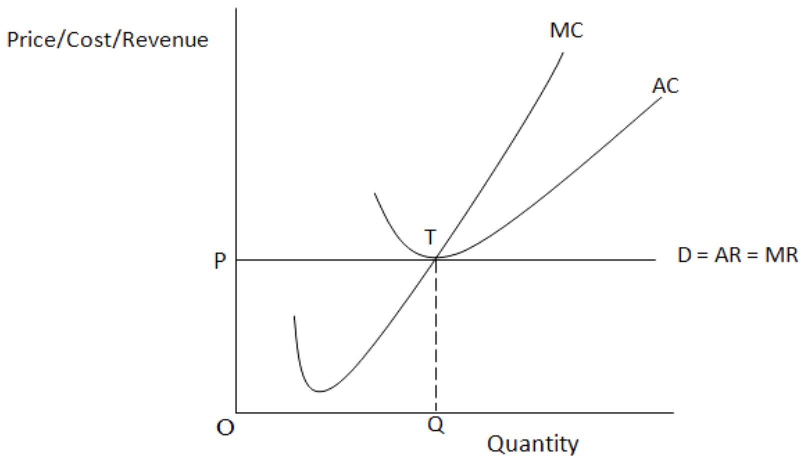
b) Examine the merits and demerits of perfect competition.

Short run



- The firm is in short run equilibrium at point T where MC=MR producing output OQ.
- Price per unit is determined by AR curve at OP because the firm is a price taker.
- Cost per unit is determined by the AC curve at OC
- The firm produces each unit at OC and sells at OP making abnormal CPTM indicated by the shaded area.

Long run



- The firm is in long run equilibrium at point T where MC=MR producing output OQ

- Price per unit is determined by the AR curve at OP because the firm is a price taker.
- Cost per unit is determined by AC curve at OP. sice price per unit is equal to the cost per unit; the firm makes normal profit in the long run.

b) Merits of perfect competition.

- **Promotes efficient allocation of resources.** The market forces of demand and supply will direct resources to their optimal use. This is because resources will only be allocated in production of those goods and services which are demanded.
- **Ensures stable prices in the market.** The invisible market forces of demand and supply will adjust themselves until equilibrium price is attained. This maintains price stability in the market.
- **Leads to increased output.** The large number of firms involved in production will lead to more output of goods and services thus, economic growth.
- **Ensures equitable distribution of income and employment.** This is due to freedom of entry of new firms into the industry. When there is abnormal profit new firms are free to enter and share with the existing firms.
- **Provides efficient standard for comparing price determination with other markets.** Prices determined by forces of demand and supply are the most realistic because the market is cleared.
- **Leads to low prices due to competition.** This improves the welfare of consumers because they buy high quality goods and services at low prices.

Demerits of perfect competition.

- **It is based on unrealistic assumptions.** It is an ideal market which does not exist in the real world. For example the assumption of non government interference in the market does not hold because the government intervenes to regulate price.
- **Associated with low level of profit.** The profit is shared by many firms and in the long run only normal profit is made. This discourages entrepreneurship in the industrial sector.
- **Limited variety to the consumer.** All the many firms in the market produce homogeneous products thus, a consumer has limited variety.
- **Leads to unemployment.** In the long run inefficient firms are out competed forcing them to quit production. In this process, the workers are rendered unemployed.
- **Cannot eliminate natural monopoly and unfair business ownership of capital.** Such advantages will make a producer to vary the price of his products without affecting supply.

16 a) What are the features of monopolistic competition?

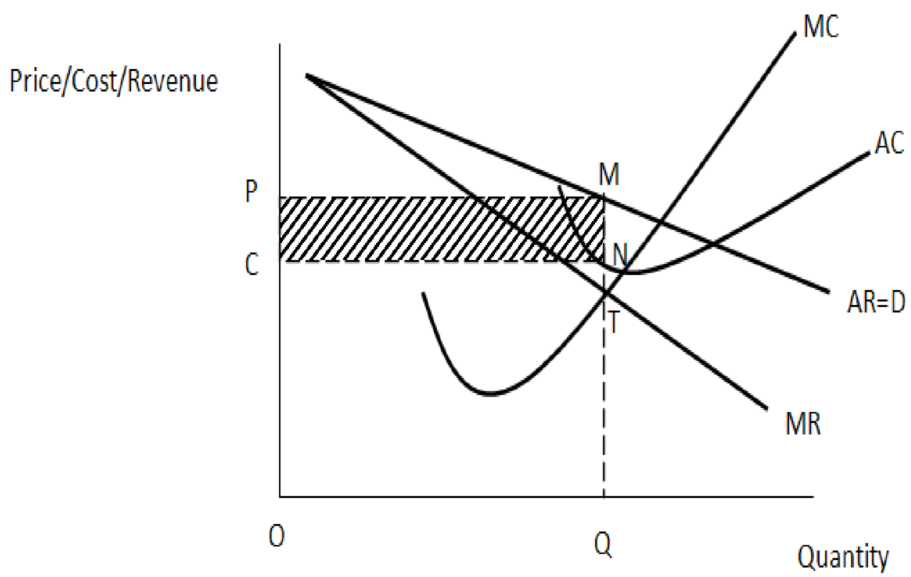
b) Explain how output, price and profits are determined under monopolistic competition in the short run and long run.

c) Examine the merits and demerits of perfect competition.

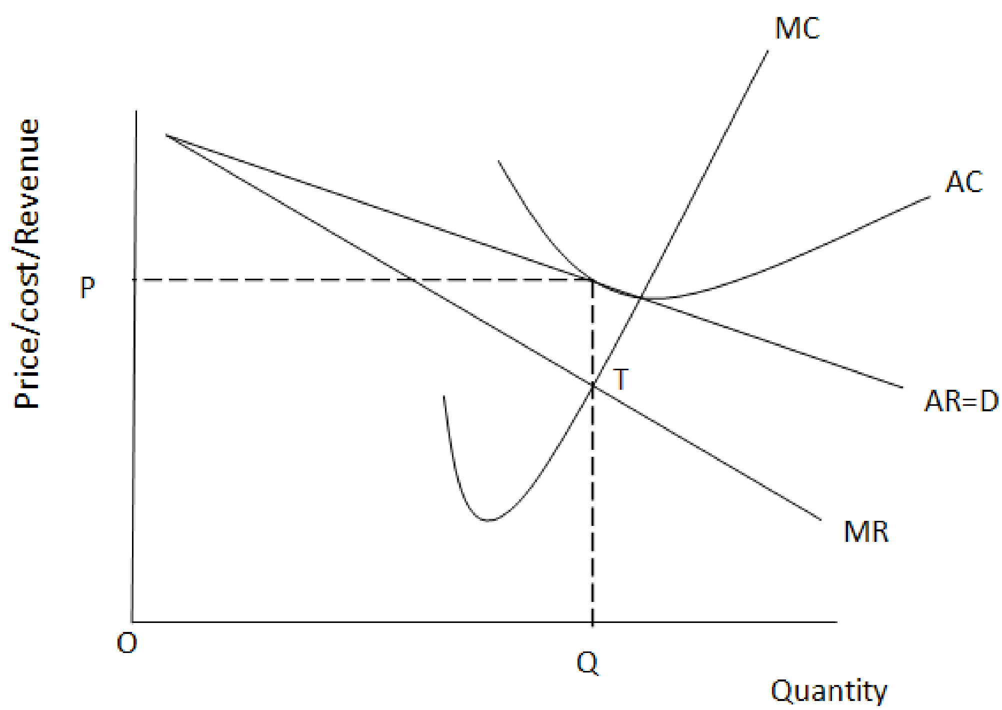
- **Large number of buyers and sellers in the industry.** There are several buyers and sellers in the market such that the action of one buyer or seller is insignificant in the market.

- **Freedom of entry and exit.** New firms are free to enter when existing firms are enjoying abnormal profits, and free to quit when losses are being made.
- **Product differentiation.** Each firm tries to make its product appear different from those of the rivals through branding, packaging, etc.
- **High degree of competitive advertisement.** Each firm struggles to bring its brand to the attention of consumers through persuasive advertisement.
- **Normal demand curve.** Firms have normal demand curves which are downward slopping from left to right but elastic due to presence of many close substitutes.
- **Profit maximization is the major goal.** Each firm aims at making as much profit as possible.
- **Existence of excess capacity.** Each firm deliberately produces at less than full capacity in order to increase price.
- **Brand loyalty.** Due to persuasive advertisement, consumers become loyal to particular brands and continue to buy even when the price is increased. This is how the aspect of monopoly comes in.
- **Less control over price due to many close substitutes.** Due to presence of many close substitutes, the firm does not have high market power like a single firm monopoly.

b) short run.



- The firm is in short run equilibrium at point T where MC=MR producing output OQ.
- Price per unit is determined by extending the output line to to AR curve corresponding to OP
- Cost per unit is detrmined by extending output line to AC curve corresponding to OC
- The firm produces each unit at OC and sells at OP making abnormal profit indicated by the shaded area CPMN



- The firm is in a long run equilibrium at point T where MC=MR producing output OQ.
- Price per unit is determined by extending output line to AR curve corresponding to OP.
- Cost per unit is determined by extending output line to meet AC curve still at OP.
- Since price per unit and AC are equal, the firm makes only normal profit in the longrun

Merits of monopolistic competition.

- **High output**. Since there are many firms in the industry, more output of goods and services are produced in the economy.
- **Leads to production of high quality products**. The stiff competition among the several firms improve the quality of products.
- **Reduced prices.** Competition among firms leads to cutting of prices. Consumers benefit by obtaining high quality goods and services at low prices.
- **More employment opportunities are created.** Since there is no restriction to entry of new firms, many firms are established leading to more job opportunities.
- **Increased variety of goods and services.** Due to product differentiation, there are many varieties available to the consumer. This increases consumer choice.

- **Increased government revenue.** The establishment of several firms increases the tax base. Thus, the government gets more tax revenue.

Demerits of monopolistic competition.

- **Leads to resource wastage.** Lot resources are wasted in competitive advertisement.
- **Under utilization of resources.** These firms operate at excess capacity(less than full capacity) thus leaves most resources idle.
- **Leads to unemployment.** Due to excess capacity, there is less demand for factors of production including labour causing unemployment.
- **Low profits.** The profit is shared among many firms which reduces individual firm's profit. In addition, in the long run firms earn only normal profits. This discourages enterprise.
- **Exploitation of consumers.** Due to excessive advertisement, consumers develop brand loyalty. They are charged high price for particular brand compared to others due to ignorance.

17a) Examine factors which give rise to monopoly power in an economy.

b) What are the implications of the existence of monopoly firms in a country?

Monopoly is a market structure where there is only one producer of a commodity with no close substitutes.

Factors which give rise to monopoly power in an economy.

- **Granting patent/copy rights.** This is the right given to a producer to exclude others from producing the same commodity. Copy right is given to writers and artists to exclude others from publishing the same materials. The purpose is to encourage new innovations. Thus, a firm with patent/copy right acquire monopoly status.
- **Large initial capital requirements.** There are some investments which require huge capital to start. Cases in point include power generation, railway services among others. Such firms operate as state monopolies because the would be competitors cannot raise the initial capital

- **Competition in the market.** In a free enterprise economy characterized by competition, loss making firms close down. In the long run the most efficient firm will be the only one remaining in production. Thus monopoly power arises.
- **Horizontal merging of firms.** Firms at the same stage of production may decide to combine in order to reduce competition among them for market. These integrated firms operate as a single firm, thus monopoly arises.
- **Act of parliament.** The law of the land may confer monopoly status on certain firms. These monopolies created by law are referred to as statutory, public or government monopolies. Example of such monopoly includes National Water and Sewerage Corporation.
- **Exclusive ownership of strategic raw materials.** A single firm may be the only one controlling the raw material used in the manufacture of a commodity. Such a firm will

operate as monopoly because potential competitors do not have such raw material. A cement firm may monopolize market in a given region because it controls limestone deposit.

- **Long distance between producers.** A firm may enjoy monopoly power in the local market because the potential competitors are far away and it may be costly for them to sell in the local market. Such monopoly created by distance is known as spatial monopoly
- **Ignorance of the potential competitors.** The would be competitors may not be aware that the existing firm is enjoying abnormal profits. Thus it continues unrivaled.
- **Dumping by international firms.** This is the selling of goods in the foreign markets at lower prices than in the home market. This has the effect of promoting international monopolies.
- **Government protection.** The government may decide to shelter domestic producers against foreign competition by imposing high tariffs on imports. This promotes growth of local monopolies.
- **Limited market size.** The existing market may be too small to support more than one firm of optimal size. In this case it is not economically viable to have more than one firm.
- **Possession of natural gift/special talent.** Some individuals are blessed with special skills that the rest in society lack. For example football stars, artists and singers possess highly rewarding talents that grant them special status in society.
- **Exclusive knowledge of production technique.** When a firm is the only one that has knowledge over the production of certain product, such a firm becomes a monopoly firm.

Implications of the existence of monopoly

The implications of monopoly are both positive and negative.

Positive implications.

- **Improves welfare of the poor.** Monopolies practice price discrimination in which the poor are charged less than the rich for the same type of commodity. In this way, the consumption level and standard of living of the poor is improved.
- **Redistributes income.** In the practice of price discrimination, the poor are charged less than the rich on the same commodity. In this way, the gap between the poor and the rich is reduced.
- **Provide more employment opportunities.** Monopolies are usually large scale firms with greater capacity to employ. This leads to creation of more employment opportunities.
- **Large abnormal profits.** Monopoly firms earn abnormal profits both in the short run and long run due to absence of competition.
- **Economies of scale are enjoyed.** Monopolies are usually large scale firms, thus enjoy benefit of large scale production associated with low average costs. This in turn leads to low prices for their products.
- **Contributes revenue to the government.** Since monopolies earn abnormal profits both in the short run and long run, corporate tax on their profits helps government raise revenue necessary to finance public expenditure.
- **Research and development.** Since monopolies enjoy abnormal profits always, they are in

position to raise funds to finance research. Through this, new and efficient methods of production are discovered.

- **Promote dumping.** International monopolies have the tendency to sell their products in foreign markets especially LDCs at lower prices than in the home market. In this way it enables the people in LDCs to consume wide range of industrial products.
- **Provide essential goods and services.** Public monopolies provide essential goods and services like water, electricity etc at relatively cheaper prices. This improves the standard of living in the country.
- **Improves infrastructure.** Monopolies promote infrastructure such as roads, railways etc which promote development of the country.

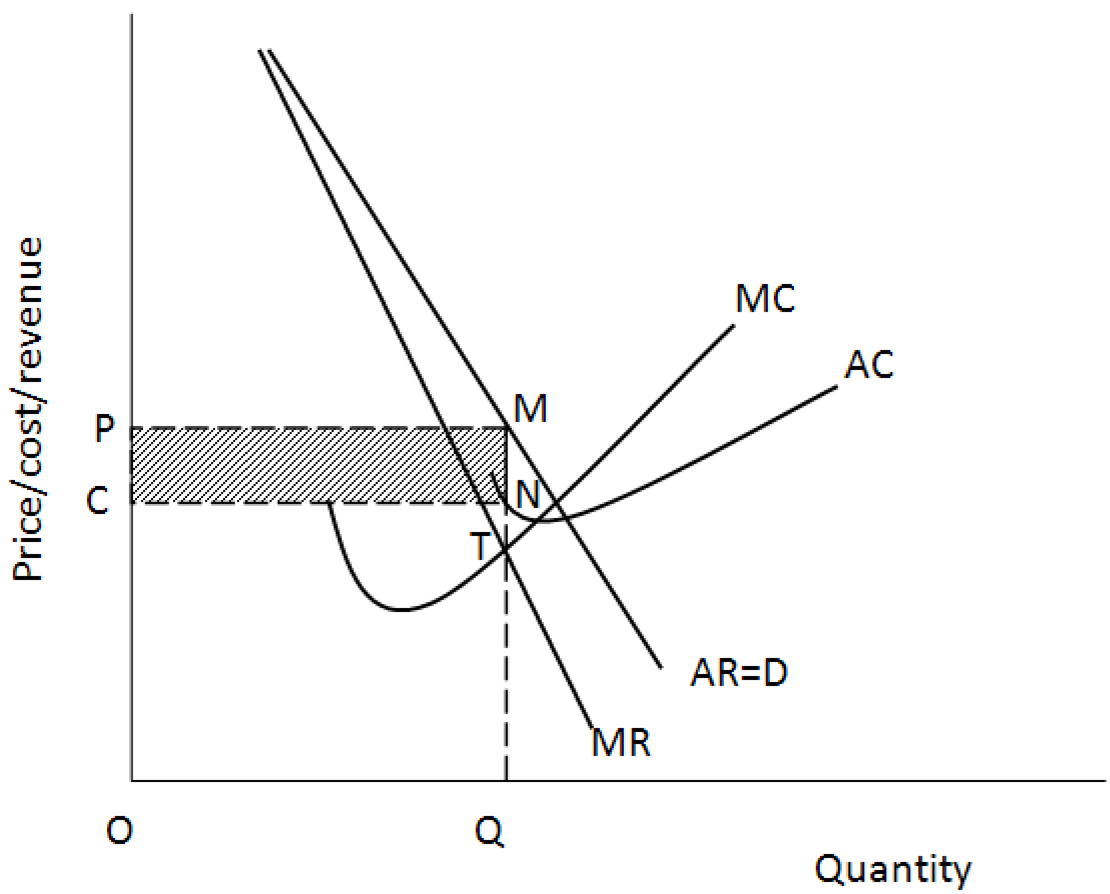
Negative implications.

- **Leads to exploitation of consumers.** Since monopoly is the only firm in the industry, it has the tendency to charge high price for its product which lead to consumer exploitation.
- **Produces poor quality product.** Due to lack of competition, monopolist is not put on his toes to improve the quality of his product. Thus consumers are charged high prices for low quality product. This reduces the welfare of the people in the country. Take the example of UMEME which charges high price for electricity but with frequent load shedding.
- **Under utilization of resources.** Monopolies usually operate at excess capacity leading to under utilization and wastage of country's resources.
- **Lead to unemployment problem.** Due to existence of excess capacity, there is under utilization of resources including labour. This leads to unemployment in the country.
- **Shortage of commodity in case the firm closes down.** Since monopoly firm is the only supplier in the market, if it closes down the commodity will disappear from the market. If the product is an essential good or service the society is bound to suffer. The decision by Uganda railways to close passenger services greatly affected people who were already used to it.
- **Negative effect on government decision.** The monopolist may use its market power to influence government decision in its favour. It may demand for long tax holidays, more government subsidies and low tax which instead strain government budget.
- **Limits industrial growth.** Monopoly puts barrier to entry of new firms. In this way, it limits expansion of industrial sector in the economy.
- **Dumping by international monopolies kill local firms.** The practice by foreign monopolies to sell their products cheaply in the markets of LDCs has killed local industries.

18. a) With help of a diagram explain how a monopolist firm maximizes profits.

b) Explain how monopoly power can be controlled in your country.

Monopoly is a market structure characterized by existence of a single producer of a commodity or service with no close substitutes. Since there is barrier to entry of new firms into the industry, monopoly firm enjoys abnormal profits, both in the short run and long run.



- The monopolist is in equilibrium where MC=MR producing output OQ
- Price per unit is determined by extending the output line to the AR curve at OP
- Cost per unit is determined by extending output line to AC curve at OC
- The firm produces each unit OC and sells at OP making normal profits

b) **How monopoly power can be controlled.**

By prohibition. The government can pass legislation or anti-trust laws banning formation of monopolies. It can also ban combination of firms and cartel arrangements among oligopoly firms.

- **By encouraging establishment of rival firms.** The government can establish firms to compete with the existing monopoly firm. The government can also encourage liberalization of the economy to open public monopolies to private competition.
- **By nationalization.** The government can transfer ownership of private monopolies to public ownership. State monopolies will act in public interest and will not exploit the consumers.
- **By fixing maximum price.** The government can fix maximum price above which a monopolist should not sell. This will reduce the capacity of the monopolist to discriminate price.
- **By imposing high taxes on monopoly profits.** The government can impose high corporate tax on monopoly profits and use the revenue to provide goods and services that benefit the

public such as health care, education roads among others.

- **By reducing period of patent.** The government can shorten the period of patent to allow competitors to enter the industry. It can also shorten the period a firm can enjoy government protection against foreign competition.

Question 19. (a)Examine the conditions necessary for price discrimination

(b) What are the implications of price discrimination in an economy?

Price discrimination is the charging of different prices to different customers for the same type of commodity by the monopolist for reasons not associated with differences in costs.

Conditions for success of price discrimination

- **Producer must be a monopolist.** Discrimination is possible when there is a single seller and that seller has complete control over the supply of the commodity. You either buy his/her commodity or you get it no where.
- **Markets must be kept separate.**
  - The monopolist must be able to divide and keep his/her markets separate. Buyers paying higher price should not easily access the low price market.
- **The cost of keeping the markets separate must be low.** The purpose of discrimination is to increase the revenue of the monopolist. If the costs of separating the markets are high it will neutralize the benefits of practicing price discrimination.
- **Product must be differentiated**. This will make it possible for the seller to charge different prices for each type e.g. seats in the stadium are classed.
- **Buyers must be ignorant.** Buyers must not be aware of prices charged on others for the same commodity. The buyer should not be aware of other markets.
- **Differences in elasticity of demand**. The elasticity of demand in the separate markets should be different so that low price is charged in market with elastic demand and high price in the market with inelastic demand.
- **Same marginal revenue**. Marginal revenue in the separate markets should be the same to ensure that the seller does not incur losses in any of the markets.
- **Resale should not be possible.** Those facing low prices must not be able to resale in the high price market.
- **Absence of government control.** The government should not fix maximum price beyond which the commodity should not be sold.

Positive implications of price discrimination.

- **Redistributes income**. Since the rich are charged more than the poor, the income gap between the two groups is reduced.
- **Facilities consumption by the poor.** It permits the poor to consume the same commodity with the rich, which would have been impossible if a single price were charged.
- **Increase revenue to the monopolist.** The surplus in the high price market is sold in the low

price market thus increased revenue.

- **Promotes efficiency of firms.** The high profit earned by a firm through price discrimination maintains the efficiency of the firm.
- **Promotes economic welfare.** Discrimination permits the provision of public utilities where the rich are charged high price and the poor subsidized. Thus the welfare of the poor is improved.
- **Facilitates dumping.** Discrimination permits selling of goods abroad at lower price than at home. This expands market.
- **It enables production of a commodity for which no single price can cover total cost.** Without discrimination society would be deprived of certain services or goods. e.g. charging different fees to different clients, a private doctor is encouraged to stay in private practice.

Demerits of price discrimination

Leads to unstable prices for goods in the market. It leads to exploitation of consumers especially those who are charged high prices.

Poor service may result. Those charged low prices may be offered poor quality services compared to those who are charged high prices.

Leads to income inequality. The monopolist generates excessive profit from this practice and will be of higher income than producers under competition.

Encourages dumping. This destroys the economies of other countries by out competing local industries.

It may lead to diversion of resources from their socially optional use.

May lead to resource wastage when people are made to pay higher prices for smaller quantities.

Question 20. (a) What are the features of oligopoly firms?

(b) Explain how output, price and profits are determined in the oligopoly industry.

Oligopoly is a market structure characterized by existence of few large firms. Each firm has substantial market share to prevent it being a price taker neither is it so dominant to become a price maker. Therefore these firms prefer to engage in non-price competition.

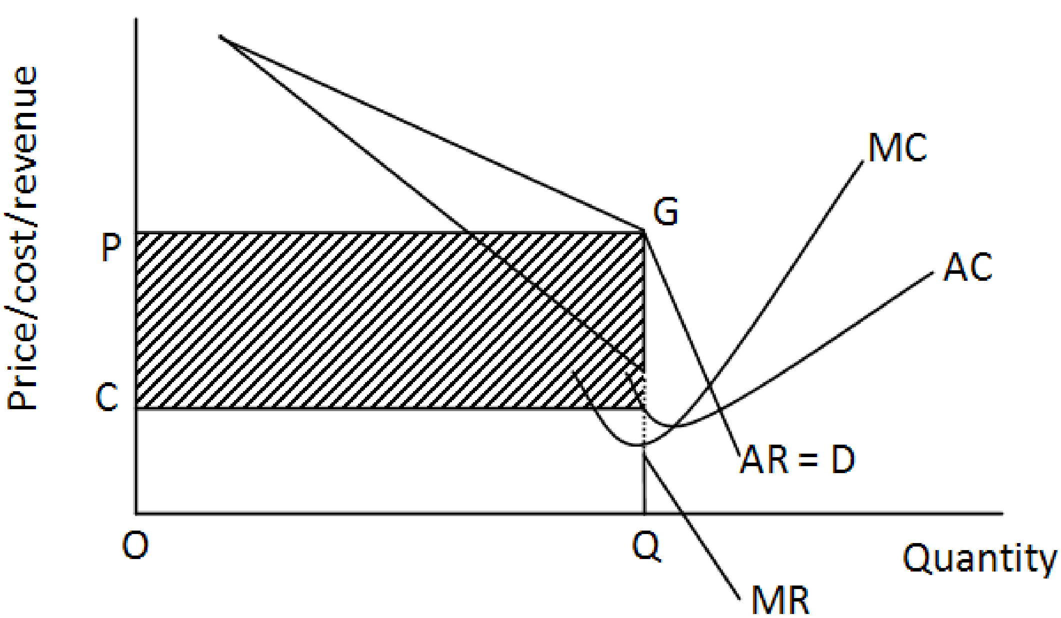
(a) Features of oligopoly firm

- **Few firms in the industry**. Few large firms each with substantial market share dominate the industry. Just few firms contribute the total supply.
- Homogeneous products in the case of perfect oligopoly and differentiated products in the case of imperfect oligopoly.
- **Restricted entry of new firms in the industry**. Because the few existing firms are large, this act as strong barrier to entry of new firms. They may not afford to compete with the established firms, which already enjoy low cost advantages.
- **Price leadership.** Sometimes the few firms may agree to follow the price set by the leading

firm in the industry.

- **Mutual dependence/collusion.** Sometime these firms may informally agree to work together especially in price determination. This agreement by the oligopoly firms to work together is referred to as cartel.
- **Price maker.** Since oligopoly firms have control over the market for their products, they have the power to fix price.
- **Kinked demand curve.** This reflects price rigidities in the oligopoly industry. The upper section of the curve is elastic and represents what happens if the oligopoly firm initiates an increase in price. The lower part is inelastic and indicates how unbeneficial it will be for the oligopoly firm to cut price.
- **Existence of cut throat competition.** This is reflected by the massive advertisement expenditure.
- **Existence of non-price competition.** Since it is not beneficial for the firms to engage in price wars, they usually engage in competition using other means that does not involve price change. For example giving gifts, after sales service, etc.

(b) Like other producers, an oligopoly firm is in equilibrium where marginal Cost (MC) is equal to marginal revenue (MR). i.e. MC = MR



The oligopoly firm is in equilibrium at Point T where MC = MR producing output OQ.

Price per unit is determined by extending the output line to the AR curve to determine price at OP.

Cost per unit is determined by extending the output line to the AC curve at OC. Thus the firm is producing each unit at OC and sells at OP making abnormal profit indicated by the shaded area.

NB the MC and AC curves must pass through the disjointed part of the MR curve.

SECTION A

45. (i) Define the term "production".

(ii) Mention any three agents of production in your country.

A. (i) Production refers to any activity that leads to output of goods and services.

Or The employment of factors of production to create goods that satisfy needs.

(ii) **Agents of production.**

- Land that is, all resources provided by nature.
- Labour that is, human effort both physical and mental that aid in production.
- Capital i.e. produced means of production.
- Entrepreneurship i.e. management skill in labour.

46. (i) What is meant by specificity of a factor of production?

(ii) How does degree of specificity of a factor affect its mobility?

A. (i) Specificity of a factor of production refers to a situation where by a factor of production can perform a particular task it is designed to perform in case of capital or trained to perform in case of labour and cannot perform other tasks.

(ii) When a factor of production is specific it becomes occupationally immobile because it cannot perform other tasks it is not meant to. For example combined harvester is only designed to harvest and cannot plough.

47. (i) What is meant by factor prices?

(ii) Name three different factor prices in an economy.

A. (i) Factor prices refer to the monetary rewards to factors of production for their contribution in production process.

(ii) Factor prices include:

- Wages/salaries for labour
- Rent for land.
- Interest on capital.
- Profit for entrepreneurship.

48. (i) What is meant by "factor mobility".

(ii) Give any three barriers to factor mobility in Uganda.

A. (i) Factor mobility refers to the ease with which a factor of production can move from one occupation to another or from one geographical location to another.

ii) **Barriers to factor mobility in Uganda.**

- High cost of movement.
- Social ties/great attachment to tradition.
- Imperfect knowledge of other places.
- Specificity of some factors.
- Prejudice/discrimination in job market.
- Advanced age of the worker.
- High cost of accommodation.
- Professional regulations that restrict entry of new members.
- International and national restrictive migration laws.
- Personal considerations/reluctance to move.
- Lack of required skills.
- Physical and mental incapacitation.
- Shortage of capital.
- Stage of children's education.

49. Differentiate between transfer earnings and economic rent in relation to land as a factor of production.

A. Transfer earnings in relation to land are the payment to land as a factor of production which is necessary to keep it in its present use OR the supply price of land.

Whereas

Economic rent is the payment made to a factor (land) which is over and above what is necessary to keep it in its present use.

OR payment to land over and above its transfer earnings or supply price.

50. Explain the meaning of the following terms:

(i) Industrial inertia.

(ii) Localization of industries.

A. (i) Industrial inertia is the tendency of industries to continue to locate in a particular area even when the factors of location are no longer favourable. With this inertia, industries can concentrate in a particular place together with their subsidies.

(ii) Localization of industries is the concentration of many firms in a particular area or region.

Or

Specialization by area or region in the location of industries or firms. Reasons for localization could be due to presence of market, raw materials etc.

51. (i) Distinguish between horizontal integration and vertical

(ii) Give any two advantages of horizontal integration of firms

A (i) Horizontal integration is the combination/merger of two or more firms at the same stage of production in the same industry.

Whereas

Vertical integration is the combination of firms at different stages of production in the same industry.

(ii**) Advantages of horizontal integration**.

- Increased skills.
- Specialization is promoted.
- Increased capital base.
- Reduced competition for market.
- Eliminates duplication of goods and services.
- Increased access to capital/loan.
- Reduces cost of advertisement.
- Research is possible due to combined resources.
- Sharing of risks.
- Increased output/profits.
- Improved efficiency in management.
- Reduced prices due to economies of scale.

52. (i) What is meant by subsistence output.

(ii) Give three demerits of large subsistence sector in your country.

A. (i) Subsistence output is the output meant for the producer's own consumption and not for market.

(ii) **Demerits of large subsistence sector.**

- Leads to low incomes to producers.
- Leads unemployment and under employment.
- Leads to low output due use of poor technology.
- Causes low tax revenue due to low tax base.
- Low capital accumulation.
- B.O.P. problem due to low exports.
- Discourages investment due to low aggregate demand.

- Poor quality output due to poor production technique.
- Low rate of economic growth and development.

53. (i) Distinguish between excess capacity and over production.

(ii) Give two causes of excess capacity in your country.

A. (i) Excess capacity is a situation where a firm or industry operates below its full capacity.

Whereas

Over production is a situation where a firm or industry produces more than what the available market can take.

Or

A situation where supply exceeds demand.

(ii) **Causes of excess capacity.**

- Shortage of raw materials.
- Limited size of market
- Political instability.
- Shortage of skilled personnel.
- Lack of required spare parts.
- Desire by entrepreneurs to make profits by restricting output.
- Use of poor technology/deterioration in technology.
- Poor management/lack of management skills.

54. (i) What is meant by productivity of labour?

(ii) Mention any three factors which determine the productivity of labour.

A. (i) Productivity of labour refers to the output both quantity and quality labour can produce in a given period of time. It is also known as efficiency of labour.

(ii) Factors that determine productivity of labour

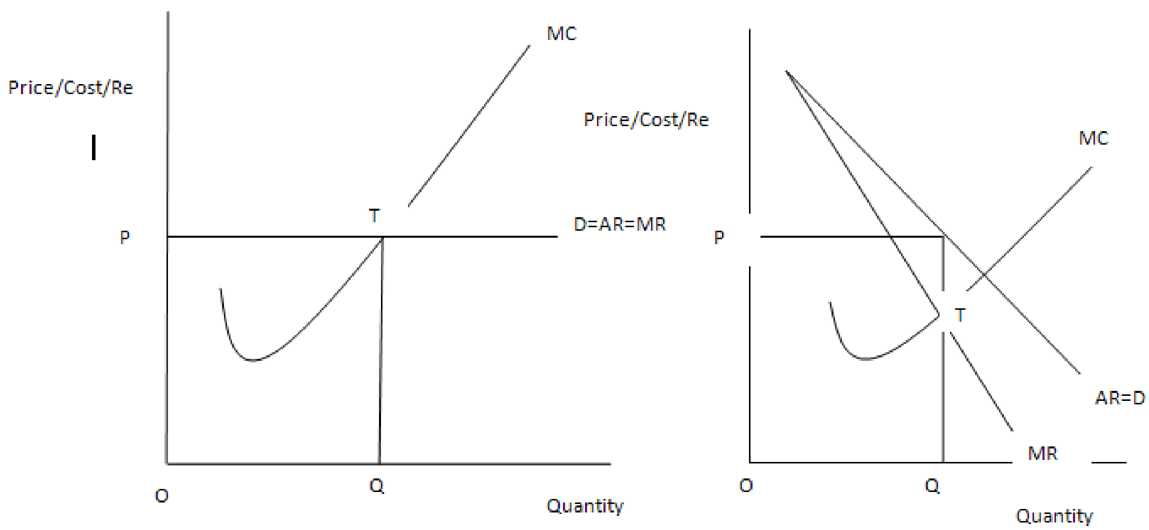
- Physical ability of labour.
- Remuneration/wages paid.
- Level of supervision.
- Efficiency of co operant factors.
- Level of motivation.
- Worker's attitude towards work.
- Level of education/training.
- The working hours.

- The health condition of the worker.
- Level of division of labour/specialization
- Level of technology.

55. With the help of diagrams distinguish between the short run equilibrium position of a monopolist and that of a firm under perfect competition.

A. Both monopoly and perfect competition are in short-run equilibrium

where SMC = MR



Monopoly firm is in equilibrium at point T where SMC = MR perfect competition is n equilibrium at point T where SMC = MR and SMC curve MR from below.

The difference in equilibrium of the two firms is in the nature of AR and MR curves. For monopoly MR falls below AR while for perfect competition MR = AR.

56. At what point of the demand curve does a monopoly fix his price?

The firm is in equilibrium where MC = MR. A monopolist will always have an output at a price when is inelastic and MR is positive. A monopolist cannot produce output beyond point A and can never charge price below P_1 thus a monopolist always restricts output towards the origin O because of the influence of elasticity of demand and where MR is positive A_1 MR is negative.

57. Distinguish between:

(i) Over head costs and prime costs.

(ii) Average fixed costs and average variable costs.

A. (i) Over head costs are the monetary expenses of production which do not vary as output changes i.e they remain constant as output changes. They are also known as fixed or indirect or supplementary costs.

Whereas

Prime costs are monetary expenses of production which are directly related to output ie changes directly with changes in output and becomes zero when output stops. It is also known as variable costs or direct cost.

(ii) Average fixed cost is the total fixed cost per unit of output.

Whereas

Average variable cost is the total variable cost per unit of output.

58. With examples distinguish between implicit cost and explicit cost.

A Explicit costs are costs which the firm is contracted to pay and are included in the calculation of the profit of the firm. Examples included wages, rent, electricity, raw materials etc.

Whereas

Implicit costs are costs which are not in included in the calculation of the profits of a firm. Such cost cannot be easily computed in monetary terms e.g. entrepreneur's own effort in the business, use of the owner's own resources such as land, building etc rather than hire them.

59. (i) Distinguish between marginal cost (MC) and marginal revenue (MR).

(ii) Give two relevancies of MC and MR in the theory of the firm.

A.(i) Marginal cost is the cost incurred in producting one additional unit of a commodity

Whereas

Marginal revenue (MR) is the amount received from the sale of each additional unit of output.

Or

Change in total revenue due to increase in sales by one unit.

(ii**) Relevancies of MC and MR in the theory of the firm.**

- They help determine equilibrium of the firm i.e. equilibrium occurs where MC = MR.
- Help to determine whether a firm is making profit or loss on each additional unit.
- Influence the decision on weather to increase or reduce output.

60. Distinguish between:

(i) Pure competition and perfect competition.

(ii) Monopoly and monopolistic competition.

A.(i) Pure competition is an ideal market which exists without any form of imperfection.

Whereas

Perfect competition is a market structure characterized by existence of many buyers and sellers of identical/homogeneous product with limited or no government. The number of producers is so large that output of only one seller is negligible fraction of total output.

(ii) Monopoly is a market structure characterized by a single seller of a commodity without close substitutes.

Whereas

Monopolistic competition is a market structure characterized by existence of many producers of differentiate products .

61. Give any four measures to regulate monopoly power.

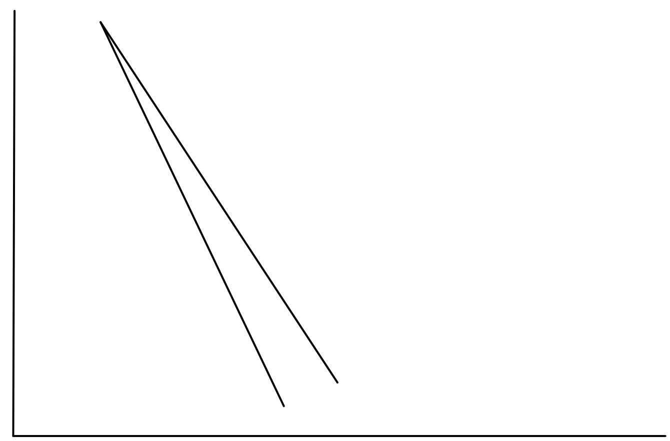
- Price control/legislation ie fixing a low maximum price.
- Taxation policy ie imposing lump sum tax which increases average cost but without effect on price and output.
- Anti-trust laws ie banning the setting up of monopolies.
- Nationalization ie government can take over the running of monopolies to reduce their effects.
- Setting up rival firms to compete with private monopolies.
- Removal of monopoly base ie remove protectionist policies.

62. Explain the effects of these taxes on monopoly profits.

(i) Lump-sum tax.

(ii) Specific tax.

A. (i) A lump-sum tax is a tax of a given amount irrespective of the level of output. It affects only the AC curve which shits upwards leaving MC unaffected.



Imposition of a lump-sum tax shift AC curve upwards to AC_2. This increases cost per unit from OC to OC_1. Since price and output condition remain unchanged, the entire burden of the lump-sum tax is born by the monopolist profit margin reduces from CPBR to C_1PBK

(ii) Specific tax. This is the tax levied per unit of output. It affects both the average cost and marginal cost. i.e. both will shift upwards.

AC curve shifts upwards to the left from AC_1 to AC_2 MC curve shifts from MC_1 to MC_2.

Output falls from OQ_0 to OQ_1. Prices rise from OP_1 to OP_2.

Profits reduce from $C_1P_1A_1B_1$ to $C_2P_2A_2B_2$. Equilibrium shifts from E_1 to E_2.

63. (i) What is meant by non-price competition.

(ii) Give three forms of non-price competition your country.

A. (i) Non-price competition is the situation in the oligopoly industry where firms complete using other means rather than price.

(ii) **Forms of non-price competition.**

- Provision of gifts to customers.
- Sales promotion.
- Branding of the product.
- Packaging the product.
- Provision of after sales services.
- Free offers to customers.
- Advertising the products.
- Sponsorship of sports, charitable events etc.
- Giving credit to trustworthy customers
- Distributing sample of their products.
- Offering free transport to customers who buy in bulk.

64. (i) What is oligopoly.

(ii) Give any three merits of oligopoly market.

A. Oligopoly is a market structure characterized by existence of few large firms. If the few firms produce similar products it is known as perfect Oligopoly; if the products are differentiated then it is imperfect oligopoly.

(ii) **Merits of Oligopoly**.

- Stable prices due to price rigidity.
- Provision of efficient services due to competition.
- High quality goods are produced.
- Provision of gifts.
- Provision additional free services.

65. (i) What is price leadership.

(ii) Give any three methods of price determination under oligopoly market.

A. (i) Price leadership is a method of price determination in oligopoly industry where the leading firm sets price and other follow.

(ii) **Methods of price determination.**

- **Independent pricing**. This is where each firm sets its own price leading to price wars.
- Perfect collision (cartel arrangement).
- Imperfect collision (price leadership).

66. (i) With reasons classify the market structure of the petrol industry in Uganda.

(ii) In which way is the price of Saudi Arabia's crude oil related to the price of bananas in any Kampala market?

A. (i) Petrol industry in Uganda is under perfect oligopoly market structure. This is because they are relatively few in number, sell homogeneous products and prices are almost the same in all.

(ii) The price of crude oil in Saudi Arabia is related to price of bananas in any Kampala market in that Uganda is a net importer of oil. The price of petroleum products in Uganda will increase, leading to increase in transport costs for all products including matooke forcing the sellers in the market to increase price.

67. (i) Define location of industries.

(ii) Why should the government influence the location of an Industry?

A. (i) Location of industries refer to selecting the site where industries should be established.

(ii) **Why government should influence location of industries.**

- To achieve balanced industrial development.
- Desire to reduce income inequalities.
- Desire to reduce rural-urban migration.
- To achieve personal interest of political leaders in government.

68. (i) What is price discrimination?

(ii) State three necessary conditions if price discrimination is to succeed.

A. (i) Price discrimination is the selling of the same type of commodity or service to different consumers in different markets at different prices by the monopolist for reason not associated with differences in costs.

(ii) **Conditions for the success of price discrimination.**

- Production is undertaken by a monopolist.
- The different markets must be kept separate.
- The cost of separating the markets must not be high
- The buyers must be ignorant of other markets.

- The marginal revenue must be the same in all the markets.
- The government must not intervene in the market to control price.
- The products must be differentiated so that it possible to charge different prices.
- It must not be possible for those facing low prices to resale in high price market.
- Elasticity of demand should different in different markets.
- Marginal revenue should be the same in all markets so that the monopolist does not incur losses in any market.

69. (i) Distinguish between partnership and a public limited company.

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

A. (i) **partnership** is a business organization whereby two to twenty (or two to fifty in case of professionals) people pool their resources in a common enterprise for the purpose of producing with a view to earning profits.

Whereas

Public limited company is a business organization formed by minimum of seven but no maximum number of shareholders run a business for profits.

Advantages of partnership.

- Diversity of talents is attracted into the business compared to sole proprietorship.
- Division of labour and specialization is possible.
- Easier to form as compared to companies.
- Enjoys privacy of account unlike public limited companies.
- Larger capital than sole proprietorship.

70. (i) What is meant by demand for labour.

(ii) Mention any three factors which determine the demand for labour.

A. (i) Demand for labour refers to the number of workers the employers are willing to offer jobs and retail in employment in a given period of time.

(ii**) Factors which determine demand for labour.**

- The level of demand for products of labour ie demand for labour is derived demand.
- The level of wages.
- The productivity of labour.
- The proportion of cost of labour to the total cost of the product.
- The ease of substituting labour for other factors.
- The availability of co operant factors with which labour works.

- The level of skill.

71. (i) Define "localization of industries".

(ii) State any three problems, which result from localization of industries.

A. (i) Localization of industries refers to the concentration of many industries/firms in the same area/region.

(ii**) Problems of localization.**

- May lead to diseconomies of scale.
- Causes regional imbalance.
- Rural urban migration is encouraged.
- May lead to structural unemployment in the event of production stopping.
- Encourages dependence ie the economy becomes reliant on localized area.
- Leads to environmental degradation e.g. pollution.
- Exhaustion of resources due to over exploitation by many industries.

72. State any four factors that give rise to monopoly in your country.

- Granting Patent right/copy right.
- Merging/integration of firms.
- Exclusive ownership of strategic raw materials.
- Act of parliament leading to statutory monopoly.
- Long distance from competitors.
- Dumping of cheap products by international firms.
- Competition among firms; most efficient firm in the long run gains monopoly status.
- Large initial capital requirement; limiting the would be competitors.
- Possession of special talent.
- Limited market which makes a single producer suitable.
- Ignorance of potential competitors.
- Exclusive knowledge of production techniques by a firm.
- Protectionist policy of government making domestic firms local monopolies.

73. What is meant by international cartels? Give one example of an international cartel.

A. This is the organizations of countries producing similar commodities formed for the purpose of increasing prices for the members by subjecting their competitive tendencies to some form of control: examples of international cartel include:

- Organization of Petroleum Exporting Countries (OPEC).

- International Coffee Association (ICA)

74 (i) Distinguish between breakeven point and shut down point of a firm.

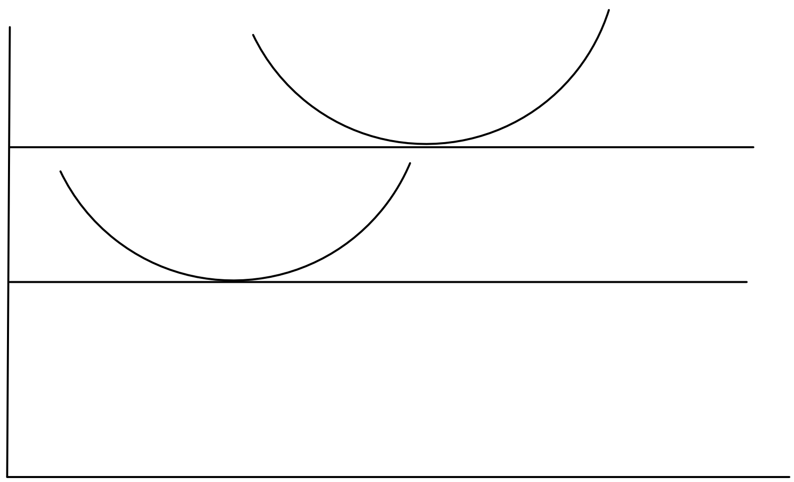
(ii) State any two reasons why a firm may continue to operate below the break even point.

A. (i) Break even point is that point corresponding to the level of output of a firm where a firm neither makes supernormal profits nor losses. It makes only normal profit and its (MC = AR = AC).

Whereas

Shut down point of a firm is the level of output where the firm makes loses but in position to cover average variable costs of operation. ie when its

AR = AVC (MC = AVC = AR)



Point B is the break even point corresponding with output Q_2 where (AR_2 = AC). The firm neither makes losses nor earns super normal profits ie it makes only normal profits. For any output less than Q_2, Losses will be incurred because AC will be above the AR curve.

Point A is the shut down point corresponding with level of output Q_1. At point A_1, AVC is tangent to AR at its lowest point ie AR = AVC. A firm cannot produce less than Q_1 because if it does so, it will not be in position to cover variable costs.

(ii) **Why firms continue to operate below break even point.**

- When it has hope of securing a bank loan.
- If the difficulties of the firm are of short term nature.

- When a firm hopes to change its management.
- If a firm fears to lose its specialized skilled workers.
- If a firm hopes to promote its product through advertisement.
- If a firm fears to lose its customers to the rival firms.
- If closing is more expensive than remaining in operation.
- When a firm is a beginner firm.
- When it has hope to restructure its workers.
- If its objective is not profit maximization.

75. Explain why Average Total Cost (ATC) curve of a perfect competition firm is U-shaped in the:

(i) short-run.

(ii) Long-run.

A. (i) ATC curve is U-shape in the short-run because of the law of diminishing returns where one factor is fixed and another is allowed to vary. As successive units of variable factor are added to a fixed factor, total product, average product and marginal product first increases, reaches a maximum and diminishes.

(ii) Average Total Cost (ATC) is U-shaped in the long-run due to economies and diseconomies of scale. In the long-run there is no fixed cost and as a firm expands output, AC first falls due to economies of scale. As expansion surpasses optimum level, cost per unit begins to rise due to diseconomies of scale.

76. Mention four demerits of nationalization.

- Leads to monopoly power and exploitation of consumers.
- Nationalized firms are characterized by existence of bureaucracy.
- Lack of profit incentives thus inefficiency.
- Political interference in operation of nationalized firms.
- Associated with corruption.
- Leads to high government expenditure to support its operation.
- Low employment opportunities due to excess capacity.
- Low output due to inefficiency.

77 (i) Differentiate between commercial rent and economic rent.

(ii) Given that a factor of production receives transfer earning of Ug.Shs. 100,000 and its economic rent is twice its transfer earnings, calculate the factor's actual earnings.

A. (i) Commercial rent is the payment made for the hire and use of durable assets for example plot of land, house, TV etc.

Whereas

Economic rent is the payment made to a factor of production, which is over and above what is necessary to keep it in the present use.

Or

Payment to a factor of production which is over and above its transfer earnings or supply price.

(ii) TE = UG. SHS. 100,000

ER = 2(TE) = 2(100,000) = 200,000

Actual earnings = TE + ER

= 100,000 + 200,000

= Ug Shs. 300,000

78. (i) Define the term "Marginal Revenue"

(ii) State the relationship between average revenue and marginal revenue of perfect competition firm.

A. (i) Marginal Revenue is the amount received from each additional unit of output sold.

Or

Change in total revenue due to increase in sales by one unit.

(ii) The relationship between marginal revenue and average revenue under perfect competition is that MR and AR are equal. This is because any additional unit must be sold at the same price since the firm is a price taker.

79. Mention four problems faced by public enterprises in your country.

- Poor management leading to inefficiency.
- Stiff competition from the private sector.
- Bureaucratic delays/slow decision making.
- Interference by politicians in the running of the enterprises.
- Limited commitments and interests on the part of workers and management.
- Foreign interference by IMF demanding privatization.
- Political instability affecting normal operations.
- Poor infrastructure.
- Corruption/lack of proper accountability.

80. Mention any four problems faced in privatization of public enterprises in your country.

- Opposition from the public.
- Opposition from the politicians.
- Dilapidated state of the enterprises making it difficult to sale.
- Poor valuation of the enterprises. Some are sold at give away prices.
- Corruption in the privatization units.
- Scrupulous foreign buyers who are only interested in the assets.
- Political instability in some areas where the enterprises are located; thus scaring the potential buyers.
- Poverty of the local people leading to selling to foreigners.

81. (i) State the law of variable proportions.

(ii) State three assumptions underlying the law of variable proportions.

A. (i) The law states that if successive units of variable factor are added to a fixed factor, total product, marginal product and average product will first rise, reach a maximum and decline

(ii) **Assumptions of the law:**

- It assumes a short-run period.
- It assumes there is a fixed factor.
- There is available factor.
- Technology is constant.
- All units of variable factor are homogenous and equally efficient.

82. (i) Distinguish between quasi rent and economic rent.

(ii) Why are payments for land always considered economic rent?

A. (i) Quasi-rent is the payment to a factor of production which is economic rent in the short-run and transfer earnings in the long-run. It occurs when the factor has a relatively inelastic supply in the short-run but elastic in the long-run.

Whereas

Economic rent is the payment made to any factor of production, which is over and above what is necessary to keep the factor in its present use. OR

Payment to a factor of production which is over and above it supply price or its transfer earnings.

Payment for land is economic rent because land is a free gift whose supply price is zero.

Factors that influence level of economic rent.

- The level of demand for a factor of production.

- The supply price/transfer earnings of a factor.
- Elasticity of demand for the factor.
- Degree of substitutability of the factor.
- Degree of specificity of a factor.
- The elasticity of supply of a factor.

83. (i) Differentiate between marginal product of labour and the average product of labour.

(ii) Mention any two factors which may increase average product of labour in an economy.

A. (i) Marginal product of labour is the output derived from each additional unit of labour employed.

Or

The change in total product due to employment of one extra-unit of labour.

Whereas

Average product of labour is the total output per unit of labour.

(ii**) Factors which increase average product of labour.**

- Improvement in the working conditions.
- Increases in wages/remuneration.
- Improvement in quality of co-operant factors e.g. capital.
- Improvement in the quality of management/supervision.
- Increase in labour's skills/training.
- Increase in worker's experience.
- Improvement in welfare service.

84. (i) Differentiate between normal profit and supernormal profit.

(ii) Give two determinants of profit in Uganda.

A. (i) Normal profit is a reward to an entrepreneur which is just sufficient to cover total costs or keep him in production without inducing other firms to enter the industry.

Whereas

Supernormal profit is the excess earnings to a firm/entrepreneur over and above normal profit.

Or

Situation where total revenue is greater than total cost.

(ii) **Determinants of normal profit.**

- Price level.
- Cost of production.
- Degree of risks and uncertainties.
- Level of output/supply.
- Market size/demand.
- Level of competition/ease of entry of new firms in an industry.
- Level of entrepreneurial skills/organizational abilities.
- Cost of production.

CHAPTER NATIONAL INCOME(NY)

Question 21. (a) Explain the approaches used in calculating National Income Statistics.

(b) Examine the factors that determine a country's National Income.

There are three methods used in compiling National Income statistics. These approaches should give nearly the same figure of GNP. But due to errors, some slight variations can occur. This is why identity rather than equal signs are used to equate the three approaches.

Output/Product/ Value added approach (O). This considers the total monetary value of all goods and services produced in an economy in a given period of time. For simplicity the economy is divided into sectors and the monetary value of output from each sector is added and for all sectors are summed up to get the total National Income i.e. GNP = O. When using this method we must consider value of final products only to avoid double counting.

Income Method (Y). This considers the various incomes received by the factor services in production. For instance labour receives wages (W), land receives rent (R), Capital receives interest (I) and entrepreneur receives profit (π). If we total these entire factor monetary rewards received in a year, we get the total National Income i.e.

GNP = W + I + π + R = Y. When using this method we consider only income received from services of factors of production. Government transfer payment is not included because this represents a redistribution of income. If such payments are included, it would result in double counting because the government raises the money to subsidize the poor by taxing the rich.

Expenditure method. This considers the various area where the income received is spent i.e. households will spend on purchase of goods and services (C), firms spend on invest (I), government expenditure on investment and consumption (G,) revenue from export (X) less expenditure on imports (M). If all these expenditures are added, we get total National Income i.e. GNP = C +I + G + (X-M) = E. When using this method we add only expenditure on final goods and services. Expenditure on intermediate goods and services are not included to avoid double counting.

Therefore since GNP = O, GNP = Y and GNP = E the O = Y and Y = E but due to errors we use identity signs hence $O \equiv Y \equiv E$

Factors that determine a country's National Income

- **The size of capital stock.** If the country's size of capital stock in form of machines, roads and factories is large, the national income rises through massive production. On the other hand if the stock of capital is small production will be limited.
- **Political Climate.** If a country is politically stable, this provides a conducive environment for increased investment and production to take place leading to high growth in size of a country's National Income. Political instability will have negative effect on investment and production.
- **Level of infrastructural development.** If a country has good infrastructure it will permit production to take place leading to increased National Income. Poor infrastructure would discourage such activities.
- **Size of market.** A large market for a country's product both domestic and foreign will stimulate expansion in production to satisfy such market thus increased income. Small market size limits large scale investments and National Income shrinks.
- **Availability of natural resources.** If a country is well endowed with valuable natural resources full exploitation of these resources will lead to increased National Income compared to a country that lacks such resources.
- **Entrepreneurial abilities.** If the level of management skills is high the National Income will be bigger than when a country lacks such skills.
- **The level of organization.** A country may be well endowed with valuable resources but the level of organization in respect to the use of these resources in important in influencing the size of National Income.
- **The level monetization of the economy.** When the economy is highly monetized, the output will be big due to large market. This leads to increased National income. If the economy is predominantly subsistence so that much of the production is for home use the National Income will be low.
- **Cultures and customs of the people.** When the people's culture and traditions are rigid, the national income will be low because people will be less willing to adapt to changes. If people's culture is flexible, they will readily accept new production techniques and level of National Income will be high.
- **Population growth rate.** When the population growth rate is high the level of national income will be low due to high dependency burden. The necessity of catering for the high population limits investment. Slow population growth rate on the other hand increases level of national income by permitting capital accumulation.
- **The Terms of Trade.** When a country's terms of trade is favourable more will be earned from export relative to expenditure on imports. The surplus earned from export increases income at home. Deteriorating terms of trade on other hand reduces national income.
- **Level of human resources availability.** If the country has large number of highly skilled labour more

output will be produced leading to high incomes.

Question 22. (a) Why does your country compile national income statistics?

(b) What problems does your country encounter in collecting national income data?

National income is the total monetary value of goods and services produced in a country in a given period of time usually one year. A country compiles national income statistics because of the following reasons:-

- **For planning purposes.** National income figures provide a basis for a country's planning, economic policy review and research.
- **To identify the leading sectors.** The figures help the government in selecting which sectors are doing well and promoting the development of others.
- **To identify the lagging sectors.** By comparing sectoral contributions, the government can identify sectors that are lagging behind and solutions can then be worked out.
- **To identify national expenditure patterns.** It helps government to establish the patterns of expenditure between households, consumption, investment etc. This forms a basis for government budgeting and intervention through expenditure to reduce poverty after knowing how much resources are available for various expenditure patterns.
- **For comparing the performance of a country over time.** By establishing the annual growth rate, a country can discover whether the economy is improving or not.
- **For comparison of economic performance between countries.** It provides statistics for international comparison of economic performance of various countries.
- **To determine the extent of dependence.** It helps in estimating the level of international transactions and the degree to which an economy relies on others in certain aspects.
- **To determine rate of resources utilization.** The figures indicate the extent of resource exploitation in the economy whereby an increase in national income figures results from increased resource utilization and vice versa.
- **To identify resource allocation.** The figures enable government to know how much resources are available for private consumption, private investment, and public investments and for exports and imports. This is important for taxation.
- **To measure per capital income.** If the GNP figures and population figures are known, then per capital income can be calculated by dividing GNP by population. This is useful in measuring welfare and standard of living.
- **For determining income distributions.** The government can use the figure to determine the extent of income distribution in the economy by using the gini co-efficient and Lorenz curve.
- **For seeking foreign aid.** The donors may wish to know the national income of a country to assess the extent of its need for assistance in form of Aid.

Problems Uganda incurs in collecting national income data.

- **Double counting.** This is the counting of economic activity twice. It arises due to failure to distinguish between final and intermediate products.
- **Inadequate skilled man power.** In Uganda there is insufficient skilled manpower to do the

exercise. There is shortage of qualified accountants and statisticians to effectively collect the data.

- **Subsistence production.** There are some activities which are carried out for owners use and not for market. It is difficult to add output from subsistence sector because it has no monetary value. Yet this sector is predominant in Uganda.
- **Timing problem.** It is difficult to determine in which year output produced this year and sold next year should be added. There are some crops which stay in the field for more than a year.
- **Difficulty of determining value of depreciation.** Fixed assets depreciate in value due to wear and tear. The value of depreciation is often estimated. This leads to inaccurate figure of national income.
- **Inadequate statistical information**. Producers and consumers rarely keep records of their transactions. Thus there is no reliable information about what they produce or consume.
- **Frequent price changes**. This affects the value of national income, such that when the general price level rises, the national income shows an increase even though the real output of goods and services have fallen. It is very difficult to adjust the effects of inflation.
- **Errors arising from omissions of transactions in the country**. Not all transactions which take place are included. Income from illegal activities such as smuggling is not added. Transfer payment, capital gain, etc are not added. This leads to under estimation of national income.
- **Difficulties of determining the boundary of production**. It is difficult to determine which goods or activities should be included. The items to be added or excluded vary from country to country. In some countries prostitutions is added while in Uganda it is considered illegal.
- **Problem of determining income from abroad**. It is difficult to determine net income from abroad since import and export trade are carried out by many people with little data available to verify the amount imported and exported by private individuals. There is additional problem of non disclosure.

Question 23. Why is per capita income of USA higher than that of Uganda?

Per capita income means income per person or income per head in a country. It is calculated by dividing GNP by total population. It is often used as an indicator of standard of living or economic welfare. Per capita income of USA is higher than that of Uganda because of the following:-

- **Differences in natural resources endowment**. USA is better endowed with valuable natural resources such as petroleum, iron ore among others. Exploitation of these resources has led to high output and high per capita income than Uganda which is less endowed with those resources.
- **Differences in human resources development.** The population of USA is more educated and better skilled than that of Uganda. This implies that labour productivity is much high in USA than Uganda hence greater output, higher GNP and consequently higher per capita

income.

- **Differences in level of industrialization**. USA economy is more industrialized than that of Uganda. The economy of Uganda is predominantly agricultural. The monetary value of industrial products is much higher than for agricultural products. This puts USA at higher GNP and therefore per capita income than Uganda.
- **Differences in infrastructural development.** USA has well developed infrastructure in the form of better roads, railways and air transport. This has boasted production leading to high GNP and per capita income. On the contrary, infrastructure in Uganda is poor and has discouraged investment leading to low output, GNP and per capita income.
- **Differences in capital accumulation.** USA has greater stock of capital accumulated over years. This has permitted investment in all fields, thus greater output, GNP and per capita income. To the contrary Uganda like other LDCS is capital deficient. This has hindered productive investments in the country.
- **Differences in market size.** USA is a vast country with population of over 259million people compared to Uganda estimated 31 million people. In addition population of USA is composed of people of higher incomes than those in Uganda. This large market has permitted large scale investment leading to greater output than Uganda with small market.
- **Differences in technological advancement.** USA is one of the most technologically advanced nations of the world. This technology has been extended to all sectors of the economy leading to greater output, high GNP and greater per capita. To the contrary Uganda is technologically backward; using primitive technology discarded in the west many decades ago.
- **Differences in supply of entrepreneurs.** Due to good education system, USA has good number of entrepreneurs who have capacity to organize factors of production. This has led to high output in USA. In Uganda entrepreneurs are very limited in supply.
- **Differences in political climate**. USA is more politically stable. This has led to high investor confidence, thus high output. On the contrary much of Uganda is politically unstable, thus discouraging investment leading to low output and low per capita income.
- **Differences in level of monetization.** USA economy is highly monetized with much of economic activities, meant for market. On the contrary Uganda economy is still largely subsistence with much of production meant for home use rather than for market. This has led to Uganda's low GNP since output from subsistence sector is not included in calculation of national income.
- **Differences in climatic conditions.** USA is located in temperate region where the climate permits agriculture to be carried out all year round. On the contrary Uganda is situated in the tropics where extreme heat and humidity has led to declining soil fertility leading to low output, GNP and per capita income.
- **Differences in culture and traditions.** USA culture and traditions has undergone evolution which has made it more acceptable to changes in production techniques. To the contrary, Uganda's traditions are rigid and do not easily open up to new production techniques. This

has led to stagnation leading to persistent low productivity.

- **Differences investment climate**. Returns on investment in USA are much higher than in LDCs like Uganda. This has attracted more multinational corporations to invest in the USA economy.

Qn.24 (a)Distinguish between Gross National Product and Gross Domestic Product.

(b)Explain why income per capita is not a good indicator of economic welfare and standard of living.

Gross National Product (GNP) is the total monetary value of all goods and services produced by the national of a country both within the country and abroad in a given period of time usually one year

Whereas

Gross Domestic Product (GDP) is the total monetary value of all goods and services produced within the boundaries of a country by both nationals and non-nationals in a given period of time, usually one year.

Why per capita income is not a good indicator of economic welfare.

- **Does not take into consideration people's tastes and preferences**. A country may have high per capita income but when goods and services produced do not meet the preference of the consumers. In that case it would be wrong to use per capita income to judge people's welfare.
- **Does not take into account the type of goods produced.** A country may have high per capita income arising from increased production of capital goods that do not directly improve welfare though in the long run it does so by facilitating greater production of consumer goods.
- **Does not take into account the state of unemployment in the country.** Country may have high per capita income when the majority of people are unemployed. There could be high investment but when entrepreneurs use capital intensive techniques. It would be wrong to conclude that individuals who have no jobs can enjoy better welfare just because the per capita income appears high.
- **Does not consider government priorities.** The per capita income of a country can be high but when the priority of the government is in defense rather than providing services that directly improve welfare. One can argue that people will enjoy the peace and freedom from the security provided by the state. But evidence show that in LDCs the governments have used these weapons to terrorize their own citizens.
- **Does not consider time worked.** A country may realize high GNP and per capita income when people are working many hours in a day. It is wrong to argue that a person working many hours without leisure is enjoying better welfare. This is because leisure is part of one's welfare.
- **Does not consider income distribution.** The per capita income may appear high when much of the income is concentrated in the hands of a few rich people while the majority of people are living in abject poverty. This gives a wrong picture of the state of welfare in the country.

- **Disregards output from subsistence sector.** Per capita income of a country like Uganda may appear low due to large subsistence sector. Output from this sector is meant for home use rather than for markets thus has no money value. When compiling national income and per capita income output from such sector is excluded, It is wrong to argue that people enjoying variety of commodities from subsistence sector have poor welfare just because the per capita income figure appears low.
- **Does not consider political climate and degree of freedom.** A country may have high per capita income but when there is political instability and many people live in camps. In addition there could be a dictatorial government in power that denies people democracy. It is wrong to argue that people in such a country have better welfare just because per capita income figure is high.
- **Does not consider quality of goods and services produced.** A country may have high per capita income but when the goods and services produced are of poor quality. It would be misleading to argue that people consuming poor quality goods and services have better welfare just because per capita income is high.
- **Does not consider educational standards in the country.** A country may have high per capita income, but when the majority of people are illiterates. It is wrong therefore to argue that population that cannot read and write are enjoying better welfare just because the per capita income appears bigger.
- **There could have been inaccuracies in GNP and population figures.** A country's per capita income may appear high because there could have been under estimation of population figures or over estimation of GNP. The per capita income will appear high due to several errors. It would be misleading to conclude that people's welfare is good basing on these errors.
- **There could have been inflation in the country.** When compiling GNP figures, we use market price of goods and services. During inflation the market prices are high and if such prices are used, GNP and consequently per capita income will be high when in actual sense the level of output may have even fallen. This disqualifies per capita income as a good indicator of economic welfare.
- **Does not consider a country's international obligations**. A country may have high per capita income but when it is highly indebted to other countries and other institutions. In this case much of the resources are channeled towards servicing debts rather than improving welfare.
- **Does not consider ownership of means of production.** A country may have high per capita income when much of the output is produced by foreigners. These may repatriate all the profits to their home countries rather than reinvesting in the host country. The state of people's welfare may remain unchanged even when the per capital income is increasing.
- **Does not consider the effect of transport cost.** Transport cost increases the market price of commodities. This increases GNP figure and per capita income. However it is wrong to argue that people buying commodities expensively due to high transport cost are enjoying

better standard of living.

- **Does not consider purchasing power of currencies.** A country may have high per capita income but when its currency has low purchasing power.

Qn. 25 (a) Distinguish between investment multiplier and government multiplier.

(b) Examine factors limiting investment multiplier in your country.

Investment multiplier (K) is the number of times initial change in investment expenditure multipliers itself to give the final change in the level of national income. It is given by:

$\boldsymbol{K = \frac{1}{1-mpc}}$ Or $K = \frac{1}{mps}$

Whereas

1)The government multiplier is the number of times a change in government expenditure multiplies itself to bring about change in national income. It is given by:

Government multiplier = $\frac{\Delta Y}{\Delta G}$

Factors limiting investment multiplier in Uganda

- **Limited industrial development.** The multiplier effect is stronger in the industrial sector. But Uganda is predominantly agricultural based economy with limited linkage with other sectors.
- **Weak private sector.** According to Keynes increase in investment will have multiplier effect on income through creation of employment opportunities and indirectly by promoting other sectors through back ward and forward linkages. However in Uganda due to shortage of skills and technology, emphasis is still on agriculture.
- Therefore opening up foreign markets for Uganda's products will have greater multiplier effect. Thus; it is the export rather than investment multiplier which is more relevant.
- **Dominance of the traditional sector.** In Uganda most of the investments are carried out in the rural sector for subsistence requirements rather than for market. This renders the investment multiplier inapplicable because incomes and consumption are very low.
- **Shortage of credit facilities.** The private sector in Uganda is dominated by small scale enterprises with limited assets to present to financial institutions to obtain loans. This is worsened by the high interest rate changed on bank loans. This discourages investments thus limiting multiplier effect in the economy.
- **Low levels of incomes.** Due to wide spread poverty, incomes in Uganda are low leading to low savings and low capital accumulation. This limits investment initiatives.
- **Lack of established security markets.** In Uganda capital and money markets are not as functional as those in developed countries. This makes it difficult to raise sufficient capital for investment. This limits the multiplier effects.
- **Effects of inappropriate technology**. The multinational corporations that dominate private investment in Uganda prefer capital rather than labour intensive technology. The machines replace labour which would have earned incomes. This renders multiplier effect weak.

- **Low level of monetization.** In Uganda due to predominance of the subsistence sector, the monetary sector is still small which limit the impact of the multiplier process.
- **Large imported component.** The industries in Uganda use mainly imported machinery and raw materials. Thus have limited domestic impact. Increase in investment will not have big impact on the domestic economy.
- **Shortage of skills.** Due to high proportion of illiteracy and inappropriate education system, the majority of Ugandans lack the required skills to get employed in the industries set up. This limits the multiplier effect on the domestic economy.
- **Domination of investment in Uganda by multinationals.** These aim at maximizing high profits which they repatriate to their home countries. They also prefer to employ expatriates rather than local labour. The multiplier impact of foreign investment in the country is very low.

Qn. 26 (a) Distinguish between cost of living and standard of living.

(b) Examine factors that determine material standard of living in a country

Cost of living is the total amount of money needed by an individual to maintain a given level of standard of living and it is influenced by the general price level in the economy.

Whereas

Standard of living is the minimum of the necessities of life to which a person or a group is accustomed to or which they desire to have. Or condition/state in which people live or enjoyed by the people in form of goods and services at their disposal.

Factors that determine material standard of living

- **Availability of natural resources.** If a country is well endowed with natural resources full exploitation of these resources will lead to more output of goods and services, thus high standard of living.
- **Level of income.** If average level of income is high, people will be able to afford more goods and services which improve their material welfare. Low income on other hand deprives people of essential goods and services and reduces welfare.
- **The price level.** When the general price level is high, it means the cost of living is high which reduces standard of living. Low price means high value of money and people will afford more goods and services thus high standard of living.
- **Level of capital stock.** When a country has massive stock of capital, production is boasted leading to increased output and better material welfare for the citizen. Shortage of capital reduces material standard of living by limiting production.
- **The Terms of Trade.** If price of a country's export is rising relative to price of import, with a given export a country will be getting more and more imports. This increases material standard of living. Deterioration in Terms of Trade reduces welfare by reducing imports.
- **Foreign aid.** If a country receives foreign aid on favourable terms, proper use of these resources will increase production capacity of a country and improve standard of living. Tied aid on the other hand makes a country dependent on others and real output may not

increase.

- **The level of investment.** High level investment raises standard of living by raising income and employment.
- **Political climate.** Stable government encourages savings and investment thereby raising level employment and output hence high material standard of living.
- **The level of organization of factors of production.** If the factors of production are properly organized and allocated to their most efficient use, more output will be produced leading to better standard of living.

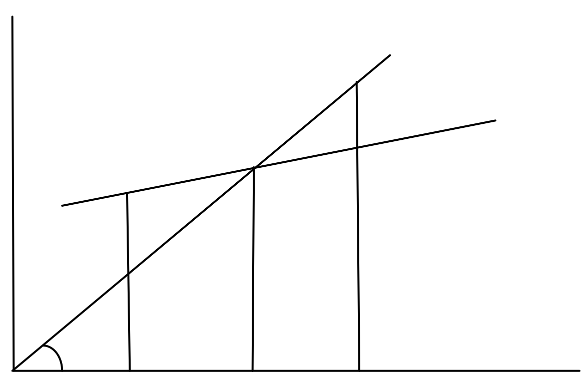
Qn. 27(a) Distinguish between inflationary and deflationary gaps.

(b) How can these two gaps be closed?

An inflationary gap is the amount by which aggregate demand exceeds aggregate supply at full employment level of income

Whereas

Deflationary gap is the amount by which aggregate supply exceeds aggregate demand at full employment level of resources (income)



Measures to close inflationary gap.

- **Increase taxation.** This helps reduce disposable income and lower aggregate demand in the economy.
- **Reduction of government expenditure.** Since government is the biggest unit, reduction in its expenditure will reduce the flow of money in circulation and this reduce people's earnings and purchasing power.
- **Tight income and wage policies.** The government can reduce real income and fix maximum wage to reduce level of aggregate demand.
- **Price control measures.** The government can fix maximum price policy to prevent price from rising.
- **Restrictive monetary policy.** The government through the Central Bank can institute tight monetary policy to reduce amount of money in circulation as a way to reduce aggregate

demand.

- **Increased importation.** The government can encourage inflow of goods from abroad to supplement domestic supply and offset shortage.
- **Discourage exports.** The government can put a ban on export of scarce commodities until domestic demand is met.
- **Conducive investment policies.** The government can struggle to provide favourable investment climatic to attract more foreign investors in the country.

Measures to close deflationary gap.

- **Reduction in taxes.** This increases the level of aggregate demand in the economy.
- **Increased government expenditure**. This helps boast the aggregate demand since government is the biggest spending unit.
- **Encourage exports**. This will enable the country to dispose off to other countries what cannot be consumed domestically.
- **Expansionary monetary policies.** This helps to increase the amount of money in circulation. Thus increase in purchasing power and aggregate demand
- **Discourage importations**. This helps to avoid adding on the already excess supply in the economy.
- **Increased wages.** This helps increase income purchasing power and consequently aggregate demand.
- **Increase producer prices.** This boosts the level of income thus high purchasing power.
- **Fiscal relief measures.** This helps to boost demand by increasing disposable income.

28. (a) Account for income inequalities in your country.

(b) What steps has your country been taking to reduce income inequality?

Income inequality refers to the disproportionate distribution of income in the country such that the share that goes to the minority rich is much greater than the share that goes to the majority poor.

Causes of Income inequalities in Uganda

- **Differences in educational levels**. In Uganda salaries and wages tend to vary with level of education attained. Those who are highly educated are paid more than those who are less educated causing income inequalities among individuals with different education levels.
- **Differences in employment.** There are some jobs which are more rewarding than others. In Uganda Lawyers, judges and doctors are more highly paid than teachers causing income inequalities among people in these professions**.**
- **Differences in talents.** There are people in society who are naturally endowed with rare but marketable talents. For instance footballers, artist and musicians are enjoying higher incomes than the rest in society who lack such natural gifts.
- **Differences in family background.** There are some individuals who are born in rich families. Such individuals have the prospect of inheriting wealth from their parent or being

supported by parents and relatives to start income generating activities. Such persons have the prospect of being of higher incomes compared to those from poor family background.

- **Differences in infrastructure development.** Places with good infrastructure such as roads, school, hospitals, and industries offer higher prospects for employment and economic activities. People in such areas are of higher incomes than their counter parts in remote areas. For instance people in Kampala are of higher income than those in other parts of the country.
- **Differences in age.** People who are old tend to be of higher income than young people. This is because older people will have worked for long and accumulated income through savings. Thus income inequality.
- **Differences in political climate.** People living in politically unstable places like Northern Uganda are of lower income compared to those living in peaceful areas. This is because political instability discourages economic activities leading to low investment in such areas.
- **Differences in natural resources endowment.** People born in areas blessed with valuable natural resources can exploit these resources and generate income thus placing them at higher income level than those in other areas lacking such resources. For instance Buganda region is blessed with fertile soils and reliable rainfall that favours agriculture. People here are of high income than those in Karamoja which is semi arid.
- **Differences in sex.** Until recently, society has tended to discriminate women in employment and ownership of productive resources such as land. This has placed women at lower income level than men.
- **Differences in physical ability.** There are people who are physically strong. These can engage in wide range of physical activities such as brick making. These tend to be of higher income than the weaklings and physically hand capped.
- **Differences in distribution of financial infrastructure.** People living in urban areas with many financial institutions can have easy access to loans and credit facilities. These will be of high income than those in areas without such institutions.
- **Differences in culture.** There are some traditions which are rigid and conservative. For instance the Karamojong have large herds of cattle for prestige rather than economic purpose. These are of lower income than other societies with dynamic cultures.
- **History background.** There are some people who are born in royal families such as the Kabaka of Buganda or the Omukama of Bunyoro. These people enjoy many privileges than ordinary people in society.
- **Nepotism and political favoritism**. There are people with high political connection; such people are favoured in employment and government contracts. These will be of higher incomes than those without such connections.
- **Effects of regressive taxation**. Uganda relies mostly on indirect/commodity taxes which in real terms affect the poor more than the rich.

Steps Uganda has been taking to reduce income inequality

- Progressive taxation policy. Uganda has been emphasizing progressive taxes such as PAYE whose burden is more on the rich. The revenue realized is used to subsidize the poor
- Increased expenditure on social services that benefit the poor. The government has been increasing her expenditure on free primary and secondary education that benefit the poor but financed by the rich who pay more taxes.
- Rural development policies. The government has been initiating many projects aimed at increasing the earnings and opportunities of the rural poor. Such projects include NAADS, rural electrification and decentralization policy to bring services nearer to the people.
- Minimum wage legislation. The government has been emphasizing minimum wage to reduce on the earning disparities of the workers.
- Balanced regional allocation of economic infrastructure. The government has been spending heavily in rehabilitating and extending the road network to promote economic activities and balance the employment opportunities in all regions.
- Land reforms measures. Several laws and amendments have been made to increase access of the poor to land for agricultural production e.g. the land act 1998.
- Promoting political stability. The government has been engaged in a concerted effort to establish peace through out the country. Military means and peace negotiation have been use to restore peace through out the country thus enabling the rural poor to engage in economic activities.
- Special programmes for the disadvantaged groups. Through affirmative actions the government has been initiating programs that target vulnerable groups like women, the disabled and youths to give them equal opportunities.
- Promotion of appropriate technologies to provide employment opportunities. The government has been supporting labour intensive projects such as labour based road construction projects in rural areas and in the informal sector.
- Education reform measures. The government has been emphasizing and supporting technical and vocational education to produce job makers and not job seekers.
- Improvement in general infrastructure e.g. road construction to facilitate income generating activities.
- Liberalization of the economy to promote self help projects. The government has been breaking state monopolies to allow private participation in economic activities.
- Agricultural modernization to boost the incomes. The government has been supporting many programs aimed at increasing incomes of those employed in agriculture. For example the plan for modernization of agriculture.
- Provision of rural and general credit scheme for the low income earners. The government has been initiating credit schemes that target the very poor e.g. the "*Entandikwa*" scheme and micro finance institutional lending.

- Subsidization policy. The government has been giving subsidies to low income earners and tax relief.

Qn.29 (a) Explain the types of inequalities that exist in your country.

(b) What are the implications of income inequalities?

Types of inequities that exist in Uganda include:

- **Personal inequities**. These are inequities that exist between people. There are people with higher incomes than others. For instance the educated have higher incomes than less educated, the employed have higher incomes than the unemployed etc.

- **Regional inequities**. Some regions are better endowed with resources that others. The central region has fertile soils, better infrastructure and industrial concentration than other regions of the country. This causes inequalities between these regions.

- **Sex/gender inequalities**. These are inequalities that exist between men and women. The traditional system favours men over women in employment, education and ownership of land which is the most productive resource. This places men above women in terms of income.

- **Intra-sectoral inequalities**. These are inequalities that exist within a sector. For instance subsistence farmers are of lower income than commercial farmers.

- **Inter-sectoral inequalities**. There are inequalities between sectors. For instance people in industrial sector have higher incomes than those in agricultural sector.

(**b) Implications of income inequalities**.

Positive implications

- **Encourages hard work**. The low income will admire the lifestyle and standard of living of the rich. This will motivate them (poor) to work harder.
- **Encourages high savings**. The rich have high marginal propensity to save while the poor have high marginal propensity to consume. Concentration of income in the hands of the rich increases the level of savings and capital accumulation in the country.
- **Leads to increased investment**. Due to increased savings and capital accumulation; the rich undertake more investments in the country.
- **Increased employment opportunities**. Due to increased investments, more employment opportunities are created in the economy.
- **Increased income levels**. These results from the multiplier effect of investment under taken by the rich. the poor improve their lot by working in projects established by the rich.
- **Increases government revenue**. The rich will pay high income taxes and taxes from profits of their investments. This increases the government revenue necessary to finance government expenditure.
- Increased welfare to the society. The whole society benefits in terms of improved roads and

other infrastructure.

- **Promotes class respect**. The poor will respect the rich in society who offer them employment. This promotes social harmony.

Negative implications

- **Promotes class hatred**. Ill feeling and apathy will be developed by the poor towards the rich.
- **Social conflict and political instability**. The poor will become dissatisfied with the status-quo thus rise against the privileged rich class as the only way to improve their lot.
- **Leads to exploitation of the poor**. The rich will take advantage of the desperation of the poor to exploit them by paying low wages.
- **Accelerates rural-urban migration**. The poor will move from rural areas to urban areas in search of better opportunities. This leads to congestion in urban areas and increased crime rates.

Increases BOP problem. Due to high expenditure on importation of consumer goods by the rich, BOP deficit will worsen.

- **Reduced government revenue**. Due to low incomes by the majority of the poor, the taxable capacity of the country reduces. This leads to low tax revenue.
- **Reduces aggregate demand**. Due to low incomes by the poor, the aggregate demand in the country will be low leading to low investment.
- **Encourages brain drain**. The poor will move to foreign countries in search of better opportunities. This reduces domestic labour supply.
- **Creates inflationary situation**. Due to high expenditure patterns of the rich, demand will exceed supply leading to price increases.
- **Leads to foreign exchange outflow**. The rich especially in LDCs have the habit of banking their money in developed countries.
- **Leads to misallocation of resources**. Resources will be concentrated in the production of luxuries of the rich at the expense o f the basic necessities of the poor.
- **Increased government expenditure**. The government will spend highly in subsidizing the poor. This leads to budget deficit.
- Reduces economic welfare of the majority poor while favouring the minority rich

30 (a) Explain how cost of living index is completed.

(b) Study the table below and answer the questions that follow.

(b) Study the table below and answer the questions that follow.

Commodities	Weight	Base year price 2006	Current year price 2008	Base year	Simple index
Posho (Kg)	5	1000	1,500	100	
Sugar (Kg)	4	1200	1,600	100	
Bread (loaves)	3	000	2,200	100	
Fuel (Litres)	2	800	2,200	100	
Salt (Kg)	1	400	800	100	

(i) Calculate the price relative of each commodity in 2008.

(ii) Calculate the weighted index.

(iii) Calculate the average weighted index.

Examine the problems of computing cost of living index.

A. How cost of living is computed.

- A base year is selected. This is a year when prices are stable. It is given a simple base year index of 100.
- A representative sample of population is selected. This is based on the consumption patterns of an average family or a typical family.
- A basket of goods is selected. This is composed of goods popularly bought and should be based on the current spending habits of the typical family chosen.
- The basket is valued at the base year price and expressed as 100.
- The same basket is them valued at current year prices.

A simple price index is then computed by expressing current year price as percentage of base year

- Weights are then attached to commodities to reflect the importance of each of the selected commodities in the consumption series.
- Weighted index is then calculated by multiplying simple index by the weights.

(b) (i) Price relative is the same as current year simple index. It is calculated by the formula.

$\underline{\text{Base year price}} \quad \text{x} \quad 100$

Current year price

Posho = $\frac{1500}{1000} \times 100$ = 150

Sugar = $\frac{1600}{1200} \times 100$ = 133.3

Bread = $\frac{2200}{2000} \times 100$ = 110

Fuel = $\frac{2200}{1800} \times 100$ = 122.2

Salt = $\frac{800}{400} \times 100$ = 200

(ii) Weighted index = price relative x weight.

Posho = 150 x 5 = 750

Sugar = 133.3 x 4 = 333.2

Bread = 110 x 3 = 330

Fuel = 122.2 x 2 = 244.4

Salt = 200 x 1 = 200

(iii) Simple index or average simple index

$$= \frac{\Sigma \text{ weighted index}}{\text{number of commodities}}$$

$$= \frac{1857.6}{5} = 371.52$$

(iv) Calculate the weighted index.

Weighted index/average weighted index $= \frac{\Sigma \text{ weighted index}}{\Sigma \text{ weight}}$

$$= \frac{1857.6}{15} = 123.8$$

Problems of computing cost of living index.

- **Difficulty of selecting reliable base year.** The year chosen may coincide with abnormally high prices.
- **Difficultly of choosing appropriate weight.** Some commodities are more significant to

consumers than others. Besides, different weights may give different results.

- **Difficulty in selection of a basket of goods.** There are several commodities and it is difficult to determine what to include and what not to include in the basket.
- **Lack of standard measure.** Some commodities are sold in kilograms others in tins while others in heaps.
- **Changes in tastes and fashion.** Consumer's tastes are dynamic. Some commodities become out dated making the data irrelevant.
- Prices are usually estimated thus may not be representative.
- Areas are usually sampled and the whole country may not be covered.
- Price changes may be due to other factors like improved quality and not necessarily inflation.
- Unreliable data may hinder effectiveness.
- Differences in prices due to differences in bargaining power make the index difficult to determine
- Problems of data collection may affect the index.
- New goods always enter the market while others go out of fashion thereby affecting the consumption pattern requiring frequent changes of weights.
- Consumers' shopping habits change.

85. (i) Distinguish between National Income at market price and National Income at factor cost.

(ii) Given that Gross National Income at market price is 276,000,000 Million shillings Net Income from abroad is 18,000,000 million Shillings. Calculate the Gross Domestic Income.

A. (i) National income at market price is the total monetary value of goods and services produced in a year valued at the price paid by the final consumers of the product.

While

National Income at factor cost is the total monetary value of goods and services produced in a country in a given period of time valued at prices paid for factors of production.

(ii) Gross Domestic Income (GDY) = Gross National Income (GNY) - Net income from abroad.

GDY = GNY - net income from abroad.

= 275,000,000m - 15,000,000m

GDY = 260,000,000m/= .

86. (i) Given Gross National Product at market price. What adjustments are required to obtain Net National Product at factor cost?

(ii) What is meant by capital consumption allowance?

A. (i) Net National Product at factor cost = Gross National Product at market price – indirect taxes plus subsidies minus net income from abroad.

NNP_{PC} = GNPmp + subsidies - indirect taxes – net income from abroad.

(ii) Capital consumption allowance is the amount set aside to replace the value of fixed assets/machines due to wear and tear or depreciation.

(ii) 87 i) Define the term marginal propensity to save.

(ii) Given that the current level of Gross Domestic Product is 300 million shillings, the increase in national investment Expenditure is 50million shillings and the marginal propensity to save is 0.2, calculate the final level of national income.

A. (i) Marginal propensity to save is the proportion of additional income saved.

Or

Change in savings due to change in income

(ii) current GDP = 300 million shillings

Δ I = 50- million shillings

MPS = 0.2

$$\text{Multiplier (K)} = \frac{1}{MPS} = \frac{1}{0.2} = \frac{10}{2} = 5$$

K = 5

Change in income is given by

Δ I x K

Δ Y = 50 million x 5 = 250 million shillings

Final level of income = initial income + Δ Y

= 300 million + 250 million

= 550 million shillings

88 (i) What is meant by Gross National Product?.

(ii) Given that Gross Domestic Product at factor cost is 2500 Million shillings; Net Income from abroad is 800 million shillings; deprecation of capital equipment is 50 million Shillings; calculate the Net National Product at market price

A. (i) Gross National Product is the measure of the money value of all goods and services produced by all nationals of a country both within and abroad in a given period of time. It excludes output of non-nationals within the country.

(ii) NNPmp = GDP_{fc} + indirect taxes + net income from abroad – subsidies - depreciation.

= 2500 million - 800 million - 50 million

= 2500m - 850m

NNPmp = 1650 million shillings.

89 (i) Differentiate between Gross National Product (GNP) and Gross Domestic Product (GDP)

(ii) Given GNP at factor cost, how would you arrive at GDP at market price.

A. (i) GNP is the total money value of all goods and service produced by nationals of a country both within and abroad in a given period of time usually one year.

Whereas

GDP is the total money value of all goods and services produced within the territorial boundary of a country by both nationals and foreigners in a given period of time usually one year.

(ii) GDP_{MP} = GNPfc + indirect taxes - subsidies - net income from abroad.

90. State any four uses of national income statistics.

- Useful for planning purposes i.e. research and policy review.
- To identify leading sectors in the economy.
- To identify lagging sectors.
- To identify national expenditure patterns.
- To compare living standards between and among countries.
- Used to measure per capita income.
- Used to determine income distribution.
- Used to determine extent of dependence.
- Used to compare economic performance of an economy over time

91. Given that a country's stock of machinery is valued at Shs. 100billion at the start of the year; the total output from the machines during the year was Shs. 500 billion; deprecation costs during the year were 20%. Calculate the:

(i) Value of depreciation.

(ii) Net output.

A. (i) $Value\ of\ depreciation = 20\% of 100 billion$

$= \frac{20 \times 100bn}{100}$ = 20bn Ug Shs.

(ii) Net output = total output - depreciation.

= 500bn - 20bn

= 480 billion Ug. Shs.

92. State any four statistical problems faced while computing national income statistics in your country.

- Double counting.
- Shortage of equipments like computers.
- Omitted market transactions.
- Inadequate statistical information.
- Difficulty of determining income from abroad.
- Difficulty of determining value of depreciation.

93 (i) Distinguish between Marginal Propensity to Save and Marginal Propensity to Consume.

(ii) Give two determinants of marginal propensity to save in your country.

A. Marginal Propensity to Save (MPS) is the proportion of additional income saved. Or change in savings due to change in income.

While

Marginal propensity to consume is the proportion of additional income consumed. Or change in consumption due to change in income.

(ii) **Determinants of MPS.**

- Size of income.
- Rate of interest on deposit.
- Availability of saving institutions.
- Government policy.
- Level of consumption/marginal propensity to consume.

94. (i) Define the term "marginal propensity to import"?

(ii) Given that a Country's Gross Domestic Product (GDP) increased from 100 million to 300 million and the value of imports increased from 25 million to 75 million and, calculate the marginal propensity to import.

A. (i) Marginal propensity to import is the proportion of change in national income or GNP spent on import.

(ii) $$Marginal\ propensity\ to\ import = \frac{change\ in\ import\ expenditure}{change\ in\ national\ income}$$

$MPM = \frac{\Delta M}{\Delta Y}$

$= \frac{75 - 25}{300 - 100} = \frac{50}{200} = \frac{1}{4}$

MPM = 0.25

95. Given that the initial equilibrium level of national income is Shs. 80,000,000 million, change in investment is 5000 million, MPC is 80%.

(i) Calculate the value of the multiplier.

(ii) Find the new equilibrium level of national income.

A. (i) Multiplier (K) = $\frac{1}{1\text{-mpc}}$ or $\frac{1}{\text{mps}}$

$= \frac{1}{1-80\%} = \frac{1}{1-80/100} = \frac{1}{1-0.8} = \frac{1}{0.2} = \frac{1}{2/10}$

$= 1 \times \frac{10}{2} = 5$

= K = 5

(ii) New equilibrium level = initial equilibrium + change in income.

But change in income = change in investment x multiplier (K)

= 5000 million x 5

= 25000 million

New equilibrium = initial equilibrium + change income

= 80,000,000 + 25,000m

= 80,025,000 million

96. Country Z had an increase in the level of investment from US$ 2million to US$ 2.4 million which led to an increase in income from US$ 150 million to US$ 225 million. Calculate the multiplier.

A. Investment multiplier (K) = $\frac{1}{1\text{-MPC}}$ or $\frac{1}{\text{MPC}}$

Δ I = 2.4 million - 2 million = 0.4 million

Δ Y = 22.5 million - 150 million = 75 million

Multiplier (K) x Δ Y.

$$K \times 0.4 \text{ million} = 75 \text{ million}$$

$$\frac{400{,}000\,K}{400{,}000} = \frac{75{,}000{,}000}{400{,}000}$$

$$K = \frac{750}{4}$$

$$K = 187.5$$

97. What is meant by the following terms?

(i) Net property income from abroad.

(ii) Net national income.

A. (i) Net property income from abroad is the difference between outflow of income from an economy resulting from production within a country using foreign resources which represent income earned by non-nationals, and inflows of income from abroad coming from assets owned by nationals outside the country.

(ii) Net national income is a measure of the net money value of goods and services produced by all the nationals of a country after removing the amount necessary to replace the asset worn out in the process of producing the output in a given period of time usually one year.

98. With examples distinguish between injections into and leakages from an open economy.

A. Injections are additions into the circular flow of income e.g. export (X), investment (I) and government expenditure (G).

While

Leakages are withdrawals from the circular of Income e.g. imports (M), Savings (S) and Taxation (T).

99. Distinguish between inflationary gap and deflationary gap.

(i) How can the inflationary gap be closed.

(ii) An inflationary gap is the amount by which aggregate demand exceed aggregate supply in the condition of full employment.

While

(i) Deflationary gap is the amount by which aggregate supply exceed aggregate demand in the condition of full employment.

(ii**) How inflationary gap can be closed.**

- Increase in taxes to reduce disposable income.
- Discourage exports.
- Tight income and wage policies.
- Price control measures i.e. fixing maximum price .
- Restrictive monetary policy.
- Provide conductive climate to attract more foreign investment.
- Reduction in government expenditure.
- Encourage imports.

100. Study the table below showing the population and GNP of countries A and country B and answer the questions that follow

(i) Calculate the per capita income of country A and country B.

(ii) Give two reasons why high per capita income may not necessarily imply high standard of living.

A. (i) Per capita income for country A.

$$= \frac{\text{GNP}}{\text{Population}} = \frac{1200}{20} = 60\$$$

Country B

$$\frac{\text{GNP}}{\text{Population}} = \frac{750}{15} = 50\$$$

(ii) **Why per capita income is not a good indicator of standard of living.**

- Does not take into account the type of product produced.
- It may be high when income is not equitably distributed.
- Does not consider political climate. It may be high but where there is political instability.
- Does not consider the priority of government.
- Does not consider people's tastes and preferences.
- It may be high when most production is by foreigners.
- It may be high due to inflation.
- It may be high due to inaccurate data.
- It may be high but when there is high level of unemployment arising from use of capital intensive technology.

- Does not consider the quality of output.

101. (i) Distinguish between investment multiplier and accelerator principle.

(ii) Give any three ways of attracting foreign investment in your country.

A. (i) Investment multiplier is the number of times a change in investment multiplies itself to bring a final change in income.

While

(i) The accelerator (a) links the rate of change of aggregate demand to the level of new investment. The theory predicts that a relatively small variation in the rate of change of national income will bring about much greater change in the level of demand for capital goods.

(ii) **Ways of attracting foreign investment in Uganda.**

- Liberalization of the economy.
- Maintenance of political stability.
- Building sound infrastructural facilities.
- Offering investment incentives e.g. tax holidays.
- Sound macro-economic policies focused on attainment/maintaining economic stability e.g. price stability.
- International publicity.
- Privatization of public enterprises.

102. (i) Define the term "marginal efficiency of capital"

(ii) Give any three factors that determine marginal efficiency of capital in your country.

A. (i) Marginal Efficiency of Capital (MEC) is the expected monetary returns on each additional unit of capital invested.

Or

The ratio of prospective monetary returns to the supply price of additional unit of capital invested.

(ii) **Factors that determine marginal efficiency of capital.**

- Anticipated output.
- Level of taxation.
- Quality and efficiency of other co-operant factors.
- Availability of excess capacity.
- Rate of interest.

- Rate of depreciation.
- Size of the market.
- Price level.

103. (i) What is meant by the term price index?

(ii) Mention any three uses of price indices in your country.

A. (i) Price index is the measure of relative changes in price over a given period of time.

Or

A ratio of current year prices to base year prices.

(ii) **Uses of price indices in Uganda.**

- It assists in wage determination as wages may vary with price indices.
- Measures change in the value of money.
- Determining the level of inflation/price level.
- Helps in determining tax levels as tax base changes.
- Helps in determining extent to which national income can be deflated to give real national income.
- Helps in determining changes in cost of living.
- Useful when determining the general level of retail and whole sale prices.

104. (i) Define the term "investment".

(ii) Mention any three factors that influence the level of investment in your country.

A. (i) Investment is the process of creating capital stock.

Or

The process of devoting part of an individual's or a nation's income/resources to creating capital stock/capital goods.

(ii**) Factors that influence the level of investment in Uganda**.

- The prevailing economic conditions e.g. inflation, unemployment, recession etc.
- Existing stock of natural resources.
- Capital inflows and outflows.
- Nature of land tenure system.
- The rate of interest on borrowed funds.
- Political climate in the country.

- The profit levels on investments.
- The level of technology.
- Level of entrepreneurship skills.
- Marginal efficiency of capital.

105. (i) What is meant by inflationary gap?

(ii) State three effects of inflationary gap in an economy.

A. (i) Inflationary gap is the amount by which aggregate demand exceed aggregate supply at full employment level of the economy.

(ii**) Effects of inflationary gap.**

- Persistent increase in prices.
- Low output.
- High aggregate demand.
- Low investment.
- Reduction in real income.

Causes BOP problems due to increased imports and re

STRUCTURE OF THE ECONOMY OF UGANDA

Question 31. (a) Describe the structure of the economy of Uganda.

(b) What are the implications of such a structure?

Uganda is a developing country and structure of her economy is similar to those of other developing countries. Uganda's economy is characterized by the following:

- **Dominance of agriculture.** Agriculture is the back borne of Uganda's economy, and it is still a significant contributor to GDP. In terms of employment it is still the leading employer. Much of the activities in the sector are still at subsistence level.
- **Existence of dualism.** Uganda like the majority of LDCs is a dual economy. There is co-existence of several types of contradicting conditions leading to various forms of dualism. Such as economic dualism including co-existence of modern sector and traditional sector, trade dualism involving monetary exchange co-existing with barter exchange, technology dualism involving use of modern capital intensive technology co-existing with labour intensive method etc.
- **Existence of small but growing industrial sector.** Compared to agriculture, industry is still a small contributor to GNP. At present industry contributors about 15% of GNP. This contribution however, is rising every year.

- **Wide spread unemployment.** Due to dominance of agriculture which is carried out seasonally there is high rate of seasonal unemployment. In addition, the emerging informal sector has encouraged under employment and disguised unemployment.
- **Existence of excess capacity.** Due to shortage of capital, skilled manpower, technology and market there is under utilization of resources i.e. most sectors produce below their optimum.
- **Mixed economy.** Uganda's economy is characterized by mixed economic systems, both government and private enterprises take part in resource allocation.
- **High population growth rate.** Uganda has one of the highest population growth rates in the world in excess of 3% per annum. This has tended to outstrip the GNP growth rate leading to falling per capita income and standard of living.
- **Poor infrastructure**. Uganda's infrastructure is poorly developed and not well maintained, the roads are in bad state and much of railway network is not in use, Busoga line is almost completed by thieves while the Pakwach and Kasese lines have not been in use for nearly a quarter of a century.
- **Open economy.** Uganda like other economies of the world is open. She interacts with other countries through international trade; she exports mainly agricultural products and imports manufactured consumer and capital goods.
- **High level of dependence**. Uganda is highly dependent. It relies on other countries for decision and finance. In field of trade it relies on a few countries for her exports and just few commodities. It is also technologically dependent. It relies on technology from advanced countries.
- **High level of illiteracy.** Uganda's labour force is largely semi-skilled and unskilled and bulk of the population is illiterate.

Implications of the structure on the economy.

- **Income inequality.** Due to wide spread unemployment, majority of people have low income. In addition, the existence of subsistence sector worsens inequality because those in modern sector have higher income than those in the traditional sector.
- **Price instability.** Due to dominance of agriculture which is dependent on weather, there are wide fluctuations of price and incomes of people employed in it.
- **Shortage of skilled labour.** Due to high level of illiteracy there is low supply of skilled labour force.
- **Scarcity of foreign exchange**. Due to dependence on agricultural exports which face unfavorable terms of trade, there is low foreign exchange earned from exports.
- **Under utilization of resources**. Due to dominance of agriculture there is low income leading to low taxable capacity. This leads to low tax revenue.
- **Profit repatriation**. Uganda depends on foreign multinational corporations for investment. These

foreign investors prefer investing the profits in their home countries. This limits capital accumulation in the country.

- **Low level of investment**. Due to poor infrastructure, investment is discouraged leading to low level of economic activities, low employment and low incomes.
- **Unfavourable terms of trade**. Due to dependence on agricultural products whose prices are on downward trend in the world market, and importation of expensive manufactured goods, the country faces B.O.P. problem.
- **Population explosion**. Due to high population growth rate the country faces population explosion leading to high dependence burden and budget deficit as the government struggles to meet the needs of the rising population.
- **Low incomes**. Due to dominance of agricultural activities, incomes of the people are low.
- **Strong foreign influence**. Due to dependence on developed countries for resources, technology and decision making; there is neo-colonialism and foreign interference in internal affairs of the country. For instance some of the IMF conditionality is not favourable for the country.
- **Existence of social tension.** Due to income inequalities and existence of dualism there is social tension leading to high crime rate.
- **Out competing of local firms.** Since the economy is open, there is free flow of foreign goods into the local market. This leads to out competing of domestic firms.

32. (a) Explain the features of the informal sector

(b) Assess the contribution of the informal sector to the economy of your country.

Informal sector in the intermediate sector that exists between the traditional sector and the modern sector. In Uganda, this sector has become dominant and rapidly growing. It has the following features:-

- **Urban and sub-urban based**. The activities of this sector are usually concentrated in urban and semi-urban areas. For example the “boda boda” riders, special hire car drivers, tailors, hawkers, furniture makers, metal fabricators etc.
- **Mainly sole proprietorship or family business**. It is mainly dominated by individuals who are self employed.
- **Uses mainly local resources.** The raw materials used in this sector are got from the country. For example the furniture makers get timber from local forests, the metal fabricator get scraps from within. There is limited imported component of their product.
- **Produce mainly for local market.** The product of the informal sector is meant to satisfy local demand. They are hardly exported to other countries. In many cases they are aimed at import substitutions. For example fabrication of exhaust pipes for vehicles in Kisenyi is an evidence of this.

- **Poor or no records are kept.** The people engaged in this sector are mainly illiterates and semi-illiterates. They rarely maintain records of their activities.
- **Poor or simple technology is used.** The sector mainly employs labour intensive technique of production using very crude methods. This explains why the quality of the product is low.
- **Production is on small scale.** Due to poor technology and limited capital, production is usually on small scale.
- **Limited capital input.** Because the business is usually sole proprietorship, it depends on limited family resources to start; it equally lacks collateral security to present to banks for loan. The capital output ratio is low.
- **Employ mainly unskilled and semi-skilled labour force**. This sector is mainly a sanctuary of illiterates, and school drop outs who find themselves in urban areas.

Positive Contributions

- **Provision of employment opportunities.** The sector absorbs unskilled and semi skilled workers whose education cannot secure them employment in the formal sector, In Uganda today, the people engaged in metal fabrications, furniture making, hawking, taxi operation, ‘boda-boda’ riding etc, out number those in formal sector and offices. This has led to increased incomes in the country.
- **Promote commercialization of the economy.** The product of the informal sector is meant for sell as opposed to those from the traditional sector. The sector thus helps in transformation of the economy from subsistence to market.
- **Widens consumer choice.** Informal sector provide variety of commodities to the local consumers which increases the range of choices available to them. This improves people’s welfare.
- **Promote fairer distribution of income.** By creating many job opportunities, the majority of people are able to engage in income generating activities. Thus increased incomes for the majority in the country.
- **Saves scarce foreign exchange.** The foreign exchange which would have been spent on importation of certain commodities such as industrial spare parts, furniture etc is saved because commodities are produced locally in the informal sector.
- **Facilitates industrial growth.** Numerous small scale industries are started in the informal sector such as grinding mills, saw mills, etc. These set foundation for industrial growth.
- **To some extent contribute revenue to the government.** Business in the informal sector pay taxes to local authorities such as retail trade licenses, parking fee for taxi’s and ‘boda boda’ cycles. These generate government revenue that helps finance public expenditure.
- **Promote acquisition of skills.** The activities in the informal sector provide practical skills to school drop outs. Through learning by doing, many Ugandans have acquired practical skills in welding, carpentry, driving etc.
- **Facilitates acquisition of Entrepreneurial Skills.** People engaged in the informal sector through

practice acquire managerial skills as workshop owners, garage owners, retail traders etc. This helps in identification of opportunities and management of risks. These are essential for increased investment in the country.

- **Production of locally affordable goods.** Most of the activities in the informal sector are import substitution. For example tailors, sofa set makers, welders etc make products which are far cheaper than imported products. This enables low income earners to acquire basic consumer goods.
- **Facilitates utilization of idle resources.** The sector makes use of resources such as metal scraps, timber etc, thus putting into use what would have been wasted materials.
- **Contributes to the country's GDP.** The output from the informal sector is meant for market. Many Ugandans get income from metal fabrications, furniture making tailoring etc. These promote economic growth of the country.
- **Promotes technological development.** Wide range of grinding mills and spare parts are now made in Katwe. This has led to development of industrial sector. In turn the sector also provides markets for agricultural products especially food stuffs.
- **Promote inter- sectoral linkages.** It produces inputs such as hoes, spades wheelbarrows etc which are used in the agricultural sector. In turn the sector also provides markets for agricultural products especially food stuffs.

Negative Contributions

- **Encourages under employment and disguised unemployment.** The sector is mainly dominated by labour intensive techniques of production. People are seen to be fully engaged but with very low output. For example a tailor can spend the whole day on one trouser.
- **Low quality output.** Due to use of poor technology, the quality of output is very low. For instance the sofa sets made in this sector appear beautiful but can hardly last for reasonable time.
- **Causes public revenue instabilities in the country.** The activities in the informal sector cannot be easily monitored by government due to the fact that they do not maintain records of their activities. This leads to low revenue to the government.
- **Creates high administrative costs.** Monitoring the activities in the informal sector is often costly and difficult due to the fact that some are mobile and change location frequently as in the case of "boda boda" riders, hawkers etc.
- **Encourages duplication of activities.** Majority of them are engaged in similar activities which lead to wasteful competition and low profitability.
- **Promote environmental degradation**. The activities in the informal sector lead to pollution especially noise. Environment in Katwe and other suburbs in Kampala are characterized by a lot of noise from banging metals. There is also poor disposal of wastes that promote environmental degradation.
- **Encourages rural-urban migration.** The sector attracts youths from rural areas to move to urban

areas. This deprives the agricultural sector of energetic labour force hence declining agricultural productivity.

- **Leads to congestion in urban and sub**-urban areas. This leads to high crime rate in urban areas.
- **Hampers development of the formal sector**. They produce cheaper substitutes to the products of the formal sector thus may stagnate the formal sector.

Question 33. (a) Explain the roles of the private sector in the development of your country.

(b) What are the problems faced by the private sector in your country.

The private sector is that part of the economy where economic activities are undertaken by private individuals mainly with the objective of maximizing profits. It is mainly composed of the informal sector, agricultural producers, and civic organizations like NGOs. The private sector performs the following roles in Uganda:-

- **Provision of employment opportunities.** A considerable portion of Uganda's labour force is engaged in the private sector. There are many people engaged in the informal sector where they are self employed. In addition there are private small scale and large scale industries which have created job opportunities.
- **Generation of government revenue.** The income generated from the private activities is taxed. This helps raise revenue necessary to finance public expenditure.
- **Encourages competition.** Since there are many private firms engaged in similar activities, there is improvement in the quality of outputs. This improves the welfare of the consumers.
- **Promotes equitable distribution of income.** Since the private sector is mainly labour intensive as evidenced in the informal sector and private farming activities, equitable distribution of income is achieved through employment creation.
- **Promotes industrialization.** The private sector encourages setting up of private industries both small scale and large scale under the umbrella of Uganda Manufacturer's Association (UMA) and Uganda small scale industries Association (USSIA).
- **Improved standard of living.** Through increased output, employment and income of the population, the standard of living of the population is improved.
- **Provision of skills.** People self employed in the informal sector acquire skills through apprenticeship. They learn by doing which lead to acquisition of practical skills.
- **Promotes economic development.** The competition in the private sector encourages innovations and inventions in the various sectors of the economy. This leads to increased output of goods and services, thus economic growth. A big portion of Uganda's GDP is from the private sector.
- **Leads to acquisition of Entrepreneurship skills.** The private sector acts as training ground to local entrepreneurs in the art of business management. For example prosperous indigenous entrepreneurs such as Wavamuno have gained experience from the private sector.

- **Promotes efficient use of a country's resources.** The private sector relies mainly on market mechanism where forces of demand and supply determine resource allocation. This minimizes resource wastage because only commodities which are demanded will be produced.

Problems faced by the private sector in Uganda.

- **High taxation.** Due to limited taxes bases, few existing enterprises are highly taxed to raise the badly needed revenue. This constrains the expansion of the private sector.
- **Profit repatriation**. Most large scale enterprises in the private sector are owned by foreign multinational corporations. These prefer to send the profit back to their home countries rather than re-investment in Uganda. This further stagnates the private sector.
- **Limited domestic market**. The domestic market is too small due to low incomes. In addition foreign markets are limited due to poor quality of locally made products and protectionist policies of the MDCs against the products of LDCs like Uganda. This limits expansion of private sector activities.
- **Shortage of capital**. Majority of local entrepreneurs lack capital to undertake investment in the private sector. In addition, they lack assets which they can present to banks as security to obtain loans. This explains why much of the private sector in Uganda is dominated by the informal sector where people are under employed and disguisedly unemployment.
- **Political instability.** The insecurity that goes with long period of civil war has negative effect on the private sector. For instance the civil war in the North has discouraged private investments in that region.
- **High production costs.** The cost of production in Uganda is very high because most of the machinery, spare parts, some raw materials and skilled labour are imported. This reduces the profitability of the private enterprises.
- **Poor infrastructure**. The infrastructure in Uganda is not well developed. The existing road network are in poor state and the railway system is almost non functional. This affects the movement of raw materials and finished products to market.
- **External competition**. Due to liberalization policy, the government no longer protects the private sector. This exposes the private domestic firms to external competition of established low cost firms of the MDCs.
- **Limited supply of entrepreneurs**. People with skills to undertake and efficiently manage private investments are few in Uganda. This results in poor performance and collapse of most enterprises in the private sector.
- **Limited access to research information**. Due to shortage of capital the private sector enterprises cannot afford cost of research. In addition they lack access to vital business information which is desirable for viability of private enterprises.
- **Limited access to credit facilities**. Due to informal nature of most of the activities in the private sector, lending institutions are less willing to lend to them. In addition these private sector enterprises lack collateral securities that they can present to the banks against the loans.
- **Low level of technology**. The technology used in the private sector especially in the informal sector is

poor. This leads to low productivity and low quality output thereby reducing the competitiveness of the products in the market.

- **Low profitability**. Uganda's economy is still heavily dependent on agriculture. This sector is characterized by traditional low productivity leading to low output and low profit. This reduces private incentives to invest in agriculture.
- **Poor land tenure system.** The system of landownership and use in Uganda does not promote large scale investments in the agricultural sector. Much of the land is fragmented into small holdings and in most cases communally owned.
- **Conservative colonial mentality.** Many people in Uganda still believe in being employed by the government. This reduces their involvement in the private sector activities.

Question 34. (a) Describe the structure of manufacturing industries in Uganda.

(b) What the implications of such a structure?

- **Composition.** Majority of these industries are processing industries. They process primary products for exports. Example includes the cotton ginneries, coffee huller etc. There are a few manufacturing industries producing mainly consumer goods e.g. textile mills.
- **Location.** Majority of these industries are urban based in the few large towns of Kampala and Jinja. In terms of distribution, they are concentrated in Southern part of the country as opposed to the North, East and West.
- **Size.** Majority of these industries are small scale industries such as cereal grinding mill, saw mills, bakeries etc. There are a few medium scale and large scale industries such as sugar mills, textile mills, breweries etc.
- **Nature of technology used**. Majority of small scale industries use labour intensive technology while large scale industries tend to use capital intensive technology.
- **Contribution to GDP.** The industries still contribute a small percentage of the total GDP. At present Uganda's industries contribute about 15% of GDP and the percentage is increasing.
- **Contribution to employment.** The industries have very small capacity to employ. The large scale industries use majorly capital intensive technology. Small scale industries mainly use semi skilled and unskilled labour.
- **Ownership.** Most of the small scale industries such as grinding mills are owned by indigenous people. Medium and large scale industries are owned by foreigners though the government has shares in some of them.
- **Capacity utilization**. Majority of these industries operate at excess capacity due to structural rigidities in the economy. Those that process agricultural products have periods of idleness due to seasonal nature of agriculture. Others have interruptions caused by power shortages and delayed delivery of imported raw materials.
- **Nature of output.** The outputs of these industries are of low quality, this causes problem of marketability.

- **Markets.** Majority of these industries produce for local market. There are few such as fish packers that produce for export.
- **Raw materials used.** Most of these industries depend on agricultural raw materials which are got locally. However, others use imported raw materials.

Positive implications

- **Promote self reliance.** Since the majority of these industries more especially small scale industries use local raw materials from the agricultural sector they promote development of agricultural industries. This makes an economy self-reliant.
- **Provision of employment industries.** Since the majority of these industries especially the small scale use labour intensive techniques, they promote generation of employment opportunities.
- **Save scarce foreign exchange**. Most of these industries are import substitution industries. They produce locally what used to be imported. This saves the country scarce foreign exchange that would have been spent on importation of the same commodities.
- **Small scale industries require limited skilled labour**. Majority of small scale industries in the formal sector do not need highly skilled manpower. This saves the country the need for expatriates because they make use of locally available semi-skilled and unskilled labour.
- **Small scale industries are easy to start**. Small scale industries such as bakeries, grinding mills etc require less capital. This promotes domestic investment.
- **Promote inter – sectoral linkages**. Since the majority of the industries both small scale and large scale use agricultural raw materials they facilitate the development of agriculture.
- **Small scale industries are suitable due to small market**. Uganda like most LDCs is characterized by low income leading to low aggregate demand. This small market is only suitable for small scale industries.

Negative implications

- **Encourage rural –urban migration**. The concentration of these industries in few urban areas, lead to rural –urban migration and its associated problems.
- **Profit repatriation**. Since majority of large scale industries are foreign owned, these foreigners prefer to take the profits back to their home countries rather than invest in the host country. This limits capital accumulation.
- **Lead to environmental degradations**. Due to concentrations of these industries in major urban areas of Kampala and Jinja they pollute the atmosphere and water. The small scale industries in the informal sector cause noise pollution.
- **Promote regional inequalities**. Since in terms of location these industries prefer to locate in urban areas, they promote unbalanced regional development of the economy. Hence, income inequality.
- **Inefficiency**. Since majority of industries are small scale they cannot enjoy economies of scale. They operate at high average cost thus low profits.
- **Promote capital outflow.** Since some industries especially the medium and large scale industries use

imported raw materials, they encourages foreign exchange outflow which in turn worsens B.O.P. deficit.

- **Low output**. Since small scale industries mainly use labour intensive technique and using semi skilled and unskilled labour force, there is low output and high labour costs.
- Vulnerability to natural hazards. Since majority of those industries use agricultural raw materials, they are affected by natural factors that interrupt their operations.

Qn. 35 (a) Account for increased privatization of public enterprises in your country.

(b) What are the likely effects of this policy to your country?

(a) Examine the problems encountered in the privatization of public enterprises in Uganda

Privatization refers to the selling of government owned corporations to the private sector owners. It is done for the following reasons:

- **To enable firms operate efficiently.** Increased competition arising from emergence of several firms will result into efficiency hence provision of quality goods and services to the public.
- To reduce corruption tendencies which are rampant with the public sector enterprises.
- **To reduce unnecessary bureaucracy**. State owned enterprises are characterized by bureaucracy in decision making. This causes delays and inefficiency in business management. Such delays are eliminated when the enterprises are placed under private management.
- **To expand tax base.** Since these corporations will operate efficiently under private ownership, the government will realize more revenue by taxing them.
- **To allow government to concentrate on provision of essential services.** The burden on the government to subsidize these corporations will be eliminated and the resources will be diverted to provision of essential services that promote the welfare of the citizens.
- **To attract foreign investors in the country.** Since it is foreign multi-national corporations with resources to buy and efficiently manage there enterprises, more will be attracted into the country. This leads to increased capital inflow.
- **To encourage private initiatives and innovations.** Diversity of talents will be attracted into economic activities leading to creativity.
- **To increase resource utilization**. Due to increased efficiency, more of the country’s resources will be put to effective use.
- **To create more job opportunities**. As many private firms enter production, in the long run more employment opportunities will be created.
- **To increase domestic output**. As many private firms enter production, more output of goods and services will be produced. This helps reduce domestic inflation and improve BOP position by increasing exports.
- **To meet conditionally of IMF**. This international financial institution puts conditions the countries that benefit from its development fund must meet. Privatization is among the top most conditions in its drive for private sector led economy.

Likely positive effects.

- **Likely to lead to increased efficiency.** The competition arising from entry of many firms will force each of the firms to operate efficiently, thus improved quality of output.
- **Likely to increase employment opportunities.** Since the firms will operate at full capacity and new ones will enter the industry, more jobs are created.
- **Likely to increase output.** This arises from the fact that many firms will be engaged in economic activities.
- **Likely to reduce burden on government.** The government will no longer be required to finance the operation of these firms. The resources will therefore be concentrated on provision of essential services for the citizens.
- **May reduce corruption and mismanagement of the enterprises.** The private owner who has invested capital in these enterprises will institute strict control measures on the finances of the business.
- **Likely to increase government tax revenue.** Since the enterprises will be operating efficiently, their profit level will be high. Thus they will raise more revenue to government through taxation.
- **Likely to reduce government budgetary deficit.** The government will no longer budget for the running of these enterprises, thus reducing government expenditure.
- **May increase availability of goods and services.** Many firms will enter production with variety of goods and services. This improves the standard of living of the citizens.
- **May attract foreign investors into the country.** It is the foreign multinational corporations with the required capital to but these enterprises. Privatization will attract many to come and invest in the country.
- **Likely to increase private sector confidence in the economy.** They will no longer fear the risk of nationalization of their property.
- **Likely to reduce government patronage.** The political interference in the running of these corporations will be minimized.

Likely negative effects.

- **May promote foreign domination of the economy.** The private corporations with capacity to buy and efficiently run these businesses are foreign owned. This promotes foreign domination of the economy.
- **Likely to increase resource outflow.** The foreign owners may prefer to repatriate their profits back to their home countries rather than plough back in the host country. This retard economic growth in the country.
- **May promote income inequality.** People with resources to purchase and own these corporations will continue to amass wealth thereby widening income gap,
- **May bring in dubious/scrupulous buyers**. Some of these buys are only interested in the assets and may cause the government losses.
- **Likely to increase foreign indebtedness.** The process is expensive and the government may be forced

to borrow in order to finance it, yet little may be realized from selling the enterprises. This will cause debt burden.

- **Likely to promote corruption.** People entrusted with selling off the corporations end up selling to themselves or their relatives and friends
- **May lead to death/closure of the enterprises.** The private owners are only interested in making profits. If this objective is not achieved, they may decide to close down.

Problems of privatization process in Uganda.

- **Corruption within the privatization unit:**

  Some of the officials of the privatization unit are not transparent and collude with the prospective buyers. They end up selling the enterprises to themselves and their relatives.
- **Opposition from the public.**

  The general public has often objected the sale of the assets which has sometimes resulted in delays in the process as their representatives in parliament sometimes block the transactions.
- **Poor Valuation of enterprises**:-

  The valuation of enterprises as going concerns always results into the assets being sold cheaply at give away prices leading to losses.
- **Poor state of enterprises**:-

  Due to poor maintenance, the enterprises are dilapidated making it very hard to sell them. The government incurs heavy expenses to rehabilitate them before they are sold.
- **Under developed capital markets:-**

  Purchasing these enterprises require large capital investment. However, in Uganda the capital market is not well developed and in most cases non functional. This makes it hard to sell the enterprises to the general public.
- **Political sabotage:-**

  Opposition politicians sometimes unfairly criticize and block the sale of enterprises just to frustrate the government and advance their causes.
- **Poverty among the nationals:-**

  Most Ugandans are poor and cannot afford to purchase the enterprises. This forces the government to sell the enterprises to foreigners thereby increasing the domination of the economy by foreigners.
- **High Cost of the process:-**

  Privatization is a very costly exercise. The government spends a lot of money to renovate the enterprises before selling them and to advertise in foreign countries. The returns from the sales are often much less than the cost of the exercise making the process unjustified.
- **Unscrupulous buyers:-**

Some buyers who win the bids to buy the enterprises are not genuine and only interested in the assets. They end up not paying after taking over the enterprises. This leads to the death of the enterprises.

- **Small domestic markets:-**

  This discourages potential buyers due to limited potential for expansion.

- **Political instability:-**

  Instability in some parts of the country also discourages potential investors from buying the enterprises.

- **Poor infrastructure:-**

  Some of these enterprises especially those up country are located in remote areas. This makes them inaccessible and less attractive to foreign investors.

SECTION A

106. Mention any four structural features of your country's economy.

- Dominance of subsistence agriculture.
- Existence of dualism.
- Existence of unemployment and under employed.
- Existence of excess capacity.
- Mixed economic system.
- High population growth rate.
- Poor infrastructure.
- Open economy.
- High level of dependence.
- High level of illiteracy.
- Poor infrastructure.
- Labour force is dominated by unskilled workers.

107. (i) Distinguish between mixed economy and dual economy.

(ii) Mention any two features of economic dualism in your country.

A. (i) Mixed economy is an economy where both the government and private organizations take part in allocation of resources.

While

Dual economy is an economy with two contradicting sectors where one is superior and desirable and another is inferior/traditional and undesirable.

(ii) **Features of economic dualism.**

- Subsistence versus commercial sector.
- Modern technology versus rudimentary technology/capital intensive and labour intensive.
- Barter exchange versus monetary economy.
- Formal sector and informal sector.
- Rural and urban areas.
- The rich and poor.
- MDCs versus LDCs.
- Small scale and large scale industries.

108. (i) What is meant by the term "economic dependence".

(ii) Suggest any three measures to reduce economic dependence.

A. (i) Economic dependence refers to the reliance of a country on others for certain economic decisions and resources for development.

(ii) **Measures to reduce dependence**.

- Increase taxes on imports.
- Import substitution industries to reduce reliance on imported inputs.
- Agricultural diversification to widen agricultural export base.
- Widen market for country's export.
- Promotion of regional integration.
- Educational reforms to emphasis technical education/skills.
- Economic reforms through structural adjustment.
- Promotion of self reliance.

109. What is the role of informal sector in your country?

- Creation of employment opportunities.
- Facilities production of locally affordable goods.
- Helps conserve foreign exchange which would have been spent on imports.
- Provision of cheap training ground for local labour.
- Facilitates development of entrepreneurial skills..
- Facilitates utilization of idle resources.
- Contributes to increase in GNP/economic growth.
- To some extent it contributes to government revenue through taxes.
- Promotes development of technology in the economy.

- Promotes industrial development though on small scale basis.
- Promotes fairer distribution of income by providing employment opportunities.
- Promotes commercialization of the economy.
- Widens consumer's choice by providing variety of goods.

110. Mention any four ways in which your country's economy is dependent.

- Reliance on imported skilled manpower/expatriates in many sectors of the economy.
- Heavy reliance on foreign assistance ie receives aids from donor institution and countries.
- Reliance on few countries for export market ie USA and Western Europe.
- Dependence on few cash crops for export earnings mainly cotton and coffee.
- Dependence on IMF and World Bank for technical advice.
- Reliance on foreign investment mainly by multinational corporations.
- Reliance on foreign technology/technology transfer.
- Financial sector is dominated by foreign owned financial institutions.
- Dependence on imported capital goods.

111. (i) what is meant by "economic dualism".

(ii) State any three examples of economic dualism.

A. (i) Economic dualism refers to the co-existence of two contradicting economic conditions in an economy one being modern and desirable while the other is traditional and undesirable.

(ii**) Examples of dualism**.

- Co-existence of modern and traditional sectors.
- The poor co-existing with the rich.
- Technology dualism ie modern technology and traditional technology/labour intensive and capital incentive technology.
- Subsistence versus commercial sectors.
- Exchange dualism ie barter exchange versus money exchange.
- International dualism ie LDCs versus MDCs.

112. (i) What is meant by informal sector.

(ii) Give any three features of informal sector.

A. (i) Informal sector is that sector which lies between the traditional pre industrial sector and the modern industrial sector.

(ii) **Features of informal sector.**

- Located in urban and semi urban areas.
- Produce mainly for local markets.
- Use mainly local resources/raw materials.
- Mainly organized on sole proprietor basis.
- Produce poor quality products.
- Poor or no record keeping.
- Employ poor technology/labour intensive techniques.
- Limited capital is invested.

POPULATION AND LABOUR

Qn. 36 (a) Define the term optimum population.

(b) Examine the implications of increasing populations in an economy.

Optimum population is the population size and structure which is the most suitable and conducive for the exploitation of the available resources of an economy.

Or

The population size which if labour force is combined with other factors of production, yields the maximum output per head, i.e. average output per head is maximum.

Positive implications of increasing population.

- **Creation of wider market.** Increasing population creates demand for goods and services. A big population size provides big market, provided they are employed and have effective demand.
- **Increased labour force.** Labour is derived from population. Increasing population therefore means increasing labour supply.
- **Increased urge of development.** The pressure on government to provide basic social and economic infrastructure will increase leading to provision of more roads, schools, hospitals etc.
- **Increased output.** If the increasing population is engaged in economic activities, more output of goods and services will be realized.
- **Increased labour mobility.** The population pressure arising from increasing population accelerates mobility of labour from areas of high population to areas of low population densities and between jobs, which increases the efficiency and productivity of labour.
- **Stimulates investments.** The increased consumer demand arising from increasing population stimulates investment in the economy leading to increased employment opportunities.
- **Increased tax revenue to government.** The increasing population means increasing tax base. As people who can be taxed increase in the country, the government realizes more

revenue to finance public expenditure.

- **Increased utilization of idle resources**. Increasing population means greater need for land to produce required food. Idle land will be cleared for agriculture.
- **Accelerates rate of economic growth**. As population grows, more output of goods and services will be produced to meet their needs, this facilitates economic growth.

Negative implications

- **Food shortages**. As population grows, feeding problem arise. The country may not have the capacity to produce food at the same rate with population growth rate. This may cause misery and starvation.
- **Increased dependence burden.** High population growth rate implies greater number of young people below the age of 15 years. These are mainly dependents and resources that would have been used for development will be diverted to meet the needs of these young people.
- **Reduced investments.** Investment is affected since expenditure tends to be focused on consumption with less savings.
- **Leads to BOP problems.** The demand for imports may increase as population increases leading to increased foreign expenditure. Exports may reduce due to high domestic demand, hence BOP deficit may arise.
- **Unemployment.** As proportion of worker to population increases, unemployment results. The economy may not have the capacity to provide employment opportunity at the same pace with increase in population.
- **May result in over population.** High population growth rate leads to over population with its negative consequences like over exploitation of natural resources, land fragmentation etc.
- **Low capital accumulation.** It retards saving which is a very important factor in capital accumulation.
- **Low standard of living.** Rising population leads to low per capita income and low standard of living.
- **Promotes rural-urban migration.** Due to pressure on land in the rural areas, rural urban migration results as people try to get employment opportunities in the urban areas.
- **Inflation.** As people increase, demand for goods and services also increases. If supply cannot increase proportionately, price will go up.
- **Imposes strain on government budget.** The government will be under pressure to provide social infrastructure for the ever increasing population. This may lead to deficit on the budget.
- **Political instability may result.** Dissatisfied group in the population may become many leading to political instability.

Qn. 37. (a) Describe the population structure in your country.

(b) Examine the implications of such a population structure.

- **High population growth rate.** Uganda's population growth rate is over 3.2% per annum which is among the highest in the world.

- **Age composition.** Majority of the population are below the age of 15 years due to high population growth rate. A small percentage is above 60 years of age due to low life expectancy.
- **The sex ratio.** There is high proportion of women than men in Uganda's population.
- **Settlement patterns**. The majority of people live in the rural areas. However there is high incidence of rural urban immigration making urban population the fastest growing.
- **Literacy levels.** Literacy level is low with the majority of population being unskilled.
- **Regional distribution**. The population is concentrated in the southern, eastern and south westerns parts of the country. The north northwest and north eastern part of the country is very sparsely populated.

- **Implications of the population structure.**

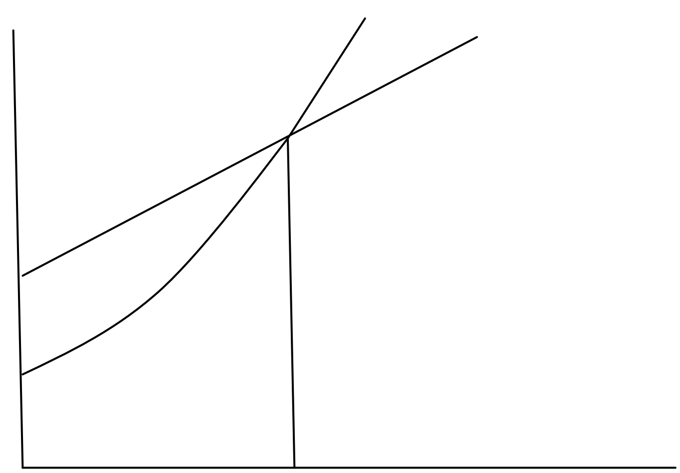
- **Limited size of labour force.** Since the majority in the production are below 15 years of age implies low supply of labour force. This is because people below 15 years are considered children and do not quality for wage employment.
- **High dependence burden**. Since the population is dominated by young people below the working age, this presents dependence burden on the small working population.
- **Slow rate of development.** Large proportion of resources is spent on feeding dependent population. This retards development because government expenditure on infrastructure, development, industry, agriculture etc is constrained.
- **High expenditure on social infrastructure.** The consumption pattern is dominated by the young who require a lot of social infrastructure such as schools.
- **Feeding problems.** The young people who dominate the population are basically consumers. The society is presented with a problem of producing and importing food to cater for large numbers of dependents.
- **May lead to BOP deficit.** To meet the requirements of the rapidly expanding population, the government may get involved in high importations to provide for their needs. In addition the exports may reduce because the increasing domestic demand may reduce the surplus for exports. This worsens BOP deficit.
- **Rural urban migration and its consequences may result.** Since the majority of people are based in the rural areas where they are engaged in agriculture, rapidly expanding population may lead to land shortage leading to rural-urban migration and its negative consequences.
- **Since the majority is women, there is decline in labour supply.** Labour market in Uganda still discriminates women in many jobs. Their domination of the population reduces labour supply.
- **Retards educational level.** The diversion of resources to cater for large populations reduces resources for education.

38. (a) Explain the Malthusian population theory.

(b) How relevant is the theory to the economy of your country?

This theory was formulated by Rev. Thomas Robert Malthus. In his essay, 'the principle of population" written in 1789, he expressed concern about the rapidly increasing population.

- He argued that population has tendency to grow faster than food supply, and if unchecked it grows at a geometrical progression i.e. (2, 4, 8, 2.16, 32 ….) and double every 25 years.
- Food supply upon which population depends increases only at arithmetical progression i.e. (1, 2, 3, 4, 5, 6…) due to law of diminishing returns given that land upon which agriculture is carried out is fixed.
- It will eventually reach a time when population will equal food supply i.e. the available food supply will only be sufficient to sustain the existing population. This point is referred to as Malthusian population trap.
- Beyond the trap food supply will not be sufficient to sustain the population and positive checks will apply i.e. misery, starvation, wars, pestilence etc.
- To avoid the situation Malthus advocated for negative/preventive checks i.e. voluntary measures which control population by reducing the growth rate. For this he advocated for moral restraint e.g. late marriages, celibacy etc.



Time T population will be trapped by food supply. Therefore it is optimum population according Malthus. Beyond T population will exceed means of subsistence resulting into misery.

To a large extent the theory is irrelevant to Uganda because:-

- It ignores advancement in technology e.g. irrigation system which increase food supply. Food shortage may never be experienced because technology is never constant.
- The theory does not take into account international trade and foreign aid. When there is severe food shortage the country can import food from other countries or seek help from donor agencies like World Food Programme.
- The theory is based on assumption of a closed economy yet LDCs Uganda inclusive are open economies.
- The theory did not foresee scientific method of birth control. In LDCs like Uganda there is increasing use of artificial birth control methods e.g. condoms, pills etc which are not natural methods proposed by Malthus.
- The theory ignores migrations of population. People cam move from areas with dense population to areas with sparse population.
- The theory did not foresee improvement in transport net work. The extension of roads and railways networks has facilitated easy transportation of food from areas with plenty and cheap to areas with scarcity.
- Malthus based his theory on food supply as the only determinant population growth rate completely ignoring other factors. In Uganda culture has greater influence on population size.
- Malthusian theory is based on assumption that the economy is at subsistence. But economies grow out of subsistence. Most LDCs including Uganda are no longer subsistence i.e. there is market production. Where food requirement can be obtained through monetary transactions.
- Malthus did not foresee the impact of modern education. It has improved quality of life and many educated people prefer fewer children.
- The law of diminishing returns upon which the theory is based does not apply always. Due to application of fertilizer increasing rather than decreasing returns has been experienced.
- There is plenty of idle land in Uganda. The availability of land therefore is not a problem. Northern and part of western regions are still sparsely populated and require increase in population for effective utilization of idle land.
- Malthus did not specify the time when the trap would be reached. The positive checks such as wars, diseases etc are evident in the country. One wonders whether we are in the trap or about to reach.
- In LDCs it is difficult to establish a mathematical relationship between the growth in food and population.

To a smaller extent the theory is relevant because:-

- In some parts of Uganda there are wars as predicted by Malthus e.g. In the North where civil wars has raged for the last two decades.

- Land conflict is now common in Uganda. This is evidenced in Mbale, Kabale and Kibale district. The most recent was the land wrangle between the Balaalo and Banyala in the district of Mulisa.
- There are many parts of the country experiencing food shortage e.g. Karamoja is always in food deficit.
- The law of diminishing returns upon which the theory is based is evidenced in the country. Land is declining in productivity due to over cultivation.
- The natural control of population is now in application in Uganda. Celibacy is being practiced by Catholic Nuns and priests. Many people now delay to marry
- Incurable diseases are now common in the country e.g. HIV/Aids.

Question 42. (a) Under what circumstances are the trade unions justified to demand for wage increases.

(b) Why do trade unions in your country fail to achieve wage increase for their members?

Trade Union is an organization for workers in a particular industry or sector whose aim is to achieve better working conditions for its members. They are justified to demand for wage rise under the following circumstances:

- **When there is rising cost of living**. During inflation the cost of living rises due to increase in prices of goods and services. Trade unions argue that if money wages are not increased proportionately, the real wage will fall and welfare of the members will be affected.
- **When there is increased profitability of the firm**.   Trade unions argue that the rise in profitability is due to the effort of the workers. Therefore it is prudent that the employer shares this increased profits with the workers.
- **When there is increased labour productivity**. If labour has acquired new skills through further training, his productivity rises. Trade unions argue that this rise in productivity is to the benefit of the employer and must be appreciated by corresponding rise in pay.
- **If the employers increases work load.** Trade unions argue that if the employer increases quantity of work or hours of work the contribution of the workers increase, this extra effort calls for increase in pay.
- **When workers in similar industry have received wage rise.** Workers doing similar jobs will prefer to receive equal pay. If workers in one industry have received pay rise, trade unions in similar industries are justified to demand wage rise to level out the wage differences.
- **When workers feel that the current wages paid are too low/they are being exploited.** They may demand for wage increase to improve their standard of living.
- **If the workers are doing risky jobs**. If the work puts the life of workers in danger, the trade unions argue that these risks should be compensated for by way of increasing pay.

- **If the employer has failed to pay minimum legislated wage**. Where the government has fixed a minimum wage, trade unions argue that any wage below that exploit workers and it is illegal.
- **When employer has failed to implement earlier agreed upon wage.** If through collection bargaining, trade union representatives and employers had agreed on a certain wage, and the employer fails to implement it the trade unions become justified to demand that rise.
- **If there is general prosperity in the economy.** Trade Unions argue that during boom the level of economic activity is high and the capacity of the employer to pay wages is also high.
- **If the demand for the product is inelastic.** The workers are justified because they know that employer can recover the wage cost by raising the price of the final product.

Why Trade Unions fail to achieve rise.

- **Weak leadership.** Majority of trade unions in Uganda like in other LDCs, are characterized by poor and inefficient leadership. They fail to effectively represent workers' interest during collective bargaining.
- **Government interference in the activities of trade unions.** In Uganda Trade Unions have limited autonomy because the government is the major employer. In addition strike action is considered illegal. This weakens the tool of industrial action as a measure to achieve wage rise.
- **Weak financial position.** The Trade unions in Uganda are poor and do not have the fighting funds to sustain workers during industrial action. This makes strikes unsustainable and workers return to work before their demands are met.
- **Unemployment problem.** In Uganda unemployment problem has reached alarming proportions. The few people in employment consider themselves privileged. Workers get satisfied with low pay than risk losing their jobs.
- **Small membership.** Majority of trade unions in Uganda have very few members. The majority of workers have no interest in the activities of trade unions. This weakens the power of trade unions to cause disorganization in society through industrial action.
- **Lack of loyalty among members.** Majority of workers have no faith in trade union activities and unwilling to take directives from union leadership. For example majority of workers may report to work during a call for a general strike. This renders the union weak and unable to achieve wage demands.
- **Ignorance about trade unions.** Many workers in Uganda are illiterate and do not understand the objectives and benefits of trade unions. Thus less interested in its activities.
- **Existence of many target workers.** A large proportion of Uganda's work force is of target workers. This makes trade union membership very unstable as many people get out of work after achieving their set targets.

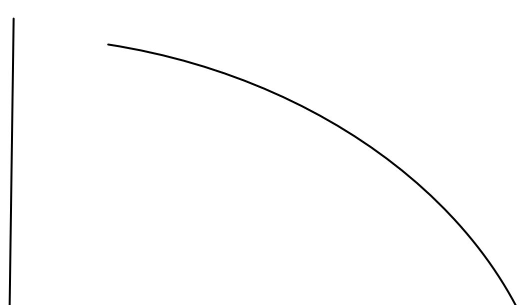
- **Weak industrial sector.** Uganda's industrial sector is still weak and small. This renders their workers' unions weak.
- **Corruption and embezzlement of funds by leaders**. The majority of trade union leaders are opportunists who want to achieve personal gains. They divert the union funds rendering the organization weak and unable to sustain workers during strike.
- **Limited bargaining skills**. Trade union leaders lack the negotiation skills to convince the employers to increase wages.
- **Amorphous membership**. The composition of the membership is difficult to define.
- **Use of trade unions by leaders to attain political positions**. Trade union leaders use the unions as stepping stone to get political jobs. They side with government against interest of workers.
- **Availability of transitory income and other economic benefits**. In Uganda it is common to find workers engaged in many business activities that give them income. They get less interested in trade unions activities.
- **Poor communication system**. The road network and other communication facilities are not well developed. This makes it difficult to coordinate the Trade Union activities and to mobilize the workers to take industrial action.

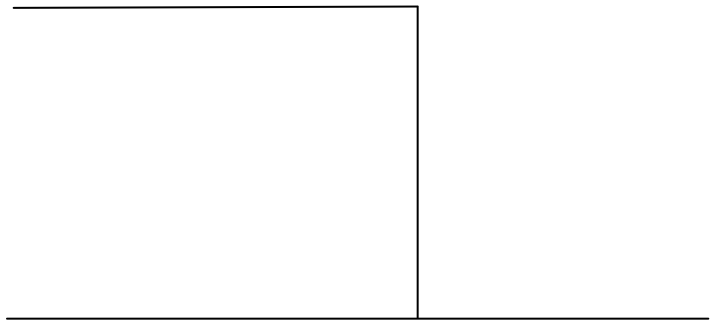
Qn. 43 (a) Explain the marginal productivity theory of wages.

(b) How relevant is this theory in wage determination in your country.

The marginal productivity theory of wages states that employer will pay the worker what is equal to the value of that worker's marginal product. When marginal product is high, a high wage is paid and as marginal product falls, wages also reduce. This theory is based on the following assumptions:-

- Employers are able to measure the marginal productivity of labour.
- Labour knows his marginal product.
- There is free and complete competition among employers for workers.
- Capital and labour are perfectly mobile.
- Capital and labour are full employed.
- Labour is homogenous
- Government does not interfere in determination
- There is free and complete competition among workers for jobs.
- Bargaining power of workers and management are equal.





The supply curve is elastic because all units of labour are homogenous. Demand curve (D_L) is downward sloping because of diminishing marginal productivity of labour.

Equilibrium wage and employment is where $D_L = S_L$ and employing L_o labour. Before $L_{o,}$ VMP_L is greater than Wo and affirm gets profit if it employs more units of labour. Beyond L_O a firm incurs losses by employing more units of labour because W_O is greater than $VMP_{L.}$ It will benefit a firm to reduce employment until where $VMP_L = W_{O.}$

(b) The theory is irrelevant in wage determination because of the following weaknesses:-

- Most employees do not know the marginal product of their workers as the theory assumes. They offer employment basing on judgment of the demand for the products in the market.
- Labour does not know its marginal product as stated in the theory. This rules out the application of this theory in wage determination in any country.
- Labour is not homogenous as stated in the theory. Labour market is heterogenous, i.e. there is both skilled and unskilled labour which called for variations in wages.
- The assumption of perfect competition for jobs is not unrealistic. In LDCs like Uganda, the government is the major employer and usually fixes wages.
- The assumption of perfect competition for jobs is not realistic. Job market in Uganda is characterized by tribalism, nepotism, religious discrimination etc.
- Labour and capital are not freely mobile as assumed in the theory. There are many barriers to occupational and geographical mobility of labour. Government policy and international restrictions may limit capital mobility.
- The assumption that capital and labour are fully employed is not always true. There are many factors that may render these factors idle.
- The bargaining power of workers' union and management are not equal. This is due to high elasticity of supply of unskilled labour drawn from agricultural sector.
- The marginal productivity does not depend entirely on labour's own effort and efficiency but on

the quality of other factors of production employed especially capital.

- The marginal productivity theory is only applicable in the conditions of perfect competition. This condition does not exist in real world.

Qn 44 (a) Explain the Iron law of wages

(b) Account for wage differentials in your country.

The Iron law of wages also known as the subsistence theory of wages was developed by French economists who had been greatly influenced by the writing of Malthus. It states that the worker should be paid the bear minimum sufficient for the basic needs. Above the subsistence wage, population drastically increases which consequently increases the labour force. Competition for jobs will increase forcing the wage level to fall to subsistence level again. This theory was used to justify the payment of low wages during the industrial revolution. In Uganda today, there are big disparities in wages paid to workers from different occupations and in some cases within the same occupation.

Causes of wages differential in Uganda.

- **Differences in occupation**. Different occupations reward their employees differently. For example doctors are more highly paid than teachers causes causing wage variation between the two occupations.
- **Differences in the level of education and training**. People with university degrees are more highly paid than those with diplomas. Those with high school certificate earn more than those with ordinary level certificates. Thus causing variations in wages among workers even in the same industry.
- **Differences in bargaining power of workers and trade unions**. There are workers with skills in bargaining and can easily convince the employers to hike their wages. The workers bound under a strong trade union are also more likely to receive higher wages than their counter parts with weak trade unions.
- **Differences in experience**. The workers who have worked for long and acquired experience receive higher wages than those doing the same job but are fresh in the field of employment thus wage differentials.
- **Differences in workers ability**. In occupations where piece rate method of wage payment is applied, the stronger and more able workers tend to be of higher wages than the weak ones. Thus differences in wages within the same industry and occupation.
- **Differences in employer's ability to pay.** Firms, industries and occupation with strong financial base usually pay their workers/employees higher wages than beginner firms and the financially disadvantaged occupations.
- **Imperfections in the labour market.** The labour market in Uganda is characterized by many imperfections, which influence wages paid to different workers in the same occupations. There

exists discrimination based on sex, tribe, religion etc. This has enhanced the difference in wages among workers in Uganda including those doing the same jobs.

- **Differences in job locations.** People working in hardship and disadvantaged areas like Karamonja and Northern Uganda are paid higher wages to compensate for the high risks. This places workers in such areas to be of higher wages than those working in politically secure areas.
- **The non-matching government policies on income and wages.** In Uganda the government is the major employer and sometimes sets minimum wages for various occupations and activities. This however always varies from sector to sector-causing differences in wages.
- **Differences in term of employment**. Workers employed on contract basis are usually more highly paid compared to those on permanent terms. This is because those on contract terms usually suffer interludes of unemployment and have to be compensated for these interruptions. Thus causing wage variations with terms of employment.
- **Differences in elasticity of demand for labour.** Since demand for labour is derived demand. The price of labour directly depends on the elasticity of demand for the product of labour. Workers producing commodities with inelastic demand receive higher pay than those producing commodities with elastic demand.
- **Differences in the elasticity of supply of labour.** There are certain professions in inelastic supply of labour such as medicine, engineering, etc, such professions have few workers and more highly paid than those in pure arts professions which are already flooded with many members. Thus causing variations in wages.
- **Differences in time worked.** In occupation that use time rate method of wage payment, those work more hours including over time are more rewarded than those who work less hours causing wage variations among workers in the industry.

SECTION A

253. (i) What is meant by population census.

(ii) Give any three reasons for population census in your country.

A. (i) Population census is the official counting of people living in an area or country in a given period of time to establish various aspects and the structure of the population for planning purposes.

(ii) **Reasons for planning.**

- To establish the size of the population.
- To establish the birth rates and death rates which help in formulating population policies?
- To discover the distribution of population and to establish population densities which help in planning for distribution of social services.
- To establish the size of the labour force and member of dependents in the country.

- To establish the sex composition of the population.
- To establish the rate of population migration both internally and externally.
- To establish the quality of the population ie establishing the level of education.
- To establish the rate of unemployment in the country.

254. Mention any four problems of population census.

- Shortage of skilled manpower for carrying out the exercise.
- Shortage of funds.
- Political instability making if difficult to count people in some areas.
- Inadequate reliable information.
- Conservation of the population.
- Language barriers.
- Political manipulation.
- Inaccessibility of some places due to bad roads.

255. (i) What is meant by population growth.

(ii) Give any three factors that influence the size of population.

A. (i) Population growth refers to the increase in the population size of an area or country brought about by such factors as migration, birth rate and death rates. The difference between the birth rate and death rate is known as natural rate of population growth.

(ii) **Factors that influence the size of population.**

- Crude birth rate ie number of live births per a thousand of population.
- The crude death rate ie number of people should die in country per thousand of the population.
- Net reproductive rate (NRR).
- Population momentum ie the tendency of the population to continue growing even when there is decline in birth rate.
- Fertility rate.
- The marriage patterns.
- The size of families.
- The migration patterns.

256. (i) What is population explosion.

(ii) Give any three causes of population explosion in LDCs.

A. (i) Population explosion refers to the rapid increase in the population of a given area relative to the available resources.

(ii) **Reasons for population explosion in LDCs.**

- Improved economic conditions leading to better housing and adequate food supply.
- Improvement in hygiene such as improved sanitation and clear water supply.
- Effective public health program leading to reduced mortality.
- Improved medical care.
- Improvement in literacy levels which lead improved nutrition standards.
- Early marriages in some societies.
- Increased rate of pre-marital pregnancies.
- Limited family planning practices due to traditional customs, ignorance and religious beliefs.

257. (i) Define optimum population.

(ii) State any three merits of over population.

A. (i) Optimum population is the population size and structure which is more suitable and conducive for the exploitation of the available resources of the economy.

(ii) **Merits of over population.**

- Large domestic market for goods and services.
- Increased supply of labour force.
- Increased labour mobility.
- Expanded investment in the economy.
- Increased urge for development effort.
- Increased tax base for the government.

258. (i) What is meant by under population.

(ii) Mention three disadvantages of under population.

A.(i) Under population is that population size which is too small to effectively utile the variable resources so that the average product of labor rises as population increases.

(ii) Disadvantages of under population.

- Resources of a country are under utilized.
- Small domestic market/low aggregate demand.
- Low investments due to limited market.
- High transport cost due scattered settlement.
- Under developed infrastructure.
- Slow economic progress.

- Less specialization in under populated areas.

259. (i) Define over population.

(ii) Give three problems of over population in an economy.

A. (i) Over population is that population size which is too large to be sustained by exiting resources. This happens when the population size exceeds the capacity of the existing resource's at a given state of technology.

(ii) Problems of over population.

- Leads to population explosion.
- Results into food shortages.
- Increases problem of rural-urban migration.
- Leads to land fragmentation.
- Puts heavy strain on existing infrastructure.
- Promotes social conflict and wide spread discontent.
- Inflation arising from imbalances in demand and supply.
- Unskilled labour force.
- Low standard of living due to insufficient resources.

260. Given that the working population in a country is 12,000,000, the young population is 14,000,000 and the elderly population is 4,000,000.

(i) Calculate the country's dependency ratio.

(ii) Give two disadvantages of such a population structure.

A. (i) Dependency ratio $= \dfrac{\text{the young population + the old}}{\text{working population}}$

$$= \frac{14{,}000{,}000 + 4{,}000{,}000}{12{,}000{,}000} \times 100$$

$$= \frac{18{,}000{,}000}{12{,}000{,}000} \times 100$$

$$= 0.6 \times 100$$

$$= 60\%$$

(ii) Disadvantages of such a population structure.

- Leads to small size labour force.
- Leads to greater dependency burden.
- Affects patterns of consumption and production of goods for predominantly young people.

- Leads to structural unemployment as industries change to production of goods demanded by the young.
- Feeding problems as population is dominated by non producers.
- Retards development because much of the resources are spent on feeding dependant population.

261. Mention four population problems in your country.

- Poor standard of living due to heavy dependence burden.
- High government expenditure on social services.
- Pressure on land.
- Low savings, capital accumulation and investment
- Pressure on existing infrastructure.
- BOP problems due to increased imports and reduced exports.
- Brain drain.
- Unemployment problems.
- Social evils e.g prostitution.
- Income inequalities.

262. Give four effects of a declining population.

- It changes the distribution of wealth in favour of the older people at the expense of the young ones hence, income inequality.
- Leads to fall in aggregate demand thus smaller market.
- Low investments due to small market.
- Increases dependency burden because the provision of social services will fall heavily on the working population.
- May lead to less expenditure on social infrastructure like schools hospitals etc.
- Reduces pressure on land and other factors of production.
- Helps a country to attain the optimum level of population in case there had been an over population.
- Strengthens government's ability top provide essential goods and services.
- Reduces unemployment problems since labour supply drops.

263. (i) Explain the Malthusian population theory of population.

(ii) State any two limitations of the Malthusian theory of population.

A. (i) The theory states that if population is not checked it has a tendency to grow at a geometrical progression while food supply will grow at arithmetical progression. It will reach a time when food supply will just be sufficient to sustain the existing population, a point known as population trap. Beyond the trap, there will be positive checks on population e.g. farming, wars, pestilences etc.

(ii) **Limitations.**

- The theory does not take into account improvements in technology.
- Ignores role of international trade.
- Disregards existence of collective resources/land in LDCs.
- Ignores scientific advancement that can increase food supply.
- Economies grow out of subsistence.
- In LDCs population growth does not depend on food alone. There are other factors like culture.
- Ignores population migrations.
- The theory disregards birth control measures e.g. family planning.
- Does not take into account improvement in transport.
- LDCs are open economies and not closed as assumed in the theory.
- Did not indicate the time when the trap would be reached.

264. (i) Define labour.

(ii) Give any three factors that determine labour supply/working population in your country.

A. (i) Labour is human effort both physical and mental used in production process. Labour force is mainly made up of working population which is mainly of age 15 to 65 years.

(ii) **Factors that determine labour supply/working population.**

- Size of the population.
- The proportion of women in the population.
- Educational level.
- Employment relations (labour laws).
- Retirement age.
- Quality of the population.

265. Give any four characteristics of labour in LDCs.

- Dominated by young people 15 – 30 years.
- Rapidly expanding in most economies it is growing faster than the economy.
- Labour conditions are poor due to poor feeding and health conditions.

- Dominated by illiterate, unskilled or semiskilled labour force.
- Small fraction of highly skilled labour force.
- Inappropriate skills for the literate class.

266. (i) State the subsistence theory of wages.

(ii) Give three weakness of the theory.

A. (i) The subsistence theory of wages also known as the iron law of wages states that a worker will be paid a wage which is just sufficient for subsistence needs and if wages rise above the subsistence level, then an increase in population will inevitably follow leading to an increase in labour supply which in turn lead to fall in wages. On the other hand if wages fall below subsistence level, few children will be born leading to reduction in labour supply which in turn raises wages back to subsistence level.

(ii) **Weakness of the theory.**

- What is considered to be subsistence level varies from time to time and place to place ie what is considered luxury to day may subsistence in future.
- The theory does not recognize differences in wages due to difference in professions.
- The theory ignores efficiency of workers which should influence the wage of the more productive workers.
- The theory only considers the supply of labour ignoring demand for labour.
- The theory does not apply to industrial economies because arise in wage income is usually accompanied by a fall in the birth rates.
- An increase in wages improves the worker's standard of living and restricts labour supply.

267. (i) State the wage fund theory.

(ii) Mention three weakness of the theory.

A. (i) The theory states that the total amount that can be paid as wages at any particular time is limited by the size of the fund at that time. It assumes that there is a fixed amount to be paid out in wages and the amount each worker receives depends upon the number of workers/population size. An income in population reduces wage rate.

(ii) **Weaknesses of the theory.**

- Wag fund is not the only means through which wages can be paid. There are other sources which can be used to pay labour.
- The theory does not explain how the funds make the payments of labour rise and how it can be measured.
- Wages do not necessarily depend on the accumulated capital because a high wage can result from employing a smaller number of workers as compared to their demand and productivity.
- The competition between employers for workers can lead to wage rise even when the fund

has not increased.

- The theory does not explain the causes of wage differentials in an industry.
- The assumption that labour is homogeneous is not true.

268. (i) State the marginal productivity theory of distribution.

(ii) Mention three limitations of the marginal productivity theory of distribution.

A. (i) The marginal productivity theory of distribution states that a factor of production is paid a monetary reward which is equal to the value of its marginal product. This theory is more applicable to labour.

(ii) **Limitations of the theory.**

- Disregards influence of trade unions in bargaining for wages.
- It is difficult to measure the marginal product of a factor of production in some sectors e.g. service sectors.
- Factors of production tend to be immobile.
- Factors of production cannot be wholly substituted.
- Ignores government intervention in fixing factor prices.
- Units of factors of production are not homogeneous as implied in the theory. A factor's productivity varies with time.
- Ignores exploitation of labourers by capitalists.
- Education and training may differ.
- The law of diminishing returns does not hold always. There may be increasing returns.
- Employers usually use subsistence level as a measure of factor prices, which may be below or above the marginal product of a factor ie rewards are determined by the cost of living.
- Historical factors inherited salary structure.
- Factor prices can be bargained.

269. (i) What is meant by the term time rate wages.

(ii) State the social economic relationship between the level of occupational hazards and the wages in your country.

A. (i) Time rate wages are wages paid according to the duration of time worked e.g. per hour, per week etc. This system requires keeping records of the number of hours or duration worked by each employee.

(ii) The social economic relationship between the level of occupational hazards and wages is that workers tend to demand higher wages for jobs which are risky and unpleasant for example in case of pilots, mine workers etc. This is because supply of labour in these occupations is inelastic.

270. (i) Differentiate between piece rate and time rate method of wage payment.

(ii) State two relationships of using time rate method of wage payment.

A. (i) This rate is a system of wage payment where labour is paid a according to duration of time worked e.g. per hour, day, week etc.

While

Piece rate is a system of wages payment where a worker is paid according to the amount of work done. It is used where individual's output can be measured.

(ii) **Advantages of time rate:-**

- Calculation of labour cost is simplified.
- Encourages workers to work long hours in order to earn more.
- Makes it easy to reach agreement between employers and employees.
- Even bad or poor workers receive equal amount if they work the same duration.

271. Give any four demerits of time rate system of wage payment.

- Lacks incentives for promotion of efficiency since workers are paid for the duration worked.
- Requires strict record keeping which may be difficult and time wasting.
- Involves high cost of supervision to prevent under performing.
- Agreement can be undermined by workers who adopt go slow attitude to work.

272. Give any two merits and two demerits of piece rate method of wage payment.

Merits.

- The quicker workers re4ceive more than the lazy ones.
- Workers can work at their pace depending on their ability.
- Prospects of earning high wage stimulates effort.
- Increased output as workers take big loads.
- There is no need for supervision because slackening affects t he employee himself.
- The employer's costing becomes easier because he knows the exact cost of labour required for a given unit of out output.
- Team spirit is developed when workers operate in small groups.

Demerits.

- Workers may over exert in effort to earn more.
- Workers may hurry in an attempt to earn more leading to reduced quality.
- Leads to misunderstanding especially in computation of work done.
- The more careful workers who take time on their work are not catered for.

- Trade unions may lose control over the supply of labour and this makes it difficult to take strike actions.

273. (i) Distinguish between bonus system and profit sharing scheme.

(ii) Give any two reasons for profit sharing.

A. (i) Bonus is a system where a worker is paid an extra wage for the work done. If the payment is for the completion of work with record time or for every hour saved it is known as premium bonus system.

While

Profit sharing is a method by which firms try to give employees direct interest in the prosperity of the firm. Under this system, workers are permitted to hold a number of shares so long as they remain in the employment and committed to the firm.

Reasons for profit sharing.

- To motivate workers.
- To provide an incentive for increased output.
- To improve the earnings of the firm
- To create good working relationship between the management and employees.

274. (i) What is a fixed wage.

(ii) Give any three reasons for fixed wage.

A. (i) A fixed wage is the wage which is pre-determined and not subject to adjustments.

(ii**) Reasons for fixed wage.**

- To avoid unnecessary salary bargain.
- Helps management in making estimates for salary payments for drawing up the budget for the firm.
- Assists employers when evaluating new assignments and when determining new rates of payments for the new jobs.
- To enable workers get wages which are commensurate to the task performed.

275. (i) What is meant by negotiable wages.

(ii) Give any three benefits of negotiable wage.

A. (i) Negotiable wages are wages which are determined through bargaining between the employer and the employee, and an agreement is reached.

(ii) **Benefits of negotiable wage.**

- Takes into account individual differences in skills.
- Recognizes the possibility of periodical changes in job content which should always be

accompanied by appropriate remunerations to the workers so that they can be motivated to carry out the necessary changes.

- Encourages increase in productivity of workers.
- Increases the possibility for promotions. This is because it provides the opportunity for workers to improve their skills.

276. (i) Differentiate between minimum wage and living wage.

(ii) Give two factors that influence the level of wages in Uganda.

A. (i) A minimum wage is one set by the government above equilibrium wage and it is illegal to pay the workers below it.

While

A living wage is a payment to a worker sufficient to provide his/her basic needs.

Or A reward that is adequate for a worker and his family to subsist comfortably.

(ii) **Factors that influence level of wages in Uganda.**

- Demand and supply of labour.
- Bargaining strength of individual workers.
- Amount of work done by the worker.
- Cost of living.
- Number of hours worked.
- Talents and natural gifts.
- Nature of jobs/type of work done.
- The level of education and skills.
- Employer's ability and willingness to pay.
- Experience, expertise or responsibility of the worker.

277. State any four reasons for minimum wage legislation in your country.

- To protect workers against exploitation by employers.
- To improve standard of living of workers.
- To reduce level of income inequality.
- To minimize industrial disputes arising from trade union pressure.
- To increase purchasing power of workers to increase their consumption.

278. (i) What is meant by the term collective bargaining.

(ii) Give any three features of trade unions in LDCs.

A. (i) Collective bargaining refers to the roundtable negotiation between the representatives of trade union and employer's association over workers' conditions of work..

(ii) **Features of trade unions in LDCs.**

- It is dominated by semi-skilled and unskilled labour force.
- Characterized by small membership.
- Weak leadership.
- High proportion of migrant labour in its membership.
- Characterized by tribal/ ethnic divisions.
- Shortage of finance for its operations.
- Weak bargaining power.

279. (i) What is meant by the term trade unions.

(ii) Give any three functions of trade unions.

A. (i) Trade Union is a voluntary association of workers in a particular firm or industry created by and for the workers to protect them against exploitation by employers and promote their interest through collective bargaining.

(ii) **Functions of trade unions.**

- To bargain with employers for high wages for members.
- To negotiate for fringe benefits such as housing allowances and longer holidays.
- To protect workers against unfair treatment and dismissal by their employers.
- To advise government on major economic policies that affect workers.
- To negotiation for improvements of working conditions and better standard of living.
- To protect workers against exploitation by the employers.
- To protect workers rights e.g. the annual leave.
- To regulate and settle disputes between members and employers and between members themselves.
- To establish friendly relationships between workers in various industries.

280. Give any four types of trade unions in your country

- White collar union
- Industrial union
- General union
- Open shop union
- Closed shop union

280. Mention any four factors that determine the strength of trade unions in your country.

- Amount of strike funds/financial strength of trade unions.
- Level of government interference.
- Degree of organization of trade unions.
- Level of unemployment.
- Prevailing economic performances.
- Level of productivity of members.
- Elastic of demand for the product o f labour.
- Nature of labour market.
- Leadership skills.

281. (i) Differentiated between wage freeze and wage restraint.

(ii) Give two causes of wage differentials in your country.

A. (i) Wage freeze is a government ban on any wage increase.

While

Wage restraint is effort on part of the government to minimize wage increases.

(ii) **Causes of wage differentials.**

- Differences in skills.
- Variations in cost of living.
- Differences in expertise.
- Variations in nature of job.
- Differences in strength of trade unions.
- Differences in ability.
- Differences in talents.
- Differences in elasticity of supply of labour.
- Differences in employer's ability.
- Differences in bargaining power.

282. (i) Differentiate between transfer earning and transfer payment.

(ii) State two sources of transfer payments in your country.

A. (i) Transfer earning is the minimum amount that a factor of production must earn in order to remain in its present use or occupation.

Or

The supply price of a factor of production.

While

Transfer payment are payments made by the government to the households which are not return for factor services e.g. pension, relief food scholarships etc. It represents redistribution of income.

(ii) **Sources of transfer payment.**

- Taxation.
- Borrowing internally and externally.
- Donations.
- Fines on low breakers.
- Rent from government owned property.
- Licenses.
- National lottery/gambling.

UNEMPLOYMENT

Question 39 (a) What is meant by the term "full employment"?

(b) Why is it difficult to attain full employment in an economy?

The term full employment should not be mistaken to mean a situation where every one wanting and able to work is constantly employed. That is to say, it does not mean zero unemployment. This is because there will always be some elements of frictional, structural, seasonal and residual unemployment.

Full employment is therefore taken to mean a situation where the number of vacancies is equal to the number of people looking for work.

The more common definition of full employment considers it in terms of politically acceptable level of employment where less than 3% of the work force is unemployed.

Why it is difficult to attain full employment in an economy

- **Seasonal variations.** There are certain activities, which are carried out seasonally. Changes in seasonal patterns greatly affect employment. For instance during dry season farmers are rendered unemployed, making it difficult to attain full employment in the agricultural sector.
- **Frequent changes in jobs.** People always change from job to job due to labour mobility. This renders labour temporarily unemployed. Therefore there are always some elements of frictional unemployment making it difficult to achieve full employment.
- **Desire for high profits by entrepreneurs.** Entrepreneurs especially monopolists will deliberately restrict output in order to increase the price. This causes excess capacity in the economy rendering all factors of production including labour unemployed.
- **Frequent changes in tastes.** People's tastes and preferences keep changing with time affecting the demand for particular product. People employed in industries whose products have fallen in tastes became unemployed.

- **Shortage of required skills.** Most LDCs have inappropriate education system, which produces mainly job seekers. The system produces labour with irrelevant skills and cannot be absorbed by the economy making it difficult to attain full employment.
- **Continuous changes in technology.** Due to innovations and inventions, new techniques are frequently introduced in production rendering workers used to the old technology unemployed. In addition, use of capital intensive techniques of production and expatriate workers by the multinational corporations that dominate investment in LDCs limit opportunity of job creation making it difficult to attain full employment.
- **Negative foreign influence on government policies.** Donor conditionality makes it difficult for the recipient countries to achieve full employment. For instance IMF policies such as retrenchment, structural adjustment programme etc has rendered many people unemployed.
- **Physical and mental incapacitation.** There are people in society who are permanently unemployable due to their physical or mental inabilities. Thus difficulty in attaining full employment.
- **Ignorance about available job opportunities.** There are some people who have limited access to information due to their remote location. This section remains unemployed even when there are available job opportunities.
- **Rural urban migration.** In most LDCs the rate at which people move from rural to urban areas far exceed the capacity of urban authorities to create jobs. This makes it difficult to attain full employment in the urban sector.
- **High population growth rates.** Most LDCs have high growth rate in excess of 3% per annum. This means high labour supply compared to job opportunities. In the rural sector this trend causes land shortages rendering people underemployed and disguisedly unemployed.
- **Political instability**. Majority of LDCs are politically unstable. The frequent civil wars disrupt economic activities rendering the population idle thus making full employment unattainable.
- **Deficiency in demand**. In LDcs due to existence of absolute poverty, the majority of people have low purchasing power. This discourages investment leading to low employment opportunities.
- **Poor manpower planning**. Particularly in LDCs the governments have failed to streamline their educational policies. This has resulted into skills imbalances. There are some professions with excess supply while others have very few people. This has caused co-existence of vacancies with surplus labour and vacancies with less labour hence difficulty in achieving full employment.

- **Shortage of co-operant factors**. Labour alone cannot produce output; it has to combine with other factors mainly capital. However, many LDCs, are capital deficient making it impossible to attain full employment of labour.

- **Imperfections in the labour market**. Job markets are characterized by many imperfections causing discrimination on the job market based on sex, tribe, religion and corruption making it impossible to attain full employment.

- **Trade union barriers**. There are many professions that have bound themselves under strong trade unions in order to maintain high wages for their members. These unions restrict the entry of new members. Thus making it difficult to attain full employment in an economy.

- **Presence of large traditional sector**. In most LDCs, subsistence sector is still predominant. Low capital, low savings, low investment and therefore low employment opportunities characterize this sector. Thus it is impossible to attain full employment in such economy without reducing the subsistence sector.

Question 40.

(a) What are causes of unemployment in your country?

(b) What measures should your country take to solve unemployment problems?

Unemployment refers to a situation where people are able and willing to work at the going wage rate but unable to find jobs.

Or

A state in which members of the labour force are idle. These definitions consider unemployment to be involuntary

Causes of unemployment in Uganda

- **High population growth rate.** Uganda experiences one of the highest population growth rates in the world at over 3.2% per annum. This out paces the rate at which jobs can be created in the economy.
- **Defective education system.** Uganda inherited the colonial education system which trains people for white collar jobs. Such theoretical skills are no longer relevant in the industrial sector. This renders people with irrelevant skills unemployed.
- **Political instability**. Many parts of the country especially the north and west have experienced long period of political turmoil. This has disrupted economic activities and rendered many people unemployed.
- **Discrimination in the labour market**. The labour market in Uganda is characterized by imperfections. There are discriminations based on tribes, religion, sex etc. This renders people with relevant skills unemployment.
- **IMF Conditionality.** Uganda is among the sub Saharan African countries, which has implemented IMF conditionally of restructuring the civil service. This has led to laying off many civil servants. Thus unemployment.
- **Rural–urban migration**. Due to rapid population growth, there is shortage of land in the rural areas for agriculture. This has led rural urban exodus causing open unemployment.

- **Deficiency of co operant factors**. Uganda has serious shortage of capital to carry out investment necessary to create employment opportunities.
- **Labour immobility**. There are obstacles to both occupationally and geographical mobility of labour. Cultural attachment is still strong making people reluctant to move to new areas.
- **Technology changes**. New technology is rapidly being introduced in the country, rendering people used to old technology unemployment. For example the introduction of computers has rendered many clerical workers unemployed.
- **Ignorance of the available jobs**. Many people have no access to the

media. They cannot afford newspaper or radios. Thus they remain unemployed even when there are job opportunities.

- **Frequent changes in jobs**. People commonly change from job to job thus remain temporarily unemployment in the course of movement.
- **Physical and mental incapacitation**. There are people who are permanently unemployed due to mental and physical inabilities. Thus residual unemployment.
- **Seasonal changes**. Uganda's economy is based on agricultural which depend on weather. During dry season many farmer are unemployed.
- **Exhaustion of natural raw materials**. When strategic raw materials get exhausted, unemployment results. For example the exhaustion of copper at Kilembe rendered former miners unemployment.
- **Existence of large substance sector**. Traditional sector is still the dominant sector in Uganda. This sector is characterized by traditional low productivity. Thus low capacity to employ.
- **Low investment**. The low and small – scale nature of investments in the country leads to low capacity of the industries to employ.

Measures to solve unemployment problems

- **Go back land policy.** The government should persuade the urban unemployed to go back to rural areas and seek alternative employment in agriculture.
- **Education reforms**. The government should revise the current educational curriculum to emphasize technical rather than literary education.
- **Diversification of the economy**. The government should revise the current educational curriculum to emphasize technical rather than literary education.
- **Diversification of the economy**. The government should encourage a variety of economic activities to be undertaken in the economy so as to reduce seasonal unemployment.
- **Population control policy**. The government should encourage family planning measures

and strengthen family planning institutions in the country to control population growth rate.

- **Expansion of the market**. The government should encourage more job creation through multiplier effect of the increase in the aggregate demand that come with market expansion.
- **Industrialization strategy**. Since industries have high rate of job creation, the government should encourage expansion of the industrial sector both by local and foreign investors.
- **Commercialization of the subsistence sector**. The government should introduce monetary incentive in the subsistence sector so as to expand economic activities and expand employment.
- **`Technological improvement.** The government should improve on the state of technology f so that they can expand and create employment opportunities.
- **Use of protectionist policies.** The government should protect local infant industries against foreign competition so that they can expand and create employment opportunities.
- **Improvement of investment climate.** The government should attract foreign investors in the country by providing favourable investment climate in the country.
- **Manpower planning.** The government should ensure that only relevant skills that are demanded in the economy are produced. This will ensure balance between demand and supply for labour in the economy.
- **Training programme for workers.** The government should provide continuous training programme for workers so that they can have variety of skills. This will make labour more flexible whenever the need to change jobs arises.
- **Maintenance of political stability.** The government should make effort to provide peace throughout the country to permit economic activities to be carried out. Thus creation of more employment opportunities.
- **Land reform policies.** The government should come up with land policy that redistribute the land in the country to enable the landless acquires land to work on.
- **Rural development programme.** Since the majority of the unemployed are in the rural areas, the government should transform the rural areas and create more jobs there.
- **Provision of credit facilities.** The government should provide credit facilities to potential investors to enable them carry out more investments in the country and create more jobs.
- **Infrastructure development.** The government should rehabilitate the roads network and build new ones to facilitate more economic activities.
- **Liberalization of the economy.** The government should allow private investors to participate in economic activities by opening up government owned monopolies to private competition thus more jobs will be created.
- **Adaptation of appropriate technology.** The government should adopt technology that makes use of local resources including labour.

- **Publication/advertisement of jobs.** The government should encourage advertisement of all available jobs to make people informed.

Question 41. (a) Explain the causes of unemployment according to Keynes.

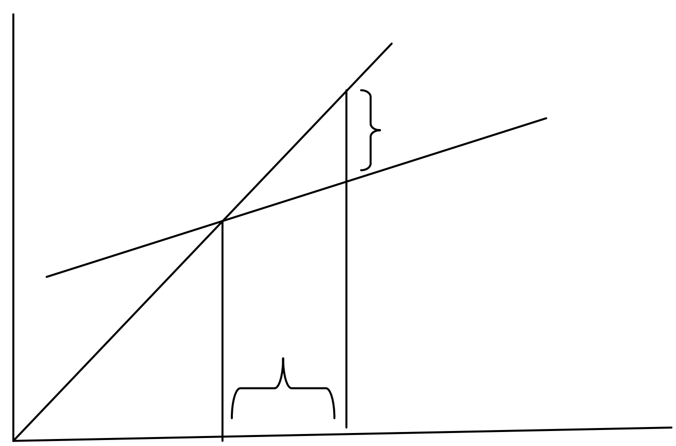
(b) How relevant is the Keynesian theory of unemployment to the economy of your country.

According to Keynes, unemployment arises due to deficiency in aggregate /effective demand for goods and services especially in times of recession or depression.

Due to low demand for final products, firms reduce their output, income level falls, and investment is discouraged leading to less labour and capital being employed.

The major remedy to unemployment according to Keynes is increasing the level of aggregate demand. This can be through:

- Reduction in taxes
- Expansionary monetary policies
- Increased government expenditure
- Subsidization of consumers etc



Unemployment (a) arises due to deficiency in aggregate demand (dg).

(b) To a greater extent Keynesian theory is irrelevant to Uganda's economy because:

- It is mainly concerned with demand deficiency yet unemployment in LDCs like Uganda is from the supply side. There exists several supply rigidities arising from bad weather, poor infrastructure, political instability etc, which affect economic activities rendering people unemployed.

- It mainly affects industrialized economies yet LDCs like Uganda is mainly agro based making the theory inapplicable.

- The theory is based on the existence of a big and strong private sector yet for Uganda private sector is still small and weak.

- The theory is applicable in the condition of full employment. This condition is absent in LDCs, Uganda inclusive. Most resources including labour are unemployed.

- As a remedy to unemployment, Keynes prescribed policies, which increase the level of aggregate demand, such as increased money supply. These policies may cause inflationary situation in the country.
- The theory is based on assumption of a highly monetized industrial economy. Uganda like other LDCs, is basically subsistence economy rendering the theory inapplicable.
- The theory is based on assumption of a well developed product, money and factor markets. However in Uganda these markets are not as functional as in MDCs. In many cases they are small, weak and sometimes non-existent.
- It is based on wrong assumption that firms will quickly respond to change in demand. Firms in LDCs like Uganda, due to structural difficulties tend not to respond quickly and effectively to change in demand.
- The theory puts emphasis on investment multiplier as a contributor to employment. Yet for LDCs it is the export multiplier, which is more relevant. Uganda economy is predominantly agricultural; opening up markets of MDCs to agricultural products of Uganda can create more employment opportunities,
- Keynes based his theory on closed economy yet Uganda like most economies of the world is open.

Minor extent to which the theory is relevant

- At time unemployment in Uganda results from the fall in demand both at home and abroad.

- In Uganda there is element of industrialization. Thus the theory cannot be ruled out in the industrial sector.

- In the long run as supply of co operant factors for labour increase, the theory becomes relevant.

- Investment climate affects employment level and therefore promotion of investment in LDCs will expand employment.

- Measures to stabilize export earnings through IMF compensatory arrangements to ensure stable export markets affect employment by reducing unemployment.

- Use of expansionary monetary policies to increase purchasing power in most LDCs have tended to increase employment levels – a policy put forward by Keynes.

SECTION A

114. (i) Differentiate between voluntary unemployment and involuntary unemployment.

(ii) Give any two causes of voluntary unemployment.

A (i) Voluntary unemployment is a situation where jobs are available but labour force is unwilling to take on the jobs at the going wage rates.

While

Involuntary unemployment is a situation where labour is willing and actively looking for jobs at the going wage rates but cannot find jobs.

(ii) **Cause of involuntary unemployment**.

- Rapid population growth rate which exceed the rate at which employment is created.
- Defective education system.
- Rural urban migration causing open urban unemployment.
- Ignorance of available job opportunities.
- Physical and mental incapacitation causing frictional unemployment.
- Technological advancement.
- Discrimination in the labour market.
- Political instability.

- IMF conditionality of restructuring civil servants.
- Deficiency of co-operant factors like capital.
- Break down in infrastructure.
- Political unrest.
- Scarcity of inputs like raw materials.
- Break down in industrial sector.
- Failure in agricultural sector due to unfavorable weather.
- Speculations by businessmen who create artificial shortages by hoarding goods.

115. (i) Give any four effects of unemployment in your country.

- Accelerates rural-urban migration.
- Worsens income disparities.
- Accelerates brain drain.
- Reduces government tax base.
- Leads to unpopularity of government.
- Increases crime rates.
- Causes political instability due to high level of idleness.
- reduces aggregate demand/market due to low purchasing power.
- Leads to low standard of living/welfare due to lack of income.
- leads to low output/ low rate growth of economy because majority of the work force is idle.
- worsens dependence burden as the unemployed will depend of the small working population.
- Reduces savings due to low incomes.
- Retards investment due to low capital accumulation.
- Positively, it leads to creativity and innovation as people struggle to create self employment.

116. (i) Distinguish between disguised unemployment and cyclical unemployment.

(ii) Give any two causes of disguised unemployment in your country.

A. (i) Disguised unemployment is the type of unemployment which occurs when the work available to a given work force is not sufficient to keep it fully employed and it is possible to remove some members of labour force without any loss of output.

Or

It is the type of unemployment which occurs when the marginal product of labour is zero.

While

Cyclical unemployment is the type of unemployment caused by deficiency of aggregate demand in the economy.

(ii) **Causes of disguised unemployment in Uganda.**

- Over population which reduces land available to every family.
- When workers hang into their job despite fall in demand for their product.
- Preference of trade union to share worker among its members as an alternative to laying off.

117. (i) Distinguish between frictional unemployment and seasonal unemployment.

(ii) Give two causes of seasonal unemployment.

A. (i) Frictional unemployment is a short term or temporary unemployment that arises when labour is changing jobs. It occurs when jobs are actually available.

While

Seasonal unemployment is the type of unemployment which occurs due to variations in weather and mainly affects the agricultural sector and other outdoor activities such as construction, tourism etc.

(ii**) Causes of seasonal unemployment.**

- Dependence on nature.
- Limited skills to switch activities.
- Low technological base ie due to low technology workers cannot engage in any economic actively during dry season.
- Immobility of labour

118. (i) Define the term "voluntary unemployment".

(ii) State three causes of voluntary unemployment.

A. (i) Voluntary unemployment is a situation where work is available but individuals do not want to work at the going wage rate.

(ii**) Causes of voluntary unemployment.**

- Laziness among some people.
- Availability of socially unacceptable jobs.
- Low wages.
- Rich family background.
- Expectation of better jobs in future.

- Poor working conditions.
- High risks involved in performing the job.
- Accumulation of past savings.

119. (i) Distinguish between seasonal unemployment and technological unemployment.

(ii) State two ways of solving seasonal unemployment.

A. (i) Seasonal unemployment defined in Q.117 .

While

Technological unemployment is the type of unemployment where machines replace labour for example the introduction of computers has rendered many clerical workers unemployment.

(ii) **Ways of solving seasonal unemployment.**

- Diversification of the economy.
- Improvement in technology e.g. use of irrigation system.
- Training labour in many skills.
- Industrialization of the economy since industries are not affected by weather.
- Introduction of activities like hand craft, which make farmers occupied during dry season.

120 (i) Define the term frictional unemployment.

(ii) Give three causes of frictional unemployment.

A. (i) Frictional unemployment already defined in Q.117.

(ii) **Causes of frictional unemployment.**

- Ignorance in the job market.
- Over specialization of labour.
- Temporary shortage of raw materials.
- Temporary changes in demand and supply.
- Temporary break down in machinery.
- Technological advancement ie workers have to be retrained to adopt the new skills.

121. Give any four causes of cyclical unemployment.

- Deficiency in aggregate demand for goods and services.
- Existence of economic depression.
- Existence of full employment of resources.
- Shortage of capital for investment.

122. (i) Define casual unemployment.

(ii) Give any three solutions to causal unemployment.

A.(i) Casual unemployment is a type of unemployment caused by erratic variations in the demand for services of labour for example causal workers in a factory who are often hired whenever work is available.

(ii) **Measures to control casual unemployment.**

- Employ labour on permanent basis.
- Provide labour with relevant skills.
- Diversification of the economy so that the services of labour are needed all year round.
- Encourage use of labour intensive techniques.

ECONOMIC GROWTH AND DEVELOPMENT

Qn.41. (a) Distinguish between economic growth and economic development

(b) Examine the benefits and costs of economic growth.

Economic growth refers to the persistent quantitative increase in the volume of goods and services produced in the country over a given period of time.

Whereas

Economic development is multi dimensional process of transformation of the whole economy involving both qualitative and quantitative changes in an economy leading better standard of living, education reforms, political freedom, availability of leisure etc.

Economic development therefore, involves economic growth which should eventually lead to changes in people's way of life, attitudes, fairer distribution of incomes, more employment opportunities, political freedom etc.

Benefits of Economic Growth

- **Improved standard of living**. Since more goods and services are produced in the country, the material welfare of the citizens will improve.
- **Fairer distribution of income.** Through the employment opportunities, taxation and public expenditure, economic growth makes possible redistribution of income in the country.
- **Positive Transformation of life.** The life style and consumption pattern of the society change progressively. For example more people buy cars, more roads are built and consumption is also boosted.
- **Provision of basic requirement**. It makes possible for an economy to provide the basic needs of the citizens e.g. good, clothing and housing for the majority of the population.
- **Increased efficiency in production.** Many firms will be established leading to competition, thus improved quality of output.

- **Promotes self reliance.** A fast growing productivity of a country makes it easier for it to generate resources to finance public expenditure. Thus reduced foreign dependency.
- **Improved technology.** It leads to improvement in technology through innovation and high degree of dynamism in the economy.
- **Improved BOP position**. Due to increased competition among the domestic firms, high quality output is produced which becomes competitive in the foreign market. Besides imports are reduced due to increase in home production.
- **Increased employment opportunities**. An expanding economy will have high level of investment spending that will sustain high level of employment. Besides new industries will be established there by reducing unemployment.
- **Stable general price level**. It makes possible for government to control inflation rate because aggregate demand will no longer exceed aggregate supply. All supply rigidities are reduced.
- **Increased urbanization**. Many industries, banks, housing estates etc will be built as growth increases, all these result in modernization and improved quality of life.

Cost of economic growth:

- **Social costs.** It imposes social costs in terms of increased noise, pollution, traffic congestion etc. These affect the innocent society and not the producers.
- **Environmental degradation.** Natural beauties are destroyed to pave way for construction of factories, hotels, housing estate etc.
- **Depletion of non renewable resources.** As rate of resources exploitation is stepped up, non renewable resources get exhausted.
- **Unemployment results.** As the economy gets transformed, new technology is constantly introduced in production rendering workers used to old technologies unemployed, The human labour is also rapidly replaced by machines as capital intensive techniques are introduced.
- **Rural urban migration**. As large commercial firms are established in rural areas people are displaced. They migrate to urban areas with many associated problems such as traffic congestion, prostitution, crimes etc.
- **Erosion of traditional values**. Economic growth is associated with modernization and adaptation of foreign cultures which lead to erosion of traditional values in favour of foreign traditions which may be harmful to society.

- **Income inequalities may result**. The benefits of growth may not be equitably shared, thus inequality of income and wealth may result.
- **Inflationary tendencies**. In the short run people's purchasing power will have increased but the volume of output may not have increased proportionally. This leads to increase in prices.
- **Profit repatriation**. Most of the investments established in the country, as a result of economic growth may be foreign owned. This facilitates profit repatriation.
- **Sacrifice of leisure.** Economic growth is at times obtained at the expense of leisure.

  Thus people's freedom is affected due to over working.
- **Present consumption is foregone.** Economic growth may force people to forego present consumption in order to save resources for investments and more capital accumulation. This affects people's welfare.

Qn. 42 (a) Distinguish between balanced growth and unbalanced growth strategies of development.

(b) Examine the advantages and disadvantages of balanced growth strategy in developing countries.

Balanced growth strategy was formulated by Ragnar Nurkes and states that for a country to achieve faster rate of development, there should be simultaneous development of several sectors which will complement each other and the whole economy will grow at the same pace.

Whereas

Unbalanced growth strategy is one proposed by Albert Hirschman and argues that since LDCs face shortage of capital, managerial ability and entrepreneurship, the available limited resources should be invested in key factors which would have maximum effect on the economy through backward and forward linkages.

Advantages of balanced growth strategy

- o **More employment opportunities are created**. By undertaking investment in many sectors of the economy, greater employment opportunities are created in these several sectors.
- o **Redistributes income.** By developing all sectors in industry, agriculture, trade etc at the same pace, fairer income distribution is achieved among individuals and between sectors.
- o **Linkages between sectors may be established over time.** By promoting industries and agriculture at the same time linkage between the two sectors can be achieved, For example agriculture can provide industries with raw materials while industries can provide agricultural sector with inputs such as hoes, pesticides, etc.
- o **Widens tax base.** By promoting all sectors of the economy wide range of economic activities will be carried out in many sectors. Thus widening tax base and increasing tax revenue to the government.
- o **Widens Market.** Balanced growth strategy increases incomes of the people in the country thus increasing aggregate demand. The expansion in market encourages large scale

investments leading to economies of scale.

- **Reduces BOP problems.** Balanced growth strategy promotes diversification of the economy importation will be reduced due to adaptation of import substitution industries, Exports will expand due to diversification of exports. The increase in export revenue and reduction in expenditure on imports reduces BOP deficit.
- **Promotes self sufficiency.** By promoting all sectors simultaneously, the country will produce all her strategic needs thus reduces her dependence on other countries.
- **Most LDCs do not have leading sectors.** Agriculture which is predominant in most LDCs have severe price instability and may not succeed in creating an impact in the economy. Thus the need to invest in all sectors.
- **Increases national income.** Balanced growth leads to an increased volume of goods an d services being produced in the economy.

Disadvantages of balanced growth

- **Shortages of capital.** Investment in many sectors requires large stock of capital to sustain such large scale investments. LDCs have limited capital resources to sustain balanced growth.
- **Promotes foreign dependence.** Balanced growth strategy call for heavy reliance on foreign aid with associated problems of debt servicing. This is because this strategy requires a lot of capital and can only be afforded by rich countries.
- **Shortage of skilled manpower and entrepreneurial abilities.** Investment in many sectors requires sustained supply of skilled man-power to efficiently run the investments. But for most LDCs skilled man-power is scarce and entrepreneurs are few due to inappropriate education system. The attempt by LDCs to rely on foreign expatriates is costly and dependence on multinationals for investment leads to profit repatriation.
- **Limited technology.** Most LDCs are still technologically backward. This makes it difficult for them to sustain balanced growth. Particularly they fail to achieve meaningful industrial growth due to limited technology.
- **Lack of adequate markets in LDCs.** Due to low incomes purchasing power in LDCs is very low. This limits demand for the products of these sectors hence rendering the strategy in appropriate for LDCs.
- **Poor infrastructure.** The social-economic infrastructure in LDCs is not favourable. The road net work is in poor state; in addition the cultural rigidities common in most LDCs make them less adoptable to change. Thus LDCs cannot sustain balanced growth strategy.
- **High degree of uncertainty in LDCs.** Due to political and economic instabilities, projects in LDCs face high degree of uncertainty. Therefore placing high stakes in critical minimum efforts may lead to heavy loss in case of failure.
- **Lack of proper planning machinery.** Balanced growth strategy requires proper planning machinery to coordinate the many sectors in the economy. In most LDCS planning authority is weak due to shortage of skilled man power.
- **Lack of linkages between sectors in LDCs.** The idea of mutually supporting industries providing market for each other is not realistic for LDCs. Industries established in LDCs by

multinational corporations use imported raw materials and cannot in anyway promote agriculture.

Question 43 (a) What is meant by the term under development?

(b) What are the causes of under development?

Under development is an economic situation where there is under utilization of resources and there is generally low standard of living characterized by low incomes, low employment levels, high illiteracy, low life expectancy et c. Countries that exhibit these characteristics are said to be under developed, backward or generally as third world by the United Nations.

Causes of under development

- **Low rates of capital accumulation.** Most LDCs are capital deficient. This limits their ability to exploit their natural potentials.
- **Existence of vicious circle of poverty.** In LDCs poverty moves in a circle which is difficult to break. There exists a low income which leads to low savings low investments and low productivity.
- **Man power constraint.** People with critical skills and knowledge necessary for efficient exploitation of resources are lacking in LDCS. This shortage leads to low labour productivity thus under development.
- **Population constraint.** Most of LDCs experience very high population growth rates in excess of 3% per annum. This increases the number of dependents, thus lower savings, investment and capital accumulation. This in turn forces the governments to spend scarce resources on infrastructures such as health and educational facilities thus reduced growth rate.
- **Technological backwardness.** LDCs rely on imported technology which does not suit their developmental needs. This inappropriate technology limits their ability to exploit natural resources.
- **Heavy dependence on agriculture.** Most LDCs put a lot of emphasis on agriculture however this sector is characterized by traditional low productivity and poor quality products. As a result, it experiences price fluctuations leading to low export earnings, thus under development arises.
- **Misallocation of resources.** Despite extreme resource constraint in LDCS the government continues to allocate the limited resources on unproductive ventures e.g. they under take heavy military expenditure, finance unproductive missions abroad etc. This drains the scarce foreign exchange leading to under development.
- **Scarcity of foreign exchange.** Most LDCs experience unfavourable T.O.T. in international trade. Prices of their exports are falling while those of imports are rising. This results in scarcity of foreign exchange needed for importation of technology and machinery critical for development needs.
- **Limited Supply of entrepreneurs.** People with organizational skills to efficiently organise other factors of production are few in LDCs. Thus there is less exploitation of potential resources leading to under development.

- **Social –** Cultural factors. Most people in LDCs still have great attachment to traditional beliefs and customs. This makes them resist economic changes and less willing to undertake risks.
- **Poor infrastructure.** In Most LDCs roads, railways and other communications net works are poorly developed. Yet they are essential for development.
- **Political instability.** Majority of LDCs are political unstable. This scares away investors both foreign and domestic.
- **Heavy external debt burden.** LDCs finance most of their projects through external borrowing. This causes problem of debt servicing and reduces resources for domestic investment.
- **Competition and misuse of public funds.** Most of the resources that could have been used to finance developmental projects are diverted for private benefits thus retarding the pace of development.
- **Demonstration effect.** The people in LDCs imitate the consumption patterns of those in developed countries. They buy expensive vehicles and luxurious life styles. This reduces savings and capital accumulation thus retarding the pace of development.

External causes

- **Negative effects of multinational corporations**. These bodies repatriate the profits back to their home countries which further retards the ability of LDCs for reinvestment.
- **Some scholars attribute the current under development to colonial legacy.** They argue that the colonialists exploited the resources of these countries leaving them disabled.
- **Neo-**Colonialism. The former colonial masters have continued to dominate under developed countries through international financial institutions such as IMF.
- **Unfair exchange rate in international trade.** The MDCs fix very low prices for agricultural products of LDCs in the world market. This makes it difficult for LDCs to finance their import requirement.

Question44 (a) Explain the determinants of economic growth

(b) Examine the limitations of economic growth

- **level of productivity of existing capital stock**:

In the short run, productivity can be raised by improvements in organization capacity which ensures better division of labour and economies of scale or more intensive use of capital equipments.

- **Availability of capital stock and capital accumulation:-**

This includes both capital widening which prevents diminishing returns to labour from faster.

- **the level of Technological :-**

This significantly rises the productivity of the economy as it enables work to be done faster.

- **Availability of natural resources:-**

If the natural resources are available and are properly exploited, the economic growth and be registered and vice versa.

- **level of Industrialization:-**

As the standards of living improves, spending changes from agricultural to manufactured goods and then to services, since the opportunities for employing more capital and technical improvement are greatest in manufacturing the growth rate increases as countries industrialize.

- **the country's TOT**:-

Favourable terms of trade (TOT) increases the productive capacity of thE economy as it is able to import more resources.

- **level of investments:-**

Investments increase the productive capacity of the economy which leads to economic growth once operationalized.

- **Political climate**

A stable political condition is good for production to take place in the economy leading to economic growth and vice versa.

- **the Government policy:**

If the government promotes the private sector, the rate of economic growth is likely to be higher and vice versa.

- **Availability of market:-**

When the market is available and expanding the output of the economy will also be expanding leading to economic growth and vice versa.

- **level of infrastructural development:-**

Existence of good infrastructure like roads, storage facilities etc enable production to continuously take place leading to increase in output and economic growth and vice versa.

- **Efficiency of labour:-**

When the quantity of skilled labour force is increased through education and training, the output rises leading to economic growth and vice versa

- **level of enrpreneurial abilities**

When the size of entreprenueral skills is large and the spirit is so high, the rate of economic growth and vice versa.

- **population size:**

When the population size for the economy is ideal, resources exploitation increases with increasing marginal productivity and also facilitates savings mobilization leading to economic growth and vice versa

- **availability of planning machinery:**

When there is proper planning and implementation, productivity increases leading to economic growth and vice versa.

- **people's cultural and tradition:**

When the economy removes cultural rigidities that are negative for production, economic growth is achieved in the economy and vice versa.

Limitations to economic growth

Full employment situations:

As an economy approaches full employment consumer demand depletes resources available for investments.

Restrictive macro economic policies:

Governments anti-inflationary measures undermine the confidence of the entrepreneurs.

Inflationary tendencies:-

Inflationary problems lead to trade union activities which disrupt production, reduce profit margins as a result of wage increase and consequently our rate of returns on capital yet rate of interest remains high, investors are then discouraged.

Structural changes:-

Rapid growth usually requires structural changes in the economy which are bound to lead to unemployment and if growth is to be achieved, then people must change jobs radically. This calls for constant retraining of labour which may prove a little difficult.

Environment consequences:-

The costs of growth generates a lot of opposition especially from the environmentalists who question the rationale of pollution, noise, loss of natural beauty destruction of the eco-system etc.

Resource constraints. sometimes the resources needed to generate growth may be lacking.

Political instability:

This discourages productive activities from being undertaken.

Small size of the market:

The limits the output of the economy to the extent of the market potential.

question 45(a) explain the distinction between economic growth and economic development

(b) examine the conditions necessary for development to take place in a country.

Difference between economic growth and economic development

Economic growth involves changes in one sector whereas economic development is a multi disciplinary change involving many sectors.

Economic growth involves increases in the quantity of output whereas development involves both quantitative and qualitative changes.

Economic growth may be achieved without changes in technology but by Extensive use of resources but in order to achieve development, there must be a change in technology.

Economic growth is a rapid process whereas economic development is a slow and gradual process since it involves several qualitative and quantitative changes across sectors.

Economic growth may not transform people's lives whereas development must bring about a transformation in peoples lives.

Conditions necessary for development to take place in a country

Indigenous base:-

There should be a domestic base for development within the country. The initiative undertakings and maintenance of development should come from within the country. The outside force should only supplement the domestic initiative.

Social cultural change:-

There should be changes in the socio-cultural institutions to lead to development. arrangements like extended families, kinship ties, religious dogmas and rural life in general should be modified to suit development. Monetary economy should replace subsistence. Education plays a leading role in laying ground for the changes.

Structural changes:-

There should be a transition from traditional agricultural to a modern industrial economy from primary production to manufacturing and tertiary production. This will lead to increase in employment and incomes. Agriculture should also be modernised

Enhancement of capital formation and accumulation:-

Savings mobilisation should be boosted through efficient banking system. Mobilised savings should then be channeled into production projects so as to accumulate capital

A strong, competent and incorrupt administration:-

Leadership should be disciplined and committed to development process which involves many sacrifices. Besides, it should be capable of maintaining internal law and order.

Improved technology:-

The level of technology should be high enough to enable increased quality of output as well as speed up production process.

Human resource development:-

Skills and quality of labour should be increased in order for development to be achieved.

Infrastructure development:-

The basic infrastructure should be developed e.g. hospitals, schools, transport (roads), power etc.

Suitable investment climate:-

There should be a well coordinated investment drive and codes to attract investors to development.

Population control:-

Population growth should be checked to reduce dependence burden, raise the level of savings and encourage capital accumulation.

Development of export sector:-

The export sector should be developed so that foreign exchange can be obtained for acquisition of capital needed for setting up industries that can provide employment opportunities.

SECTION A

123. (i) What is meant by the term economic growth.

(ii) Give three costs of economic growth.

A.(i) Economic growth is the persistent/sustained increase in the country's volume of goods and services.

Or

The quantitative increase in the GNP of an economy over time.

(ii**) Costs of growth.**

- Involves foregoing leisure because growth calls for hard work.
- Widens income disparities.
- Leads to social cost e.g. pollution.
- Urbanization associated with growth leads to rural-urban migration.
- Rapid technological progress associated with growth leads to unemployment.
- Involves foregoing the present consumption, which can affect welfare.

124. State four major development goals in your country.

A.(i) A least developed country is one which is stagnant, with very low levels of income, persistent unemployment, poor living conditions far below international poverty line.

While

Underdeveloped country is one which is developing but living conditions are still low. There is less than full employment levels, the GNP growth is low and the majority of the people are just able to afford bear minimum of life.

(ii) **SAP alone cannot achieve Rostowian take off because;**

- There is severe shortage of entrepreneurial skills necessary for the take off.
- There are institutional rigidities that do not permit high growth rate of social infrastructure.
- Political and economic frame work desirable in expansion of modern sector is lacking in Uganda.
- Slow growth rate of manufacturing sector due to shortages of capital and technology.
- Low savings leading to low capital accumulation.
- Political instability.
- Large traditional sector.
- High population growth rate which outstrips growth of GNP.

127. State four features of an economy which has attained drive to maturity stage of economic growth.

- High level of research and discoveries.
- Low population growth rate
- High level of infrastructural development.
- High level of urbanization.
- Savings are high about 10-20% of GNP.
- Heavy industries develop.
- New import and export requirements develop.
- Formerly imported goods are now produced at home.
- Labour and other factor efficiency are advanced hence high productivity.
- Economy demonstrates technological and entrepreneurial skills to produce anything it chooses.
- Real wages start rising.
- New leading sectors are created.
- New production techniques replace old ones.
- Employment opportunities increase.

128. Mention any four structural adjustment conditionality of International Monetary fund (IMF) that your country has implemented.

- Privatization of state owned enterprises/divestiture programs.
- Retrenchment of civil servants/public service reforms.
- Cost sharing in government provided services.
- Devaluation.
- Exchange liberalization.
- Trade liberalization.
- Institutional reforms.
- Economic liberalization.
- Reduction in military expenditure.
- Reduction in government expenditure.

129. State any four costs of economic growth in your country.

- Air and water pollution.
- Environmental degradation.
- Congestion e.g. traffic, houses are near to each other.
- Industrial hazards – occupational hazards.
- Problems of rural-urban migration.
- Leisure foreign in order to increase the volume of goods.
- Erosion of cultural values.
- Current consumption is foregone.
- Debt burden due to borrowing.

130. Mention four reasons why economic growth many not be accompanied by economic development.

- There may be increase in GNP but, when there is un equal distribution of income.
- Growth may come as a result of increase in population but without employment opportunities.
- Increase in growth could be as a result of producing armaments.
- It may take time for nationals to take advantage of growth to transform it into development.
- When there is inflation in the economy.
- When there is increase in quantity without corresponding increase in quality.
- When people are over working/lack of leisure.
- When the growth is not accompanied by freedom and democracy for the citizens.

131. Mention any four characteristics of Rostow's "'take off" stage of economic growth.

- Savings increase to 5-15% of GDP.
- Investment increase from below 5% to 10% GDP.
- Industries expand.
- Increased monetization of the economy.
- Increased urbanization.
- New techniques of production are introduced in all sectors.
- One or more leading sectors of the economy emerge.
- Increase in per capita output outstrips the population growth.
- The market expands.
- Elimination of obstacle to developments like high population growth rate.

132. (i) Define the term "critical minimum effort" as used in balanced growth strategy of economic development.

(ii) Mention two limitations of balanced growth strategy.

A. (i) Critical minimum effort refers to minimum scale of development effort which is necessary to launch an economy on development path through substantial capital accumulation.

(ii) **Limitations of balanced growth strategy.**

- Shortage of capital to finance investment in all sectors.
- Necessitates heavy borrowing which leads to debt servicing.
- LDCs have limited technology to sustain balanced growth strategy.
- Project in LDCs face high degree of uncertainty thus high risks of losses.
- Shortage of skilled manpower and entrepreneurial abilities to effectively manage the strategy.
- Political instability which hinders investment in some areas.
- Poor infrastructure.
- Heavy losses in case of failure.

133. (i) State the Big Push Theory.

(ii) Give three factors that limit the application of the Big Push Theory in Uganda.

A. (i) The Big Push Theory states that for a backward economy (LDCs) to take off into self sustained growth, massive investment programme in industries and economic infrastructure is required.

(ii) **Factors that limit applications in Uganda.**

- Political instability.

- Limited basic infrastructure.
- Shortage of capital.
- Weak policy implementation machinery.
- Small market size.
- Limited entrepreneurial skills.
- Poor land tenure system.
- Corruption.
- Poor investment climate.
- Conservatism.
- Limited skills.

134. (i) Distinguish between economic development and under development.

(ii) Give any two features of under development.

A. Economic development is a multidimensional process involving qualitative and quantitative improvement in the productive capacity of an economy over along period of time. It is associated with transformation of the whole economy resulting into economic and social freedom, democracy, high employment high, literacy etc.

While

Under development is an economic situation where there is persistent low standard of living characterized by existence of absolute poverty, illiteracy, unemployment etc.

(ii) **Features of under development.**

- Existence of vicious cycle of poverty.
- Rampant unemployment and underemployment.
- High level of illiteracy.
- Political instability.
- High population growth rate.
- Over dependence on agriculture.
- High debt burden.
- Low life expectancy.
- Existence of economic dualism.
- Conservatism ie greater attachment to traditional beliefs and customs.
- Predominance of peasant agriculture.
- Low levels of living characterized by poor nutrition, housing etc.

- Limited range of choice.
- Poor technology.
- Low productivity.

MONEY AND BANKING

Qn. 45 (a) Explain the credit creation process by commercial banks.

(b) What are the limitations of credit creation process by commercial banks in LDCS?

Credit creation is the process through which commercial banks create new deposit/loans for their clients without receiving any new cash/primary deposit from customers but instead continues leading the excess funds.

Assumptions:

- An initial deposit is made in the bank. For illustrations let us assume 100,000 is deposited.
- There are many banks involved in the system and all transaction are carried out through the bank by use of Cheques.
- There is a cash ratio which remains constant through out the process. For this purpose let assume it is 10%.
- The public is willing to deposit money in the banks i.e. banks have no difficulties in raising deposits.
- The public is willing to borrow money i.e. there are many profitable investment opportunities.
- The public is credit worthy i.e. they have collateral securities to present to the banks for mortgages.

Illustration

Bank/bank branch	**New deposi**	**Cash ratio 10%**	**New loans**
A	100,000	10,000	90,000
B	90,000	9,000	81,000
C	81,000	8,100	72,000
D	72,900	7,290	65,610
E	65,610	6,561	59,069
“	“	“	“
“	“	“	“
“	“	“	“
Total	1,000,000	100,000	900,000

- If the process is carried on to the end, the cash ratio will add up to the initial deposit of 100,000 new deposits will add up to 1,000,000 and new loans will up to 900,000.

- Another way to fund credit created by working out the credit multiplier

Credit multiplier (CM) = $\frac{1}{\text{Cash ratio}}$

1)

$$CM = \frac{1}{10\%} = \frac{1}{10/100} = 10$$

- Credit created = credit multiplier x initial deposit

= 10 x 100,000 = 1,000,000/=

NB: If the numbers of participating banks are given, the amount created can be worked out using the formula:-

1)

$$a\left[\frac{1-(1-r)^n}{r}\right]$$

where: a = Initial deposit

n = Number of banks involved in the credit creation process

r = Cash ratio

Assuming four banks were involved, credit created will be:-

$$\frac{100{,}000\left[1-(1-0.1)^4\right]}{0.1}$$

[1-(1-0.1)^4

9

$= \frac{100{,}000}{0.1}$ = 100,000(0.4839)

= 48399

Limitation of credit creation process.

- **Unpopularity of loans in LDCs**. The public is less willing to borrow from banks, due to many unfavourable conditionality. Even people, who are credit worthy, are reluctant to get loans.
- **Leakages at every stage as each bank retains cash ratio**. This sets upper limit to credit creation process.
- **Minimum reserve requirements of the central bank**. The central bank in its effort to control inflation by reducing money supply may increase the reserve requirements, of commercial banks. This reduces the amount available for commercial banks to advance loans.
- **High marginal propensity to hoard money**. In LDCs, people have high liquidity preference. This reduces cash deposits thus limiting ability of commercial banks to create credit.
- **High marginal propensity to hoard money**. In LDCs, people have high liquidity preference. This reduces cash deposits thus limiting ability of commercial banks to create credit.
- **Lack of credit worthy borrowers**. The people who can make proper use of borrowed funds are few in LDCs. This is compounded by lack of collateral securities. This reduces demand for excess reserves of commercial banks.
- **Low propensity to save in LDCs**. Due to low incomes, the propensity to save is low. This reduces bank deposits thus reducing reserve for lending which in turn limits credit creation.
- **Low investment opportunities**. The economic conditions in LDCs are not favourable for investment. This reduces demand for loans thus limiting credit creation process.
- **Restrictive monetary policies of central Bank**. The application of the tools of monetary policy reduces money held in commercial banks thus reducing their capacity to lend.
- **Limited branch network**. Commercial banks in LDCs do not have wide coverage. They have few branches which are not evenly distributed. This limits the banks' accessibility to potential borrowers and savers.
- **High interest rates**. The rates of interest charge by commercial banks in LDCS are too high and prohibitive. This discourages borrowing. Yet interest on deposit is very low. This limits credit creation by discouraging savings and borrowing.
- **Limitation of money supply**. Most LDCs are still predominantly subsistence. This leads to low money supply in the economy, thus undermining process of credit creation.

Question 45. (a) What are the assets and liabilities of commercial banks?

(b) How are the commercial banks able to reconcile the conflicting objectives of liquidity, profitability and security?

Commercial bank assets refer to what the commercial banks own.

They include:

- Cash held by the bank and cash due from other banks
- Liquid assets like loans to bill brokers
- Bills discounted for customers

- Investment in securities both short term and long term
- Reserves maintained with the central bank
- Time deposits with other banks.
- Fixed assets such as buildings.
- Acceptance and guarantees by other parties.

Liabilities are what a bank owes other parties that are in the banks possession, they include

- Share capital of the bank contributed by bank's owners.
- Reserves of other banks with the bank
- Deposits by customers both on current account and fixed deposit account.
- Time deposits from other banks
- Time deposit from non-bank financial intermediaries and government
- Obligations on behalf of customers.
- Cheques drawn on the bank by other banks
- Bills discounted with the Central Bank.
- Dividend payment to shareholders
- . Acceptances and guarantees on behalf of the customers

The assets and liabilities of the bank must always balance.

Reconciliation of bank's conflicting objectives

The commercial banks aim at achieving the objectives of security, profitability, liquidity and shift ability. These objectives conflict with each other and commercial banks reconcile them in the following ways.

Liquidity objectives. Commercial banks reconcile liquidity objectives in the following ways:

- **Maintain a cash ratio** i.e. proportion of each deposit that must be kept in cash form. This enables the bank to have cash at all times to meet the demands of customers in need of cash.
- **Maintain liquid assets** i.e. asset s which can easily and quickly be converted into cash. They include short term securities and commercial bills. When the bank is in cash needs it sells back these securities to the Central bank.
- **Lend money in phases**. Commercial banks schedule their borrowers in such away that they do not all get loans at the same time.
- **Regulate withdrawals**. The commercial banks regulate withdrawal from savings account to certain amount per visit and number of withdrawals is also restricted. This restriction however is dying out with the introduction of ATM where the customer can withdraw daily but the amount per visit is still restricted.
- **Accept only highly marketable collateral securities**. Assets presented by borrowers for loans

should be those which can easily and quickly be sold in the even of default.

- **Give loan at short notice**. These are loans where the borrower can be notified with a very short time to pay back to strengthen the liquidity of the bank.

- **Give loans at call**. These are loans where the borrower can be made to pay without any due notice, the moment the need for cash arises.

- **Profitability objectives**. The bank fulfils profitability objective in the following ways:

- **Advance loans to projects that pay high interest**. Commercial banks must first evaluate the profitability of projects for which loans are sought. Loans are only advanced to project s with highest returns.

- **Under take highly profitable investment**. Commercial banks invest in long term government securities which attract high rates of interest and can be sold at any time in stock exchange market.

- **They operate profitable business**. i.e. they purchase shares in profitable companies.

- Give profitable advance. Commercial banks give advances such as over drafts which earns interests.

Security objective:

- **Advance loans against security.** Borrowers are required to present collected security to the banks and these can be sold by the bank to recover the money in the event of failure to repay.

- **Keep fixed assets.** Commercial banks invest in fixed assets such as buildings which they can sell when in liquidity problem.

- **Maintain reserve with the central bank.** As a legal requirement all commercial banks are required to deposit with the central bank. This is an asset of the bank which can be used during times of need.

- **Avoid lending to very risky projects.** This explains why most commercial banks are reluctant to lend to agricultural projects due to many risks associated to them.

Question 46. (a) Explain the quantity theory of money according to Irving Fisher

(b) What are limitations of quantity theory of money?

Fisher's quantity theory of money states that the general price level is determined by the volume of production, velocity of circulation and the quantity of money in circulation.

- And that the general price level varies directly with the quantity of money in circulation and velocity of circulation and inversely with the volume of transaction

- It can be stated as:

MV = PT or $P = \frac{MV}{T}$

Where:

M = Quantity of money in circulation

V = Velocity of circulation

T = The total volume of transaction in the economy

P = The general Price level

V and T are considered to be constant in the short run. A change in any of the variable will affect the price.

- The four variable M,V,P,T are assumed to be independent of one another.

Limitations of the quantity theory of money.

- The theory assumes a general price level but there is nothing like that in an economy but a series of prices of commodities. Each commodity has its own price different from the other commodities. Even for a particular commodity, there are series of prices i.e. wholesale price, retail price etc.
- The theory does not take into account the influence of the rate of interest on the demand for money. Therefore it is incomplete as a theory of money.
- The four variables M,V,P and T are not independent of one another as assumed in the theory. A change in one induces change in one or all. For example a change in money supply may stimulate investment and cause increase in output, (T).
- The theory does not take into account barter trade. It assumes that all transactions are carried out by use of money, which is unrealistic. Many transactions take place through the use of barter exchange.
- The theory assumes that all money supply is spent on the purchases of goods and services, which is unrealistic. Part of the money supply may be horded out of circulation, thus no increase in price in response to increase in money supply.
- The assumption that V and T are constant is not true. Increase in money supply many encourage more production thus affecting the two variables.
- The theory considers increase in money supply as the only cause of the increase in price ignoring other factors. Increase in cost of production will force entrepreneur to increase the price even when the money supply has not changed.
- If the marginal propensity to save is high, then increase in money supply may lead to higher savings, which reduces the velocity of circulation, and price may instead fall.
- The theory ignores haggling between buyers and sellers to reach an agreeable price. The price may instead fall if the bargaining power of the buyer is high.
- The theory is one sided. It focuses on the supply of money completely ignoring demand for money. Money supply may increase while the demand for money may also rise leaving price unchanged.
- They theory does not take into account the other motives for money demand. It only consider transaction motive ignoring speculative and precautionary motives.
- The theory assumes full employment of resources, which is unrealistic, There are many unemployed resources which can be employed to increase supply.
- The theory attempts to explain changes in the value of money but does not show how the value of money is in the first place determined.

- The theory ignores government price control to stabilize price. The government may have fixed maximum prices for certain commodities thus prices remain unchanged even when the money supply has increased.
- It is said this is not a theory but a truism. It only shows how these variables are related. It is the same ways of saying the same thing. MV is not only equal to PT but MV is PT
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Question 47. Study the table showing commodity prices for selected items (2002-2006) and answer the questions that follow.

Commodity	Average Price Index 2002 (Ug. Shs.)	Simple Index (2002)	Average Price 2006 (Ug. Shs.)	Simple Index	Weight	Weighted Index
Meat (Kg)	2,500	100	3,000	-	2	-
Sugar (Kg)	1.200	100	2,000	-	4	-
Soap (Bar)	750	100	900	-	3	-
Paraffin (L)	1,400	100	1,800	-	5	-
Salt (Kg)	400	100	500	-	1	-
Bread	1,500	100	1,800	-	2	-

Calculate the:

(i) Simple index for 2006

(ii) Weighted index for 2006

(iii) Average weighted index

(b) Explain the problems which are faced in the computation of price indices in your country.

$$\text{Current year simple index} = \frac{\text{current year price}}{\text{base year price}} \times 100$$

Meat current year simple index = $\frac{3000}{2500} \times 100 = 120$

Sugar current year simple index = $\frac{2900}{750} \times 100 = 166.7$

Soap current year simple index = $\frac{900}{750} \times 100 = 120$

Paraffin current year simple index = $\frac{1,800}{1,400} \times 100 = 128.57$

Salt current year simple index = $\frac{500}{400} \times 100 = 125$

Bread current simple index = $\frac{1,800}{1,500} \times 100 = 120$

(ii) Weighted index = Current year simple index X Weight

Meat weighted index = 120 x 2 = 240.

Sugar weighted index = 166.7 x 4 = 666.8

Soap weighted index = 120 x 3 = 360

Paraffin weighted index = 128.57 x 5 = 642.85

Salt weighted index = 125 x 1 = 125

Bread weighted index = 120 x 2 = 240

$$\text{(iii) Average weighted index} = \frac{\text{Summation of weighted index}}{\text{Summation of weights}}$$

$$\text{AWI} = \frac{\sum WI}{\sum W}$$

$$\text{AWI} = \frac{240 + 666.8 + 360 + 642.85 + 125 + 120}{2 + 4 + 3 + 5 + 1 + 2} = \frac{2154.65}{}$$

NB: The value of money has fallen by 26.74.6% between 2002 and 2006.

Problem which are faced in computation of price indices in Uganda

- **Difficulty of getting reliable base year.** A reliable base year should be that year when prices are relatively stable. It is difficult to get such a year in Uganda due to persistent inflation. A selected year may coincide with abnormally high prices due to inflation.
- **Lack of standard measures.** In Uganda some commodities sold in heaps, others use tins, while others use kilograms. This makes it difficult to have a uniform standard.
- **Existence of barter exchange.** In Uganda due to existence of the traditional sector, some transactions still involve exchange of commodities for commodities. This system is arbitrary because it lacks clear standards.
- **Differences in prices of goods due to differences in bargaining power.** In Uganda most commodities have no fixed prices. For example cars, clothes and electronic products imported into the country are partly used. These have no fixed prices and how much an individual pays depends on his/her bargaining strength. Therefore an individual may pay high prices not as a result fall in value of money, but due to weak bargaining power.
- **Shortage of skilled manpower.** Due to high proportion of illiteracy and inappropriate education system, Uganda lacks trained manpower to handle the exercise leading to inaccurate statistical data.
- **There are no uniform prices throughout the country.** In Uganda prices for similar commodities tend to vary from place to place. Prices of agricultural commodities are higher in towns than villages due to transport costs and differences in purchasing power. This makes it difficult to select prices to be used.
- **Difficulty of getting valid weights.** People's tastes and patterns of expenditure vary between societies. Importance a Muganda attaches on matooke may not be the same to an Itesot who may not eat if he/she has other alternatives. This renders the weights attached inappropriate.
- **Does not take into account improvement in quality.** Over time the quality of goods imported such as cars, computers etc are frequently changing in design. The rise in price may be due improvement in quality rather tan fall in value of money.
- **Commodities are usually sampled.** This may not be representative enough since most commodities are included. The basket of goods' may be misleading because the most vital commodities be left out.
- **Does not put into account changes in tastes and fashion.** Individuals are dynamic in fashion. Consider what has happened in the last ten years in terms of dressing, furniture etc. Many commodities go out of fashion and their decline in price is not an indicator of increase

in value of money.

 Areas are usually sampled. This is misleading because not all parts of the country are covered.

81. (a) What is meant by the term tools of monetary policy.

(b) Explain the tools of monetary policy used in the central bank in your country.

A. Tools of monetary policy are instruments used by the central bank to maintain economic stability by regulating money supply through controlling the activities of commercial banks.

Tools of monetary policy.

- **Bank rate.** This is the rate of interest charged by the central bank on loans advanced to commercial banks. During inflation, the central bank raises the bank rate. The commercial banks, respond by increasing the market rate of interest which discourages the public from obtaining commercial bank loans. Credit creation activities of commercial banks are discouraged leading to reduced money supply. On the other hand during depression the bank rate is lowered, this reduces t he market rate of interest leading to increased credit creation activities of commercial banks.
- **Open market operation (OMO).** This involves buying and selling of government securities by the central bank through commercial banks. During inflation, the central bank sells securities to the public people remove their money to buy securities, thus reducing money available to commercial banks to create credit on the other hand, during depression the central bank buys securities which lead to increase in money supply.
- **Legal reserve requirements**. This is the proportion of deposits which commercial banks are required by law to keep with the central bank. During inflationary periods, the reserve requirement is increased and during recession it is reduced to encourage credit creation activities of commercial banks.
- **Special deposit**. This is the amount over above the legal reserve requirement. During inflation the central bank calls for special deposit thus reducing ability of commercial banks to lend.
- **Selective credit control**. This is where the central bank directs commercial banks to lend to certain sectors and discriminate others. The central bank may also get maximum limits of loans that commercial banks can lend to any borrower.
- **Moral suasion**. This is where the central bank persuades commercial banks to act in certain ways conducive to stability of the economy. It may also be public actives and distribute to commercial banks.
- **Margin requirement**. This is the difference between the value of security and the loan that can be got against that security. During inflation, the margin requirement is widened to reduce borrowing. During recession the margin requirement is narrowed.

Question 48. (a) Explain the objectives of monetary policy in an economy.

(b) What factors, limit successful implementation of monetary policy in your country.

Monetary policies are measures set by the government through the central bank aimed at influencing and directing economic activities by registering money supply. It aims at achieving the following objectives:

- **To stimulate economic growth of the country.** This is by creating conducive atmosphere that encourages increased production.
- **To attain and mention full employment level in the economy.** This is done by creating favourable investment climate to stimulate more economic activities and create more employment opportunities.
- **To main domestic price stability**. This is done by ensuring that there is just the right quantity of money in circulation to avoid inflation or deflation.
- **Provision of monetary incentives to prospective investors**. This can be through reduction of interest rate on the borrowed funds.
- **Attainment of balanced growth and development of the economy**. The government must ensure that all regions of the country grow at the same pace.
- **Attainment of equitable distribution of income**. It is the responsibility of the government to ensure equitable distribution of income by reducing the income gaps.
- **Maintenance of stable B.O.P.** It is the responsibility of the government to ensure that the deficit on the B.O.P. is reduced to minimize the need for external borrowing.
- **To create broad and continuous market for government securities**.

This permits operation of open market operation thus regulation of money supply.

- **To maintain a low rate of interest rate.** This permits borrowing investment and creation of more employment opportunities.
- To ensure that government deficits are financial at low interest rates.
- To foster savings of the community. This is achieved through promoting development of saving institutions throughout the country.

Factors limiting successful operation of monetary policies in Uganda

- **Poor lending/borrowing habits.** There are few credit worthy borrowers in Uganda. The majority of people are poor lack and collateral securities to present to banks for loans.
- **Dominance of foreign commercial banks.** These institutions are not under direct control of the central bank. They take directives from their headquarters in developed countries. This undermines the authority of the central bank.
- **Excess liquidity among the commercial banks.** The foreign owned commercial banks have excess liquidity and rarely borrow from the central bank.. This renders the tool of bank rate ineffective.

 Under developed money markets. In Uganda the money market is not as functional as in MDCs. This makes it difficult to sell government securities.

 Ignorance of the public about facilities offered by the Central Bank.. When the Central Bank advertises for sell of securities, the response is low because the public is ignorant of these securities. This renders the tool of open market operation less effective.

 Corporation in the implementation of some of the instruments like selective credit control. Sectors which are not supported to get credit are the ones that receive them.

 Foreign interference e.g. IMF conditionality renders Central Bank control weak.

 High liquidity preference. People in Uganda prefer to keep their money with themselves rather than deposit in the Bank. A central Bank tool of monetary policy only regulates money in Commercial Banks.

 Persistent inflation. This makes it difficult to use tools of monetary policy to achieve price stability.

 Poor distribution of Commercial banks. The banks are concentrated only in the urban centres. This makes mobilization of savings especially in rural areas difficult.

 Interference by politician Politicians usually interfere with the operations of the central bank. This compromises the independence of the institution.

SECTION A

141.(i) Distinguish between money supply and demand for money.

(ii) Give two determinants of money supply in an economy.

A. (i) Money supply is the total cash in circulation outside the banks plus bank deposits.

Or

The quantity of money in circulation in a country at a particular time.

While

Demand for money refers to the desire to hold wealth/assets in form of cash.

(ii) **Determinants of money supply in an economy.**

- The rate of interest.
- Inflows of funds from abroad.
- Level of economic activity/level of investment.
- Government borrowing/government expenditure.
- Level of monetization of the economy.
- Government monetary policy.
- Level of liquidity preference.

- Size of gold reserve held by the central bank.

142. (i) Distinguish between dividends and profits.

(ii) Distinguish between demand deposits and time deposit.

A. (i) Dividends are a proportion of company profits distributed to shareholders

Whereas

Profits are rewards to entrepreneurs for risking the capital or returns on capital invested.

(ii) Demand deposit is a type of account maintained in commercial bank for agreed period of time and no withdraw is permitted until the agreed period elapses. It is also known as fixed deposit account.

143. (i) State Irving Fisher's quantity theory of money.

(ii) Given that the amount of money in circulation is 200 million Ug. Shs. And its velocity is 10 and the level of transaction is 40,000. Calculate the general price of level in the economy.

A. (i) The quantity theory of money states that the general price level is determined by the volume of production, velocity of circulation and quantity of money in circulation. And that the general price level varies directly with the amount of money in circulation and velocity of circulation, and inversely with volume of transaction.

(ii)

$$P = \frac{MV}{T}$$

$$P = \frac{200{,}000 \ \text{x} \ 10}{400{,}000} = \frac{200{,}000}{4}$$

$$P = 50{,}000 \ \text{Ug. Shs.}$$

144. (i) What is meant by non-bank financial intermediaries?

(ii) State any two functions of financial intermediaries in your country.

A. (i) Non bank financial intermediaries are institutions that receive deposits from the public give loans but do not create credit. Examples include insurance companies, development bank, housing finance, building societies, savings and credit schemes etc.

(ii) **Functions of financial intermediaries.**

- Bridge the gap between savers and borrowers.
- Pooling risks and secures economies of scale.
- Increasing liquidity of financial systems.
- Provision of specialist knowledge of investment.

145. (i) Distinguish between fiduciary issue and fiat money.

(ii) Give any two motives for money demand.

A. (i) Fiduciary issue is the currency notes and coins issued by the central bank on orders of the government without backing of gold or foreign reserves.

While

Fiat money is the inconvertible paper money that is issued on orders of government and not backed by gold or foreign exchange.

(ii) **Motives of money demand.**

- Transaction motive.
- Precautionary motive.
- Speculative motive.

146. (i) Define the term liquidity preference.

(ii) State any three factors that influence liquidity preference.

A.(i) Liquidity preference is the desire by people to hold their wealth in cash or near cash form instead of assets. It is also known as demand for money.

(ii) **Factors that influence liquidity preference.**

- The level of transaction
- Price levels.
- Degree of uncertainty.
- Level of income.
- Level of infrastructural development.
- Level of speculation/rate of interest.
- The level of monetization of the economy.
- Banking habits.

147. (i) Distinguish between cash ratio and liquidity ratio.

(ii) What factors influence the level of liquidity preference in your country.

A. (i) Cash ratio is the proportion of each deposit made in commercial bank that must be kept in cash to meet the requirements of the depositors.

Whereas

Liquidity ratio is the proportion of commercial bank assets which are kept in cash or near cash form.

(ii) Factors influencing liquidity preference already given.

148. (i) What is meant by bank deposit multiplier.

(ii) State three determinants of the bank deposit multiplier in your country.

A. (i) Bank deposit multiplier is the number of times initial bank deposit multipliers itself to give the final amount after credit creation.

(ii) **Determinants of bank deposit multiplier.**

- The initial deposit in the bank.
- Number of banks involved in credit creation process.
- Willingness of the public to borrow.
- Willingness of the public to deposit in the bank.
- The credit worthiness of borrowers.

149. (i) Define supplementary reserve requirement.

(ii) What is meant by the term liquidity?

A. (i) supplementary reserve requirements is the amount required by the central bank from commercial banks to deposit with it over and above their legal reserve requirements. In case commercial banks have met their legal reserve requirements and central bank realizes there is still to much money in circulation then it calls for this requirement.

(ii) Liquidity refers to the existence of assets in cash or near cash form.

150. (i) Clearly differentiates between precautionary and transaction motive for money demand.

(ii) Relate interest rate and demand for money in an economy.

A. (i) Precautionary demand for money refers to money balance that must be kept in cash form to cater for unforeseen eventualities.

While

The transaction demand for money is part of money balance that must be kept in cash to meet the day to day purchases.

(ii) The relationship between interest and demand for money is that when the rate of interest increases the demand for money falls because individuals will prefer to save their money in banks and earn high interest rather than maintain cash and when the interest rate falls, demand for money increases.

151. (i) State four reasons why increase in money supply may not necessarily lead to inflation.

- If there is increase in output/production.
- When there is increase in government taxes.
- If there is government price control.
- If the increased money supply in the economy is hoarded out of circulation.
- When the exchange in the economy is by use of barter rather than money.
- If there is increase in savings by household.

152. (i) Distinguish between cash ratio and liquidity ratio.

(ii) Calculate the credit created where initial deposits amount 10,000 shillings cash ratio is 5% and four banks are involved.

A. (i) Cash ratio is the proportion of each deposit which a commercial bank must maintain in cash to meet the requirements of customers.

Whereas

Liquidity ratio is the proportion of the bank assets that must be maintained in cash or near cash form.

(ii) Credit created $= \frac{a\,[1-(1-r)\;]\,n}{r}$

Where a = initial deposit

n = number of banks involved in the credit creation process

r = cash ratio.

$10{,}000\ \frac{[\,1-1\ -0.2\,)^4}{0.2} = 29520$

$= 10{,}000\,[\frac{1-\ 0.8}{0.2})^4] = 10{,}000(1\text{-}0.4096) = 10{,}000\ (0.5094)$

$= \frac{5904}{0.2} = \frac{59040}{2} = 29{,}520$

153. (i) Differentiate between interest and rent.

(ii) Mention any two determinants of interest rate in your country.

A. (i) Interest is monetary payment for the use of capital as a factor of production.

While

Rent is the monetary reward/payment for the use of land as a factor of production.

(ii**) Determinants of interest rates in Uganda.**

- Duration of the loan/period of loan repayment.
- Demand for loanable funds/investment capital.
- Money supply in the economy.
- Economic situations e.g. inflation, boom etc.
- Policy of individual lender.
- Level of stability of the banking sector.
- Supply of liquidity/investment capital.

- Government policy in case of public businesses ie degree of liberalization of the economy.

154. (i) Differentiate between interest and profit.

(ii) Calculate the compound interest earned on the principle sum of Shs. 100,000 lent out for a period of three years at the interest rate of 10% per annum.

A. (i) Interest is the monetary payment made for the use of the services of capital or loanable fund.

While

Profit is a reward to the entrepreneur for taking risks in production of goods and services.

(ii) Year I

r (n) where r is the rate of interest and n is the principle sum.

$$10\% (100{,}000) = \frac{10}{100} \times 100{,}000 = 10{,}000/=$$

Year II

$$r (n + 10{,}000) = 10\% (100{,}000 + 10{,}000) = \frac{10}{100} \times 110{,}000 = 11{,}000$$

Year III

$$r (n + 10{,}000 + 11{,}000) = 10\% (100{,}000 + 21{,}000) = \frac{10}{100} \times 121{,}000$$

$$= 12{,}100=$$

Compound interest

$$= 10{,}000 + 11{,}000 + 12{,}000$$

Shs. 33,100=

155. (i) Given a cash ratio of 0.1% and initial deposit of shs. 250,000, determine the total credit created.

(ii) Credit multiplier.

A. (i) $\text{Total credit created} = \text{initial deposit} \times \frac{1}{\text{Cash ratio}}$

$$= 250{,}000 \times \frac{1}{0.1\%}$$

$$= 250{,}000 \times \frac{1}{\frac{1}{1000}} = 250{,}000 \times \frac{1000}{1}$$

$= \text{shs. } 250{,}000{,}000$

(ii) Credit multiplier

$$= \frac{1}{\text{cash ratio}} = \frac{1}{0.1\%} = \frac{1}{} = 1 \times \frac{1000}{1} = 1000$$

156. (i) What is meant by the term monetary policy.

(ii) Give any three instruments of monetary policy.

A. (i) Monetary policy refers to measures used by the government through the central bank to maintain economic stability by regulating money supply.

(ii) **Instruments of monetary policy.**

- Bank rate.
- Open market operation.
- Selective credit control.
- Special deposit/supplementary deposit.
- Minimum legal reserve requirements.
- Credit rationing.
- Margin requirement.

INFLATION

Question 49. (a) Examine the causes of inflation in your country.

(b) What measures has your country been taking to control Inflation?

Inflation refers to the persistent increase in the general price level for goods and services. The major causes of inflation in Uganda include the following:

- **Excessive demand for commodities.** Uganda experiences high rate of population growth. This implies excess demand compared to the amount of goods available causing continuous increase in price.
- **High production costs.** Most producers in Uganda incur high cost of production due to the use of imported raw materials, increased wage demand and high taxes. The producers recover these high costs by increasing the price of their products causing price increases.
- **Importation of goods from inflation prone countries.** Most of the manufactured goods and raw materials for the industries are imported. This has made the country vulnerable to imported inflation arising from rising prices in the producing countries.
- **Excessive printing of money.** During the regimes of Amin and Obote II, there was unregulated printing of money in the country resulting into persistent monetary inflation.

- **Supply rigidities**. This is more especially in the agricultural sector, which depends mainly on weather. Unfavourable weather conditions reduce supply causing producers to increase price.
- **Speculation by businessmen**. Sometime the businessmen deliberately hoard goods so as to increase price. This artificial scarcity causes increase in price.
- **Desire for excessive profits** by entrepreneurs. Entrepreneurs may want to increase their profit margins. This makes them hike the prices of their products, thus setting in motion inflation spiral.
- **Political instability. Many** parts of the country are politically unstable. This disrupts economic activities; causing shortages thus rise in prices.
- **Depreciation of the local currency.** The local currency is falling in value against foreign currencies due exchange rate liberalization. This fall in value is reflected in the rise of domestic prices.

Measures Uganda has been taking to control inflation

- **Increased rate of taxation.** The government has been instituting progressive taxation to reduce aggregate demand especially among the rich.
- **Reduction in government expenditure.** The government has been reducing its expenditure as a measure to scale down it's borrowing from the central bank.
- **Open market operations by the central bank.** The government trough the central bank has been selling securities such as treasury bills to the public to reduce the amount of money in circulation.
- **Income and wage policies.** The government has been consolidating allowances and wage freezing for those in high- income brackets to reduce the level of aggregate demand in the country.
- **Provision of investment incentives.** The government has been providing incentives to the investors by granting them tax holidays. This has stimulated more investment in the country both domestic and foreign. This has in turn led to increased supply of goods and services to meet the demand.
- **Fiscal policies to encourage production.** The government has been instituting fiscal policy measures such as liberalization, privatization, etc to increase domestic supply.
- **Improvement in infrastructure.** The government has been rehabilitating the roads and railway network to ease transportation of raw martial and finished products to market. This has ensured steady supply and stable price.
- **Stabilization of the political climate.** The government has been making efforts to promote political stability through out the country. This will provide favorable conditions for increased production.
- **Population control policies.** The government has been encouraging population control by

strengthening the family planning institutions. This will help reduce aggregate demand in the country.

- **Restricting importation.** The government has been regulating importation of goods into the country. It has been trying to discourage importation from inflation prone countries. This has minimized imported inflation.
- **Restrictive monetary policy.** The government has been strict on printing of money. This has reduced monetary inflation in the country
- **Currency reforms.** The government has been carrying out currency reform measures such as demonetization of the currency to reduce quality of money in circulation.
- **Modernization of agriculture.** The government has been trying to modernize agriculture to increase supply to meet the rising demand.

Question 50. (a) Distinguish between demand pull inflation and cost push inflation

(b) Examine the effects of inflation in an economy.

Demand pull inflation a situation where aggregate demand persistently exceeds aggregate supply at current prices and at full employment level of the economy so that prices keep rising or pulled upwards.

whereas

Cost push inflation is the type of inflation, which originates from the supply side and is a situation where rising prices are initiated and sustained by the rising costs of production.

Effects of inflation

Positive Effects:-

The positive effects of inflation are mainly associated with mild inflation.

- **Mild inflation encourages hard work and effort among the citizens in order to meet the high cost of living.** Individuals are encouraged to work hard in order to maintain their current living standards
- **It stimulates investments and profits:-**
  Mild inflation increases the producers' profits which boost the level of investments in the economy.
- **Leads to increased Government revenue**:-

  It increases the revenue through increased taxation on expanding tax base.
- **Promotes economic growth:-**

  It stimulates economic activities leading to expansion of GDP.
- **Encourages increased innovations**:-
  Workers come up with innovations to improve on their earnings.
- **Encourages import substitution industrialization:-**

Because of the need to avoid imported inflation, the establishment of import substitution industries leads to self reliance of the economy.

- **Leads to increased labour mobility**:-
  Labour becomes more mobile both geographically and occupationally in order to earn a living.
- **Encourages forced savings:-**
  Because during times of inflation, people receive incomes which cannot buy any reasonable amount of goods, they are therefore forced to make savings through the accumulation of small incomes which cannot buy anything substantial at once.
- **Increased resource exploitation**:-
  Due to effects of inflation, the hitherto idle resources are exploited as people struggle to earn a living.
- **Leads to acquisition of entrepreneurship skills:-**
  It promotes the development of entrepreneurship skills as people learn to do things that can enable them earn a living in hard times.
- **Promotes Commercialization of the economy:-**
  The use of money becomes widespread which eventually diminishes the subsistence sector. **Leads to creation of employment opportunities**
  Some jobs are created by entrepreneurs who invest in order to take advantage of rising profitability in the economy.
- Debtors benefit because by the time they pay back the money, it will be less in value

(b) Negative Effects:-

- **Discourages savings**
  It affects people's savings through constant loss of money value i.e. it represents a major disincentive to save and discourages investment initiatives as well.
- **Loss of confidence in money:-**
  People begin to reject money as a medium of exchange in preference to barter transactions.
- **Government unpopularity:-**
  People generally do not like inflation and it generates a source of grievances among many of the sufferers. The tension and industrial unrest created may discredit the government**.**
- **Leads to increased importation:-**
  It encourages importation of cheaper goods from abroad.
- **Worsens BOP problems:-**
  The rising prices at home lead to a fall in exports but increase in imports. Exports become too expensive for the foreigners to buy yet imports become cheaper.
- **Increases immorality:-**

It causes immorality in the society as people strive for a living e.g. smuggling, prostitution, gambling, speculation etc.

- **Increased crime rates:-**
  Crime rate increases as people struggle to earn a living through dubious means e.g. corruptions, theft, robberies, embezzlement etc.
- **Increased strain:-**
  It causes strain among people through long hours of work in order to earn a living.
- **Unfair income distribution**
  During times of inflation, some groups become better off while others worsen off. The stronger group gains while the weaker one loses. This causes misery among the majority who cannot afford high prices of goods and services.
- **Huge loses:-**
  Factories/industries make heavy losses and may close down because of cost push inflation leading to inflationary spiral in the economy.
- **Worsens unemployment problem:-**
  Some workers quit wage employment in urban areas because they cannot afford high cost of living.
- **Leads high interest rates:-**
  Interest rates rise because lenders expect high rewards for lending their money. This discourages borrowing for investments yet the savings will also not rise due to money losing value.
- **Leads fall in real incomes:-**
  Fixed income earns (salaried workers) suffer as their real income falls with a rise in inflation.
- **Loss to creditors:-**
  Lenders and creditors in general tend to lose as they lend money of high value but are paid back money of low value whereas borrowers (debtors) gain because the real worth of the principle declines.
- **Causes Distortion of government plans:-**
  Government and individual plans cannot be implemented which consequently retard economic growth and development.
- **Leads to increased hoarding of money:-**
  The amount of money held for speculation purposes increases.
- **Failure of economic targets:-**
  Inflation makes it difficult to attain goals or other targets of economic policy.

Question. 50. (a) what is meant by stag inflation?

(b) Why may mild inflation be desirable in an economy?

Stag inflation is an economic situation whereby high rate of inflation co-exist with high rate of unemployment in an economy. It reflects a policy failure. The government may want to control inflation by increasing taxes on income. The resulting fall in aggregate demand may discourage investment leading to unemployment and worsened inflation.

Why mild inflation is desirable:

- **Mild inflation may encourage investment.** The rise in price is a signal for increased profit. More investment will be stimulated in the economy, leading to more employment opportunities.
- **Mild inflation may encourage hard work.** Inflation affects standard of living and welfare of the citizens by increasing cost of living. Individuals will be encouraged to work hard in order to maintain the standard of living they are already accustomed to.
- **May lead to more employment opportunities in the country.** Many entrepreneurs may want to take advantage of increasing investment. This creates more job opportunities in the country.
- **Promote commercialization of the economy.** The use of money becomes widely spread. This reduces subsistence sector.
- **May lift the economy out of a depression.** During economic depression, the level of economic activity is low. Little rise in price may stimulate economic activities leading to increased investment in the economy.
- **Increased labour mobility.** The economic difficulties arising out of inflation may force labour to be more mobile both geographically and occupationally as people struggle to cope up with the rising cost of living. Labour will be on the move in search of better paying jobs.
- **May provide justification for workers to demand wage increase.** If labour productivity has not risen, trade union may not have justification to demand for wage rise. Rise in cost of living due to inflation may present trade union with justification to demand wage rise in the face of constant labour productivity.
- **My stimulate growth of GDP.** The increased investment stimulated by inflation leads to more output of goods and services. This leads to economic growth.
- **May increase government revenue.** Mild inflation expands economic activities. This increases tax base of the country.
- **May increase savings.** In times of financial constraint the government may raise funds through forced savings, by printing money; the purchasing power is transferred from individual to the government. This is popularly known as inflation tax.
- **May encourage import substitution industries.** The desire to control imported inflation may encourage domestic production of such goods thus increased innovation.

SECTION A

157. (i) Differentiate between creeping inflation and run away inflation.

(ii) Give two policy instruments for controlling inflation in your country.

A. (i) Creeping inflation is a type of inflation where by persistent increase in the general price level is at slow rate usually not exceeding 10%.

While

Run away inflation is where the general price level increases at a very fast rate, the increments taking place within hours, days or weeks. It is also known as galloping inflation.

(ii) **Policy instrument for controlling inflation.**

- High direct taxes.
- Controlled government expenditure.
- Selling of securities.
- Currency reforms.
- Liberalization of the economy.
- Privatization drive.
- Improvement of infrastructure.
- Controlled issuing of currency.
- Improving political situation in Uganda.
- Import substitution strategy to reduce imported inflation.
- Restrictive income policies ie restrict wage increase.

158.(i) Give any four positive effects of inflation.

- Encourages savings.
- Provides incentives to hard work.
- Promotes entrepreneurship as many people are encouraged to take risks in business venture.
- Innovativeness and creativity are encouraged in production hence more output.
- Idle potentials are exploited as profit margin improves.
- Commercialization is encouraged thus reduction in subsistence sector.
- More employment opportunities are created.
- Debtors gain in real terms.
- Encourages labour mobility.
- Increased government revenue.

159. (i) Differentiate between structural inflation and demand pull inflation.

(ii) Mention two effects of demand pull inflation.

A.(i) Structural inflation is the type of inflation which is caused by reduction in output of the major sectors due to supply rigidities arising from breakdown in the production process, fall in agricultural production, foreign exchange constraint etc.

While

Demand pull inflation is a situation in which aggregate demand persistently aggregate exceed aggregate supply in the condition of full employment leading to upward movement of prices.

(ii) **Effect of demand pull inflation.**

- Discourages investments in the economy.
- Money rapidly loses value and people lose confidence in it as store of value.
- Reduces welfare/standard of living in the country.
- Increase in cost of living.
- Increased importation of cheaper goods from abroad.
- Causes BOP problems by discouraging exports and encouraging imports.
- Worsens income inequality.
- High rate of interest of loans.
- Creditors lose because they receive back less in real terms.
- Government loses popularity

160. Give any four causes of inflation in your country.

- High population growth rate/increase in aggregate demand.
- Excessive printing of money.
- Poor infrastructure.
- Supply rigidities.
- High cost of production.
- Increasing oil prices.
- Excessive importation of goods from inflation prone countries.
- Break down of industries.
- Excessive government borrowing/deficit financing.

161. (i) Distinguish between imported inflation and bottleneck/structural inflation.

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

A. (i) Imported inflation is the type of inflation which arises due to importation of commodities from inflation prone countries/regions.

While

Bottleneck inflation is that type of inflation arising from structural rigidities causing shortage in the supply of goods in the domestic economy.

(ii) **Causes of imported inflation in Uganda.**

- Importation of commodities from countries experiencing inflation.
- Rising prices in the international market.
- Increased government taxes on imports.
- Increasing prices of petroleum products.
- Reliance on imported raw materials by home industries.

162. Give any four causes of structural inflation in your country.

- Breakdown in infrastructure.
- Political unrest in the producing areas.
- Scarcity of inputs like raw materials.
- Breakdown in industrial sector.
- Failure in agricultural sector due to unfavorable weather.
- Speculation by businessmen who create artificial shortages by hoarding goods.
- Foreign exchange constraints.
- Mismanagement of the economy.

163. Give any four measures to control demand pull inflation.

- Restrictive monetary policy.
- Restrictive fiscal policy.
- Restrictive income policies.
- Price control policy ie fixing maximum prices for essential commodities.
- Increased importation of goods.
- Increased inflow of foreign investments.
- Organizational controls ie control distribution outlet/rationing.
- Currency reforms issue of new currency to replace old ones.

164. (i) Distinguish between suppressed inflation and cost push inflation.

(ii) Give any two measures to correct cost push inflation.

A. (i) Suppressed inflation is a situation where demand exceeds supply but the effect on price is minimized by use of such devices as maximum price control.

While

Cost push inflation is the type of inflation, which originates from the supply side and is a situation in which rising prices are initiated and sustained by the rising costs of production.

(ii) **Measures to correct cost push inflation**.

- Provision of subsidies to reduce cost of production.
- Increased availability of goods.
- Price policy ie government fixing maximum price for essential goods.
- Income policy ie government setting a maximum wage which is followed by wage reduction in the economy.
- Organizational control ie government taking over distribution outlets and practices rationing so that every consumer gets opportunity to buy the commodity.
- Control in level of interest rate.

165. Give any four measures to correct structural inflation.

- Rehabilitation of the productive sectors in the economy.
- Organizational control through rationing.
- Provision of security and stability in producing areas.
- Restrictive income policy to reduce excess demand.
- Increase in local production in the economy.
- Improvement in the foreign exchange earning sectors by strengthening the exporting sector to boost the import capacity of the economy.
- Ensuring strict and proper management of the economy.
- Institution of pricing policy by setting up maximum prices to avoid upward pressure on price.
- Improvement in technology to take care of unpredictable weather.
- Provision of farm inputs so as to raise agricultural productivity.

DEVELOPMENT PLANNING

QUESTION 51a)Describe the characteristic of a good development plan.

(b) Examine the pre-requisites of successful planning in LDCs.

A. (a) **Characteristics of a good development plan.**

- **Comprehensive.** A good plan should cover the whole economy with established linkages between all sectors.
- **Consistency.** It should be consisted with the resources available planned investments should be balanced by expected supply of finance, skilled manpower requirement which should not exceed what is available.

- **Compatibility**. Different aspects of the plan should agree with each other.
- **Sequency**. All stages should follow each other in logical and chronological order. ie implementation of projects should be done in orderly manner, one after another.
- **Politically acceptable**. It should be politically and administratively feasible for easy implementation.
- **Socially relevant**. It should be in line with the socio economic system of the country.
- **Economically feasible**. The objectives should be with the reach of the economy.
- **Proportionality**. The demand for goods and be equal to the expected supply.
- It should be internationally acceptable.

(b) Pre requisites for successful planning.

- **Availability for reliable statistical data.** There should be an organized system for collecting data. There should be information about the existing resource potential of the country together with its deficiencies. Such information helps in fixing targets and priorities in the plan.
- **Political will.** There must be commitment and willingness on the part of the leadership to implement the plan.
- **Political stability and security.** Meaningful development is achieved when there is political stability.
- **Mobilization of resources.** A plan fizzes the public sector expenditure for which resources have to be mobilized for the purpose. The plan itself should have laid down policies and instruments for mobilizing resources to finance the various projects.
- **Efficient administration.** An efficient strong and incorrupt administration is a necessary prerequisite for successful planning.
- **Public support**. It requires the co-operation of the people for it to succeed. It should be regarded as a national plan and should be accepted by the various groups in the country.
- **Balancing in the plan.** Plan should ensure proper balance in the economy. There should be the balance between saving, investment, demand for imports and availability of foreign exchange.
- **Setting of target and priorities.** The targets and priorities for achieving the objectives laid down in the plan should be fixed. The targets should be both general and sectoral which should be mutually consistent to attain the required growth rate of the economy.
- **Set objectives.** What the planners intent to achieve should reflect the wide of interests of various social, economic and political groups with the country. The key objectives may include job creations industrialization, self reliance reduction of income inequalities, macro-economic stability etc.

- **Availability of the technical personnel.** planning requires a great deal of expertise and sound training in research and statistical methods.
- **Effective planning machinery.** It requires establishment and maintenance of a planning department which should be properly organized.

79. (a) Distinguish between decentralized planning and centralized planning.

(b) Examine the merits and demerits of decentralized planning.

A. Decentralized planning refers to planning from the grassroots, regional or sectoral levels which are later incorporated into the central government plan.

While

Centralized planning is the planning by central authority and covers the various sections of the economy. The entire planning process in a country is under a central planning authority which formulates a central plan, fixes objectives, targets and priorities for every sector of the economy. The entire planning process is based on bureaucratic control.

Merits of decentralized control.

- **Favours local interests and priorities.** Planning at local level identifies the fundamental needs of the people. Ideas and input of the local people is taken into account.
- **Appropriate where the country is large**. Planning at local level brings services nearer to the people especially to those areas that are far form the centre.
- **Makes use of local resources.** Each region with tap is unique local resources, and this will be provided for in the plan.
- **Guarantees employment to the people in a given locally**. Projects established by the plan will create employment opportunities to the local people. Thus leading to increased incomes.
- **Encourages local participation in development**. People in a given region will get committed to development of their areas.
- **Creates responsibility for all people in the region**. It gets down to each person in the region unlike centralized planning.
- **Promotes division of labour**. Division of labour between central and local government is possible.
- Ensures efficient tax collection hence more revenue.
- Decentralization of projects leads to regional development.
- **Promotes self reliance.** It compels each region to cater for itself due to limited capital to cater for all regions at the same time.

- **Reduces rural-urban migration.** People will get employment in their local areas. Thus migration to the centre will be unnecessary.

Demerits of decentralized planning.

- Lack of local skills in specific regions may hinder planning.
- Uneven distribution of resources in the economy makes planning difficult.
- **Unequal regional development**. Regions which are more endeavored with resources will develop more than others.
- **Puts burden on the local bodies.** Raising resources to finance the plan may put heavy strain on the local people.
- The central government may become relaxed in service provision.
- May lead to quick depletion of resources in an area.
- Encourages wastage of resources through depletion.
- It lacks coordination in sectoral development.

Question.51(a) Explain why LDCs carry out development

(b)Examine the limitations to successful planning in LDCs

Economic development planning is a deliberate and conscious government effort aimed at influencing, directing and controlling economic decisions to achieve specific objectives of national development and within a specific period of time. The rationale for planning in LDCs includes;

- **To equitably distribute income**. Planning is necessary for equitable distribution of wealth. Through effective planning, individuals are able to gain equality from economic development of the country. For example through the budget, high taxes can be imposed on the rich and the revenue realized used to improve the welfare of the poor.
- **To solicit foreign aid**. The formulation of detailed development plans with the specific sectoral output targets and carefully designed investment projects has often been a necessary condition for the receipts of bilateral and multinational foreign aid. With a list of projects LDCs governments are better equipped to solicit foreign assistance and persuade donors that their money will be applied productively.
- **To maintain economic stability of a country.** Planning is a powerful instrument to maintain economic stability of a country by ensuring that economic variables and demand and supply conditions are balanced.
- **To correct market failure**. Most LDCs are characterized by imperfections both of structure and operation. Commodity and factor markets are poorly organized, leading to distorted prices. Planning therefore is necessary to correct failure of price mechanism.

- **To correct B.O.P. Problems**. Planning can ensure that TOT remains favourable to the country. In this way foreign trade plays a very important role in economic development of a country. Through careful planning, a country's resources can be utilized to increase exports.
- **To eliminate wasteful competition**. Unfair competition may be harmful for the country. Planning is the only way to direct economic life wisely and safely.
- **To mobilize and allocate resources efficiently**. Planning helps government to direct effort to gather resources needed for development.
- **To harmonize the use of scarce resources**. Without planning, no country can harmonize the economic decisions. The resources of the country can be utilized in a systematic way through planning. Planning is assumed to help modify the restraining influence of limited resources by recognizing the existence of particular constraints and by choosing and coordination investment projects so as to channel the scarce factors into their most productive outlets.
- **To mobilize the population for development.** Planning can help in mobilizing popular support cutting across classes, caste, racial, religious or tribal factions with the plea to all citizens to work together towards building the nation.
- **To reduce unemployment problems.** Unemployment can be removed through careful planning. More investments can be made to absorb the excess labour force.
- **To reduce dependence.** Through planning the governments ensures that resources are allocated in such a way that needs of the society are catered for. This promotes self reliance.
- **To identity investment opportunities.** Plans are used to identify areas suitable for public and private investments.
- **To state government development programmes.** It shows how the government intends to develop the whole country. Planning is advocated on grounds that the decisions of the state are superior to that of the individuals. The state can develop the country economically at desired speed and can relate the present to the future.
- **To promote inter-sectoral linkages**. Planning can help government to invest in the various sectors and indicate how various sectors can be coordinated to supplement each other.
- **To determine rate of economic growth.** Planning can help government to direct resources in strategic sectors of the economy to promote faster rate of growth.

Limitations of economic planning in LDCs

- **Deficiencies in plans and their implementation.** Plans are often over ambitious trying to accomplish too many objectives at once without consideration of conflicting and competing objectives. They are often broad in design, vague on specific policies needed to achieve stated objectives, and the gap between plan formation and its implementation is large. This is why most LDCs plans are just on paper and never implemented.

- **Limited information.** Accurate and relevant information is needed to prepare future plans. But for most LDCs the available data is always unreliable and inadequate which makes the implementation of plans very difficult.
- **Limited supply of trained staff**. There is inadequate supply of qualified economics, statisticians and other planning personnel to formulate and carry our comprehensive and detailed development plan. In such situations it is a waste of scare resources to engage in a comprehensive planning exercise.
- **Prevalence of inflation**. Inflation is a serious problem for most of the LDCs. Due to rapid rise in prices, it is difficult to predict the cost of various projects in advance.
- **Unanticipated economic disturbance both internal and externa**l. Since LDCs are open economices with considerable dependence on external variables such as trade, changes in international commodity prices, irregularity in the flow of private and public development assistance, it becomes difficult for them to engage in even short term forecasting, let alone long range planning in the face of such uncertainties.
- **Lack of political will**. The major cause of LDCs planning failure is the poor performance and the growing gap between formulation and implementation and political will on the part of many LDCS leaders and high level civil servants. The available evidence shows that lack of adequate government support is the prime reason why most plans are never carried.
- **Shortage of funds**. Lack of adequate capital is another problem for the planners; Most of the projects cannot be completed due to insufficient funds.
- **Presence of private sector**. Most LDCs are mixed economies with the private sector becoming larger and larger due to adoption of privatization policy and other structural adjustment programmes. Due to this reason, planners cannot prepare adequate and comprehensive plans.
- **Political instability and frequent changes in government**. Many plans are started and never completed due to insecurity. Subsequent governments that come to power come with their own programmes and projects of previous regimes are often abandoned.
- **Corruption among the implementers**. Most of the resources and funds raised for the projects often end up in private accounts of project officials and senior politicians.
- **External interference**. Donors tend to interfere with the planning process of LDCs by dictating the projects which should be catered for by the planners.
- **Limited viable projects**. In LDCs, planners usually find it difficult to identify worthwhile and viable projects to plan for.
- **Lack of public support**. Most LDCs governments are not popular with the masses due to their respective and dictatorial; tendencies. Therefore their plans lack the public good will and support. In addition the public are not well informed about the plans. The plans are always contained in a massive document which the public cannot follow:

Problems faced in planning formulation and implementation in LDCs

Limited information and reliable data:-

Accurate and relevant information is needed to prepare a future plan. But this information is not available in most of the cases especially in LDCs. Economic wisdom of a development plan depend to a greater extent on the quality and reliability of the statistical data on which it is based. When these data are weak, unreliable or simply non existent, as in many poor countries, the quality and accuracy of comprehensive plans are greatly diminished.

Unanticipated economic disturbances both internal and external:-

Since LDCs are open economies with considerable dependence on external variables such as changes in international commodity prices, fluctuating trade and irregular flow of private and public development assistance, it becomes difficult for LDCs to engage even in short term planning.

Political instability and frequent changes in government:-

This means most of the plans are not accomplished, and every new government comes with its own plans.

Deficiencies in plans and their implementation:-

Plans are often over ambitious trying to accomplish too many objectives at once without consideration of conflicting and competing objectives. They are often broad in design, vague on specific policies needed to achieve stated objectives; and finally the gap between plan formulation and its implementation is large. Many plans just remain on paper.

Institutional weaknesses:-

LDCs have weak administrative and technical staff to draw plans. Thus there is lack of coordination resulting into a gap between the planning body and the day to day decision making machinery of government. This leads to failure by planners, administrative and political leaders to coordinate goals and strategies.

Lack of fund:-

Most of the projects cannot be implemented due to insufficient funds.

Plans rigidities:-

LDCs plans are rigid and are sometimes formulated by foreigners who never supervise the implementation of projects. This makes the plan adjustments difficult.

Lack of public support:-

The plans lack the public goodwill and support because the public is not always well informed. The plans are always contained in massive documents which are hard to follow.

External pressure/ Influence:-

The donors tend to interfere with the planning process of LDCs by dictating the projects which should be catered for by the planners.

Corruption among plan implementers:-

The resources meant for plan implementation is often misappropriated. This hampers the completion of most plans.

Limited viable projects:-

In LDCs, planners usually find it difficult to identify worthwhile and viable projects to plan for.

Presence of private sector.

In mixed economies private sector is very large and it does not fall under the control of planning authority. Due to this reason planners cannot prepare adequate comprehensive plans.

Lack of political will.

The governments in LDCs are not committed to the plans. The available evidence makes it clear that in countries with development plans, lack of government support for the plans is the prime reason why most are never carried out.

***Inflation:* -** inflation is a serious problem for most of the countries. Due to rapid rise of prices, it is difficult to predict the cost of various projects in advance.

SECTION A

135. Distinguish between:

(i) Marco planning and project planning.

(ii) A partial plan and comprehensive plan.

A. (i) Marco-planning is planning which is carried out for the whole economy, over a given duration of time.

Whereas

Project planning is the planning at project level, which involves identification of possible projects, appraisal of the projects and their implementation.

(ii) Partial plan is a type of plan that covers only a part of the national economy such as agriculture or industry.

Whereas

Comprehensive plan is a plan which covers the whole economy, both public and private sectors.

136. (i) What is economic planning.

(ii) Distinguish between comprehensive planning and perspective planning.

A. (i) Economic planning refers to deliberate government attempts to formulate decisions on how productive resources shall be allocated among different uses in order to achieve targeted rate of economic growth and output over a certain period of time.

(ii) Comprehensive planning is the planning intended to cover the whole economy or all sectors of the economy.

Whereas

Perspective planning is the long term planning covering a period of 10 years and above.

137. Mention any four problems faced by government in formulating a perspective plan.

- Limited information/unreliable data.
- Unanticipated economic disturbances.
- Frequent political changes/unstable political climate.
- Over ambitious plans.
- Unreliable sources of funding.
- Institutional weaknesses due to shortage of staff.
- Plan rigidities.
- Lack of public support.
- External interference/influence.
- Corruption and embezzlement of funds.
- Limited viable projects.

138. Mention any four merits of a comprehensive plan.

- Ensures balanced regional development.
- Ensures equitable distribution of employment opportunities.
- Widening of tax bases.
- Promotes inter-sectoral linkages.
- Promotes equitable distribution of income.

139. (i) Define the term "economic development planning".

(ii) Mention three problems encountered in economic development planning in LDCs.

A. (i) Economic development planning is a deliberate attempt by the government to influence and control economic choices and activities towards a specified objective in a period of time.

(ii) **Problems encountered economic development planning.**

- Limited information/data.

- Unforeseen economic disturbances.
- Unstable political administration.
- Over ambitious plans.
- Institutional weaknesses ie the administrative and technical staff to draw plans is weak leading to coordination failure.
- Limited and unreliable sources of funds.
- Plans rigidities ie fails to adjust according to the prevailing conditions.
- Lack of public support and good will.
- External interference ie donors dictating projects which should be undertaken in the plan.
- Corruption among plan formulators.
- Limited viable projects.

140. Give four prerequisites for successful planning.

- Stable political climate.
- Availability of specialized technical personnel.
- Political will.
- Fixation of targets and priorities.
- Establishment and maintenance of planning machinery.
- There should be organized system for collecting data.
- Statement of objectives.
- Mobilization of resources.
- Efficient administration.
- Public co-operation..

141. Properties of a good development plan

- It should state objectives i.e. what is should be achieved.
- It should mention the institution which will execute the plans e.g. ministry responsible for planning.
- It should mention policy, measures and administrative controls to ensure implementation consistency.
- It should mention priority areas where investment should be located.
- It should mention how the plan is to be financed.
- It should examine the costs and benefits to the society.
- It should state a country's natural, physical and financial resources.

- It should mention a country's recent past national development record for ease of forecast on the future.
- It should state quantities of annual feasible growth rate of output and income, the productive capacity, government accounts and inter sector flows.

DEVELOPMENT PROCESS AND CHOICE OF DEVELOPMENT STRATEGY

Question. 51.(a) What are multinational corporations?

(b) Assess the contributions of multinational corporations to the economic development of your country.

Multinational corporations are international business originations with the head quarters in developed countries but with branches in many countries including LDCs. Examples in Uganda include palm olive coca cola, Bata, BAT etc. They carry out direct foreign investment [DFI] and they are the major source of investment capital for LDCS like Uganda.

Positive contributions of multinational corporations.

- **Fill investment gap.** Due to low incomes, the level of private savings in Uganda is too to finance domestic investment. Multinational corporations fill this gap by transferring foreign savings to finance investment in the country through direct foreign investment.
- **Fill foreign exchange gap.** Due to declining revenue from export, and over reliance on export of agricultural products which face unfavorable terms of trade, Uganda suffers chromic foreign exchange deficiency. Multinationals fill this gap by bringing in foreign exchange deficiency.
- **Fill the manpower gap.** The multinationals come into the country with their own skilled man power to manage their investments. This bring into the country wide range of skills that cannot be locally trained due to our inappropriate education system.
- **Create employment opportunities.** By establishing their plants and businesses multinationals create employment opportunities for Ugandans. Factories such as palm olive, cocoa cola, Bata etc have created many jobs for Ugandans. Even in the banking industry foreign owned banks such as standard chartered, Barclays etc have generated employment opportunities.
- **Lead to efficiency of local firms.** The foreign multinationals promote competition in the home market forcing local firms to improve their efficiency in production. This leads to improved quality of goods consumed, hence improved welfare. The establishment of foreign banks in the country has forced indigenous banks and financial institutions to provide quality services to their customers.

- **Lead to acquisition of skills.** The Ugandans who work in industries established by the multinationals acquire skills in banking, welding and fabrication, marketing etc. This has been very useful in the formal sector and self employment.
- **Development of infrastructure.** Multinationals tend to provide essential infrastructure such as roads and services such as electricity and water. All these promote development of an area. For instance the establishment of the Coca cola plant in Namanve forests has lead to transformation of the area due to the infrastructure in has provided.
- **Contribute revenue to the government.** The multinationals pay taxes to the government from the profits they make and also workers they employ pay income tax. This leads to increase in the government revenue necessary for financing public expenditure.
- **Promote industrial growth.** By setting up their plants in the country multinationals contribute to the industrial; growth in the country. Majority of industries we have in the country such as palm olive, Bata, Coca cola etc belong to the multinationals.
- **Facilitate exploitation of local resources.** Due to capital deficiency much of the country's natural resources would have remained idle. With establishment of the plants by multinationals these resources are put to use. The discovery of petroleum in western Uganda will attract many multinationals to invest in its exploitation.
- **Promote international relationship.** Multinationals corporations provide beneficial links between the host country and their home country this promotes international trade and friendship.
- **Transfer technology.** Multinational corporations use advanced technology developed in their homes countries in their plants established in the host country. Uganda enjoys advanced technology without going through the difficult and expensive process of developing it locally.

Negative contributions.

- Demand excessive concessions from government. The multinationals demand a lot of privileges from government in form of subsidies, tax holidays among other. These out weigh the expected benefits to the country. For instance BAT closed its plant in Jinja in 2006 due to disagreement with government over taxation.
- **Worsen unemployment situations in the country**. The multinational corporations prefer to use advanced capital intensive technology in their plants rather than labour intensive. The use of computers and ATM by multinational banks has limited job opportunities for clerks and cashier. In addition the multinationals prefer to employ expatriated rather than indigenous people.
- **Profit repatriation**. The multinationals merely use the host country as market for their finished product. They prefer to invest their profits back at home. This limits capital accumulation in the country.

- **Unbalanced regional development**. The multinationals often prefer to locate their businesses and industries in major towns. In Uganda most of the multinationals have located their industries in Kampala. This has promoted regional inequalities.
- **Provide no linkage in the economy**. The industries established by the multinationals mainly use imported raw materials. Therefore they do not provide market to agricultural raw materials produced in the country. Thus these industries cannot support agriculture and other sectors of the economy to grow.
- **Promote technology dependency**. These industries established in the country prefer imported technology. Thus, they suffocate the development of indigenous technology.
- **Irrational exploitation of resources.** The industries established aim at maximizing high profits. This leads to over exploitation of resources causing quick depletion. For example, Tororo Cement is very rapidly depleting the limestone in Tororo. Nile Ply in Jinja is said to have cut down over 400 hectares of forest in Mabira.

- **Lead to environmental degradation.** The industries established pollute the atmosphere as well as depositing their waste in Lake Victoria. These industries turn out to be health hazards to the nationals.
- **Encourage rural-urban migration.** The multinationals prefer to establish their plants in Kampala. This leads to rural urban migration in search of employment. This has led to many problems in urban areas such as congestion open urban unemployment, rise in crime rates, among others.
- **Worsens BOP problems**. The importation of machines, spare parts and expatriates may lead to increased foreign exchange outflow. This worsens the BOP deficit of the country.
- **Promote influence of their government in the host country**. Multinationals may promote the interest of their mother country in the host country. This leads to neocolonialism and its negative consequences.
- **Exploitation of consumers**. Multinationals usually demand protection from their hosts against foreign competition. This gives them monopoly position

Question 52. (a) Explain why expenditure on education is both an investment and consumption.

(b) Assess the role of education in economic development

Education refers to expenditure on human resources aimed at increasing stock of knowledge, skills and experience. Education increases labour productivity and it is one of the most expensive undertaking to both governments and individuals. Education is considered an investment because:

- **Involve high monetary costs**. Education is a very expensive undertaking. It accounts for big proportion of national budget of many countries. It is one of the most strenuous expenditures to families in terms of fees payment.
- **Increases stock of skills.** Education increases stock of a country's skilled manpower just in the same way investment increases stock of capital accumulated.
- **Education has opportunity cost.** It involves sacrifice of present consumption for future benefits in terms of increased output. It consumes resources that could have been spent on current consumption. An individual has to foreign his/her leisure time.
- **Takes long to yield benefits.** The benefits are realized after along time like any other investment.
- **Education has risks.** Like other investments, education has many risks. The person can die or fail examinations in the same way an investor can make losses

Why education is consumption

- The knowledge which people acquire from education makes them buys books, pens, and newspapers just like they would spend money on any other consumer goods.
- **Provides utility.** Educated people enjoy direct utility from the social status which education brings, something on which people might place very high value.
- **Permit enjoyment of wide range of facilities.** Educated people enjoy additional range of goods and services which illustrates put no value e.g. buying news papers, magazines etc.
- **It is an end in itself.** Education has transforming effect on individuals who have acquired it.

Positive roles of education

- **Changes people's attitudes.** Education helps in transforming people's attitudes from the rigid traditional, social, cultural systems to those required in modern economy. This facilitates development.
- **Promotes industrial development.** Education equips people with relevant skills that are required in the industrial sector. This leads to industrial development.
- **Increases aggregate demand.** By transforming the consumption patterns, education increases aggregate demand in the economy hence widening domestic market.
- **Endows labour with skills.** The knowledge which labour acquires through education increases its productivity and efficiency. Thus increased output leading to economic growth.
- **Improves the levels of income.** Educated people have the prospects of securing high paying jobs thus high incomes.

- **Reduces a country's dependence on expatriates.** If the population of a country is well educated the need to import expatriates from other countries is reduced. Hence reduced foreign expenditure.
- **Facilitates development of technology.** Skills acquired through education can be used to carry out scientific research through which new and better techniques are discovered.
- **Raises standard of living.** Through education, the welfare of the population improves as a result of better feeding hygiene etc. Thus education helps improve the living conditions in the economy.
- **Promote rural transformation.** Education is delaying mechanism. When girls stay longer in schools, their fertility rate reduces, hence give birth to fewer children. In addition educated people prefer smaller families.
- **Promotes fairer distribution of income.** When the majority of people in society are educated, they can get jobs which they earn incomes. This reduces inequalities in income distribution.
- **Provide employment opportunities**. Educations provide jobs directly to teachers and other support staff in educational institutions. In addition, more employment opportunities are created indirectly to producers of stationary, text-books, uniforms, furniture etc.

Negative roles of education

- **Encourages rural-urban migration**. Products of formal education prefer to settle in urban areas. This deprives rural areas of energetic labour force leading to declining agricultural production.
- **Promotes income inequality**. Wages tend to vary with education level. Those with higher educational standard are more highly paid leading to income inequalities.
- **Leads to unemployment**. Due to inappropriate education, the product of education system of LDCs has theoretical knowledge which makes them white collar job seekers. This has resulted in graduate unemployment.
- **Create biased altitudes**. Educated people hate manual work in agricultural sector. In addition, they prefer consuming imported goods to locally made goods. This hinders growth of local industries.

Question 53. (a) Examine the merits of technology transfer to LDCs

(b) Discuss the problems limiting technology transfer to developing countries.

Merits of technology transfer

- **Facilitate exploitation of a country's resources.** LDCs have abundant natural resources which are lying untapped due to poor technology. Transfer of advanced technology from MDCs can facilitate efficient utilization of these resources.

- **Increase labour productivity.** The use of advanced technology from MDCs makes labour force in LDCs more efficient hence high output.
- **Leads to production of high quality output.** The use of high technology is associated with high quality products. This improves the welfare of the citizens.
- **Leads social cultural transformation.** The use of advanced technology transferred from MDCs is associated with modernity. It will possible change people's social attitudes.
- **Technology can be exported to earn income.** The LDCs can re-export the technology to other LDCs thus earn income.
- **Leads to acquisition of new skills.** The labour force in LDCs will have to be trained in the use of the new technology. Thus new skills are obtained in the process.
- **Facilitates research and innovation.** Sustaining the advanced technology need constant innovation through research and development. More investment will be put in research leading to improved efficiency.
- **Leads to improvement in infrastructure.** Sustaining the technology transferred from MDCs require that a country improves her state of infrastructural development. Therefore better roads will be built.

Limitation of technology transfer to LDCs

- **Lack of required skills:-**
  LDCs usually suffer from shortage of skilled man power required for effective operation of new machines.
- **Protectionist policies of MDCs:-**
- MDCs usually do not permit LDCs to get knowledge about certain types of technology e.g. nuclear technology.
- **Shortage of capital:-**
  LDCs sometimes fail to acquire technology due to shortage of capital to purchase them
- **Lack of strategic raw materials:-**
  New technology may require certain special raw materials which may be lacking in LDCs. Failure to avail such raw materials may prevent the technology transfer from one country to another.
- **Small size of the market**:-
  Some of the technologies from MDCs may not be suitable for the conditions existing in LDCs.
- **Inappropriateness of technology:-**
  Some of the technologies designed in the MDCs may not be suitable for the conditions existing in LDCs.

Question.54 (a) Distinguish between intermediate technology and appropriate technology

(b) Examine the roles of intermediate technology in the economic development of LDCs

Intermediate technology is a type of technology which fits into the level of development of the host country i.e. it is the one which is easily adaptable to the society's level of development. It should neither be too advanced nor too simple.

Whereas

Appropriate technology is type of technology which matches with the existing conditions in the host country.

It is thus the right type of technology which fits the conditions existing and responds to the need of the society at the time i.e. it is the technology which is suitable for the conditions of the economy and employs factors in their correct proportions.

Role of intermediate Technology

- **Employment creation:-**
  Since the available skilled man power can easily be employed with such technology, the unemployment problems can be solved.
- **Foreign exchange conservation:-**
  The technology uses very little imported inputs like labour.
- **Improved efficiency:-**
  The productivity increases as the economy will be in position to produce greater volume of output in a given period of time by using an intermediate technology.
- **Promotes linkages:-**
  The promotion of linkages between sectors limits the wastage of resources.
- **Facilitates resources exploitation:-**
  It enables local resources (raw materials) to be exploited so as to reduce the excess capacity.
- **Acquisition of skills:-**
  When workers begin to work with intermediate technology, they learn and acquire new skills or knowledge.
- **Income development:-**
  Through job creation, many people receive incomes which help to reduce income inequality.
- **Rural development:-**
  Since it is always rural based, intermediate technology makes it possible to initiate a development process in the rural areas.
- **Reduced foreign dependence:-**

It can be easily developed from within the country and does not require importation of inputs.

Question 54 Assess the role of foreign capital in the economic development of LDCs.

Foreign capital in LDCs exists in the form of Direct Foreign Investments (DFIs), Multinational Corporations (MNCs) and Joint Venture Corporations (JVCs). All these involve the flow of capital and other productive resources from MDCs to LDCs.

Positive Roles of Foreign capital in LDCs.

Filling the foreign exchange gap:-

Since LDCs have poor export sector they usually experience shortage of foreign exchange which foreign capital helps to supplement.

Closing the savings – investment gap:-

It helps to overcome the shortage of domestic savings through the inflow of capital equipment and other inputs thereby raising the rate of savings and capital formation in LDCs projects**.**

Employment creation:-

It creates employment opportunities in the economy by setting up various production projects.

Government revenue transfer:-

When the government taxes the activities for the foreign capitalism, it raises revenue for public expenditure.

Means of technology transfer:-

Through foreign capital inflow, technology moves from the MDCs to LDCs in the form of machines, ideas etc that accompany foreign investments,

Development of local skills:-

Foreign capital is always accompanied by acquisition of skills through training of local personnel to work in the projects.

Accelerating individual sector growth:-

Foreign capital helps in establishing heavy industries that promote the process of industrialisation in the economy.

Development of infrastructure:-

Foreign capital helps in establishing infrastructure in LDCs which are very essential for development.

Facilities production of a wide variety of quality products:-

Since foreign capital leads to the establishment of many firms/projects, a variety of goods and services will be produced in the economy which widens the consumer choice

Encourages competition:-

Since foreign capital leads to the establishment of many new firms in the industry, competition is encouraged leading to improved efficiency of local firms.

Promotion of international cooperation:-

The movement of capital from one country to another forces the country of origin and the host country to develop good relationships which promotes trade among the countries.

Filling in the man power gap:-

Since LDCs have shortages of skilled man power, foreign capital which is always accompanied by the flow of skills helps to overcome this man power problem for LDCs.

Closes the BOP deficit:-

In the long run the BOP deficit which is a problem in LDCs is overcome through establishment of import substitution industries and production for quality exports which can fetch more foreign exchange.

Raising the level of national productivity income:-

This eventually leads to higher real wages for labour and lower consumer prices leading to increased standard of living in the economy.

Negative Roles of Foreign capital in LDCs.

Acceleration of capital outflow:-

Through profit repatriation, a large amount of resources flow out of LDCs causing BOP problems for LDCs.

Worsening income disparities:-

Since few capitalists own the production processes, in the end, much of the income is Concentrated in the hands of the very few leading to widespread income inequality.

Technological unemployment:-

The use of advanced and inappropriate capital intensive technology results into unemployment.

Rural –urban Migration:-

Because of the concentration of foreign capital activities in the urban areas, people usually move from rural areas to urban areas in search of employment.

Promotion of external dependence:-

Capital inflow makes LDCs over dependent on MDCs for the supply of investible funds.

Out competing of local firms:-

Foreign investments tend to be superior in terms of organization and technological capacity. Their presence and efficiency may lead to the closure for the local firms.

Regional imbalance:-

Due to preferences of urban concentration of foreign investment there is an imbalance between the centres of investment concentration and the rest.

Irrational resources exploitation:-

This leads to quick depletion (or exhaustion) of the non-renewable natural resources of LDCs.

Excessive concessions by governments:-

This lowers the net benefit in real terms of this foreign capital investment e.g. tax holidays, free land etc.

Question 61. (a) Examine the role of foreign aid in the economic development of your country.

(b) Examine problems associated with over relying on foreign aid.

Foreign aid refers to the net transfer of resources from one country to another mainly from MDC's to LDC's.

Roles of Foreign Aid

- **Fills foreign exchange gap.** It supplements the domestic savings for investment which is usually low due to vicious circle of poverty.
- **Fills the manpower gap.** In Uganda there is inadequate supply of skilled manpower due inappropriate education system/ Foreign aid in form of technical assistance helps to fill the gap,
- **It fills the foreign exchange gap.** Uganda like most LDCs suffers from chronic shortage of foreign exchange due to declining value of export. Foreign aids helps to narrow this gap.
- **It is important in times of natural disasters and catastrophes.** Aid help to support people hit by famine, earth quakes etc.
- **Aid brings new technology into the country.** It can come in the form of training program or offer of direct technological know-how.
- **Supplement government revenue needed to finance public expenditure.** Due to low revenue from taxes, aid helps the government to finance the budgetary deficit.
- **It improves labour productivity.** It promotes acquisition of skills through technical assistance.
- **Creates employment opportunities.** The aid can be used to build industries thus creating job opportunities.
- **It helps boost the GDP.** Aid can be invested in productive activates leading to increased output.

- **Facilities technology transfer to the country.** This promotes technology development of the country.

Problems associated with foreign aid.

- **Debt servicing**. Repayment of loans and interest imposes big budget to the country and limits ability of the country to provide for the nationals.
- **Encourages wasteful expenditure**. Government officials may become extravagant because of the ease of raising funds through borrowing.
- **Aid is usually directed towards unprofitable projects**. Thus absence of continuity consistency and internal linkages between projects.
- **Encourages interference and dominance of the recipient country by the donor country**. This negatively affects development of the country.
- **It is associated with high local costs**. For example housing and allowance for expatriates which out way expected benefits.
- **Encourages dumping of outdated machinery into the country**. Thus through aid, the country is turned into dumping ground.
- It encourages extension and imposition of foreign culture of the donor country on the recipient country.
- It turns the country into dumping ground for inexperienced personnel of the donors to gain valuable experience.
- **Worsens the country's B.O.P.** position through raising debt repayment obligations and aid tying manipulation.
- It imposes inappropriate technology on the country.

The political string attached imposes foreign political ideologies that undermine the country's independence

SECTION A

211. (i) What is technology transfer.

(ii) Give any three merits of technology transfer.

A. (i) Technology transfer is the movement of technology from one country to another mainly from MDCs to LDCs

(ii) **Merits of technology transfer.**

- Facilitates exploitation of idle resources in the recipient country.
- Increases productivity of the economy.
- Lead to production of better quality products.
- Lead to development of man-made substitutes for limited natural resources.

- Leads to social and cultural transformation of the society.
- Technology can be exported to other countries to earn income.
- Leads to development of new skills and ideas through innovations.

212. (i) What is intermediate technology.

(ii) State any three roles of intermediate technology.

A. (i) Intermediate technology is the type of technology which fits into the level of development of the host country. ie it is neither too advanced nor too simple.

(ii) **Roles of intermediate technology.**

- Makes use of available resources.
- Leads to development of skills.
- Reduced foreign dependence because it can easily be developed locally.
- Leads to technological development.
- Promotes linkages between sectors hence limiting resources wastage.
- Income redistribution through job creation.
- Rural development since it is always rural based.
- Creation of employment.
- Conservation of foreign exchange.

213. (i) What is "appropriate technology".

(ii) Give any three factors which have affected development of appropriate technology in your country.

A. (i) Appropriate technology is the type of technology which matches with existing conditions in the host country.

Or

It is the technology which is suitable for the correct proportions.

(ii) **Factors which have affected development of appropriate technology.**

- Availability of resources.
- Level of infrastructural development.
- Availability of skilled labour.
- Political climate.
- Government policy.

214. Give any four benefits of appropriate technology.

- Technically, it is easily adoptable.

- Does not require heavy investment for its success.
- Improves standard of living in the economy.
- Encourages exploitation of local raw materials. Promotes self-reliance since local resources and skills are used.
- Provides employment opportunities.
- Improves productivity of the economy leading to economic equitable income distribution through job creation.

215. (i) Distinguish between Bilateral aid and multilateral Aid.

(ii) Give any two reasons why countries give aid.

A. (i) Bilateral aid is a type of aid granted by one country to another government for country directly. This type of aid promotes aid tying and manipulation of the recipient countries by the donor countries.

While

Multi lateral aid is a type of aid provided through international institutions and aid agencies such as IMF, World Bank, the UN agencies etc.

(ii) Reasons why countries give aid.

- To create international reputation for themselves.
- For humanitarian reasons ie to avert humanitarian crisis.
- To spread their culture to recipient countries.
- To maintain their prosperity ie prosperity of MDCs is linked to prosperity of LDCs.
- To secure raw materials for home industries.
- To secure influence over LDCs.
- To create employment for their nationals in the recipient countries.
- To expand market for their produce.
- To sell off domestic surplus/rent for surplus.

(iii) Project tying.

This is a situation where a donor country dictates projects to be put up or what should be done with the aid. This limits the recipient's freedom to implement its priority- planned projects because the donor country may finance only those projects where it has interests. If the aid is tied both by procurement and project, a situation is refereed to as double typing.

(iv) United Aid.

This is the type of aid whose disbursement and utilization is in accordance with the recipient's needs and development plans programmes. United aid reduces the real cost of the aid as the recipient can buy its requirements at competitive rates from the world market.

217. Give any four types of foreign aid.

- Technical assistance ie sending technical personnel/experts by donors to recipient countries.
- Training facilities ie offering scholarships to citizens of the recipient countries for training both at home and abroad.
- Consumers goods e.g. food, medicine etc.
- Military assistance ie providing training for the soldiers and providing military hardware.
- Machinery and equipment.
- Technology transfer.

INTERNATIONAL TRADE AND FINANCE

Question 56.(a) Explain the principle of comparative cost advantage in international trade.

(b) What are the limitations of comparative advantage to LDCs?

The principle of comparative cost advantage state that even where one country has an absolute advantage over others in production of both commodities under consideration, specialization and trade can benefit both countries providing each country has a comparative cost advantage. Comparative cost relates to the opportunity cost of producing the commodities and not absolute costs

Illustration:

Countries	**Wheat**	**Tractor**
A	3oo	120
B	200	30
Total	500	150

Assuming the two countries are using the same amount of resources, the cost of production for both tractor and wheat are lower in the country A than B. Country A has absolute advantage over B in production of both commodities.

However, country A is 1 times better in production of wheat. But four times better in production of tractors. It should therefore specialize in production of tractors and leave country B to produce wheat.

After specialization.

Countri	**wheat**	**Tract**

es		or
A	0	240
B	400	0
Total	400	240

Assuming resources are equally efficient.

World production of tractors has increased by 90 whereas that of wheat has reduced by 100 tones. But in terms of value, assuming exchange rate of 1 tractor to 10 tons of wheat, 10 tractors would cancel out the loss of wheat. Therefore there is net gain of 80 tractors to be enjoyed.

Weakness of the theory of comparative advantage.

- **The theory ignores transport costs**. Gains from trade are modified by the existence of transport costs which increases prices of goods.
- **The opportunity cost ratios are not constant as the theory assumes**. The theory is based on unrealistic assumptions that the opportunity cost ratios remain unchanged as resources are moved from one industry to the other. This is not very likely since some resources will be more efficient in one industry than the other.
- **Comparative cost advantage is always changing.** New methods of production, the use of newer type of raw materials, improvement in transport and changes in market condition will change the relative efficiency of different countries in different types of economic activity.
- **The assumption of free trade between countries is unrealistic.** Today almost all countries operate some form of restriction on trade with other nations to safeguard their national interests.
- **The assumption of only two countries is an over simplification.** The world is composed of several countries each struggling for greater share of world trade.
- **The assumption of only two commodities is unrealistic**. In LDCs there are cases of under employment
- **The assumption of constant cost is not realistic.** This assumption is weak because there is always increasing costs and diminishing cost.
- The theory considers only supply side of international trade but ignores the demand side.

57. (a) Explain the different forms of protectionism

(b) What are the implications of protectionism in an economy?

Protectionism refers to restrictions imposing on free trade. It is usually adopted by trading nation to regulate its trade with rest of the world.

The types of restriction most commonly used include:

- **Quotas.** This is the most serious kind of restriction and takes the form of a physical limitation on the quantity of the commodity which is allowed to enter the country in a given year. Quotas bring in no revenue to the state, and foreign producers cannot overcome them by reducing prices as is the case with tariffs.
- **Tariffs.** This is the most common barrier to trade. It raises the price of foreign product as it enters the country. Tariffs may be advalorem i.e. a percentage of monetary value of the imports, or specific, i.e. a tax per unit of weight or physical quantity.
- **Exchange control.** This involves government restricting the amount of foreign exchange that should be availed for the importation of certain commodities. A through –going system of exchange control will require the foreign currencies earned by exporters to be surrendered to the central bank which will pay for them in home currency. Importers requiring foreign currency must apply to the central bank which can then, very effectively, control the variety ad volume of imports by controlling the issue of foreign currency.
- **Subsidies.** A nation can subsidize domestic industries as a means of protecting them from competition of lower priced foreign goods. Subsidies will reduce the price of the domestic product, thus making it difficult for the foreign producer to sell a similar product in the market.
- **Embargo/Total ban.** This involves a complete prohibition of certain products in the home market. It is mainly adapted mainly when a country faces severe foreign exchange shortage to avoid entry of certain commodities considered harmful to health and for strategic reasons such as ensuring food security.
- **Special deposits on imports.** This involves requiring importers to advance payment for their order before delivery. This limits the ability of importers.
- **Exchange rate manipulation.** This may impose multiple exchange rate system that favour certain importers at the expense of others e.g. the window system of the 1980s during the Obote II regime.
- **Preferential duties.** This may involve taxing some commodities less than others.
- **Administration regulation.** This may involve instituting lengthy bureaucratic procedure which makes it difficult to carry out trade. For example the government can make it hard to obtain import license. This reduces imports.
- **Voluntary export reduction.** This is an arrangement where by an exporting country agrees to cut the amount it exports to a second country.

Positive implications of protectionism.

- **Protects domestic infant industries**. By subsidizing domestic infant industries, the price of their product will be lower making it difficult for foreign firms to sell similar products in the home market. This safeguards home industries and employment.
- **Prevents dumping.** Protectionism shelters domestic market against the unfair competition of foreign firms that deliberately sell their products at very low prices. This practice may make a country dependent on others.
- **Creates employment opportunities**. By sheltering domestic firms against foreign competition, they will grow and provide employment opportunities. This reduces unemployment problems in the country.
- **Improves BOP position**. By increasing tariffs on imports the country's expenditure on imports will reduce, thus reducing BOP deficit.
- **Improves TOT:** A country can improve is TOT by increasing the price of exports through restriction on the supply of the commodities at the expense of importers.
- **Discourages consumption of harmful commodities.** There are some commodities which are dangerous or socially undesirable such as drugs and alcohol. A ban on use of such commodities may minimize their consumption.
- **Raises revenue to government.** The tariff imposed on imports generates revenue to the government which is used to finance public expenditure.
- **Strengthens political ties.** A preferential tariff that gives lower rates to some countries may strengthen political relations.
- **Retaliatory tool.** Protectionism is a bargaining tool in international trade. By imposing tariff against the country that initiated the tariff war, countries can agree to come to a round table negotiation for fair trade terms.
- **Reduces inflationary tendencies.** By imposing ban on imports from inflation prone countries, protectionism guards against imported inflation thereby achieving domestic price stability.
- **Promotes self-reliance**. By protecting domestic industries against foreign competition, a country becomes self reliant in certain strategic requirements.
- **Protects a country's standard of living.** Protectionism, safeguard an economy against dumping of cheap low quality goods that would determine people's standard of living.
- **Protects declining industries.** When the products of an industry are declining in demand, government protection against foreign competition can save such industry against collapsing. Thus protecting home employment.

Negative implications of protectionism

- **Consumer exploitation.** The protected domestic industries may become local monopolies and use this position to exploit consumers by charging high prices.

- **Reduces consumer choice.** By restricting the entry of foreign goods, domestic consumers are forced to consume only locally produced good. This reduces variety of goods available to a consumer which reduces her/his choice.
- **Discourages specialization.** Protectionism may encourage a country to attempt to produce all her needs for self-reliance. This denies her the benefits of specialization based on comparative advantage i.e. she may produce some commodities more expensively that if she had imported.
- **Reduces competition.** By sheltering domestic industries, they are not exposed to foreign competition. This lowers the quality of goods produced forcing consumers to consume low quality goods at high prices.
- **Narrows market for producers of home industries.** By restricting imports other countries may retaliate by protecting their economies. This reduces market for the country's products.
- **Discourages international cooperation.** By restricting each other's commodities, the relations between countries may be strained.
- **Limits advantages of economies of scale.** By reducing market for a country's products, domestic firm will be restricted to small domestic market. The advantages if large scale production is therefore lost.
- **Limits information flow between countries.** This compels a country to under take domestic research at very high cost.
- **Reduces rate of foreign resource mobilization.** Protectionism may not only restrict movement of goods, it can also restrict movement of capital, technology and manpower. A country may be denied access to such vital resources.

Question 58. (a) Account for unfavourable terms of trade in LDCs.

(b) What measures should LDCs take to improve their terms of trade?

Terms of trade are the rate at which one nation's goods exchange against those of other countries. It is expressed in terms of index of import prices and index of export prices in

$$TOT = \frac{\text{Index of export prices}}{\text{Index of import prices}} \times 100$$

The following are the causes of unfavourable TOT for LDCs.

- **Falling prices of export.** Agricultural products constitute the bulk of export of LDCs. These products such as coffee, cotton, tea, vanilla experience falling prices in the world market.
- **Inelastic demand for the products of LDCs.** LDCs export primary products which have high income elasticity of demand. As world income increases, people prefer to spend large proportion of income on manufactured rather than agricultural products. This results into falling prices of exports and increasing prices of imports.

- **Introduction of raw material saving technology by MDCs.** Advancement in technology in the west which is the major buyers of agricultural raw materials of LDCs has further aggravated the falling prices of exports. As technology advances MDCs continue to require less and less raw materials of LDCs leading to fall in prices.
- **Increased substitution of LDCs products with synthetic fibre**. The discovery of synthetic products has reduced demand for natural fibres of LDCs. For instance the increased use of cheap synthetic fibres has led to fall in demand for cotton and sisal thereby lowering their prices.
- **High competition among LDCs for markets of MDCs.** The LDCs produce nearly similar products for the same non-expanding markets of MDCs which are experiencing static or even declining population growth rates. This competition has led to under cutting of prices.
- **Protectionist policies of MDCs.** MDCs restrict entry of LDCs products in their markets by fixing quotas and quality standard which LDCs cannot meet. This limits demand for the products of LDCs causing prices to fall.
- **Weak bargaining power.** LDCs have weak commodity agreements which cannot negotiate for favourable prices for agricultural products. In addition these agreements fail to regulate the supply of the commodities so as to raise price due to natural factors and lack of commitment on the part of member countries to the activities of the agreement.
- **Flooding of market with agricultural products.** LDCs have no control over the production because agriculture depends on weather, this results in excess production which leads to fall in price.
- **Export of low quality products.** Due to low technological base, LDCs produce poor quality products which cannot fetch high prices in the international market.
- **Devaluation policies of LDCs.** As a measure to correct BOP deficit, LDCs frequently devalue their currencies leading to falling prices of their exports and rising prices of imports.
- **Importation of expensive manufactured consumer and capital goods.** Due to demonstration effects, people in LDCs prefer to consume expensive consumer and capital goods imported compared to low prices exports.
- **Exportation of semi processed agricultural and mineral products.** These have low value addition leading to low prices.
- **Increased subsidization by MDCs to their farmers.** This has led to low prices of products in MDCs forcing LDCs to dump their products at very low prices.

Measures LDCs should adopt to improve their TOT.

- **Formation of regional integrations**. LDCs should strengthen their regional markets where they will have high bargaining power and will negotiate for favourable prices for their products.

- **Economic diversification**. LDCs should encourage wide range of economic activities so as to export variety of products. This will enable tem substitute commodities whose prices are falling with those whose prices are rising
- **Strengthen commodity agreements.** LDCs should enter strong international commodity agreements which can regulate supply and negotiate for high prices for the products of member states.
- **Carry out market research.** LDCs should search for markets that pay high prices for their products.
- **Export of processed products.** LDCs should process their products into finished products. This value addition will lead to increase in price in the world market.
- **Under take industrialization strategy.** Since industrial products fetch high prices in the world market, LDCs should change their economies from agricultural to industrial. However shortage of capital, skilled labour and technology may make industrialization strategy inappropriate for LDCs.
- **Improvement in quality of products.** LDCs should improve their production technology so that they can produce high quality products that can fetch high price in the market.
- **Negotiate for favourable trade terms.** Through the WTO, the LDCs should demand for removal of trade restrictions by MCs on products of LDCs.
- **Seek Patents**. LDCs should obtain patents on commodities in which they have intellectual property. Intellectual property rights will enable LDCs regulate the supply of their products and avoid over flooding of markets. Thus they will be in position to raise prices.
- **Encourage specialization**. LDCs should encourage specialization on particular commodities among themselves to reduce competition. The specialized countries will be position to raise the prices of their products in the world market.

Question 59. (a) Account for balance payment disequilibrium in your country.

(b) What measures should your country take to reduce balance of payment disequilibrium?

Balance of payment is a record of a country’s monetary transaction with the rest of the world in a given period of time usually one year. For LDCs the balance of payment problem they experience is a deficit.

Causes of BOP problems (deficit) in Uganda.

- **Political instability.** Since independence Uganda has witnessed a series of civil wars. This has disrupted production leading to reduced export. At the same time there has been heavy expenditure on importation of arms to fight the war. This has sustained BOP deficit.
- **Limited capital inflow.** Due to structural limited market poor government policies poor infrastructural and political instability, the investment climate in Uganda is not favourable. This has discouraged foreign investors leading to low capital inflow.

- **Deteriorating terms of trade.** Uganda exports are dominated by agricultural products which inelastic demand in the world market. The continuous fall in price of imports implies appreciation in price of imports for outstrips revenue from exports leading to BOP deficit.
- **Excessive capital out flow.** Majority of investors in Uganda especially in the industrial sector are the multinational corporations. These prefer to repatriate their profits back to their countries rather than reinvest in the country. Thus increased out flow causing BOP deficit.
- **Effect of imported in flow.** Uganda relies on other countries for manufacture goods. In addition the domestic industries use imported raw materials. This has resulted into increased price of imports which means increased import expenditure leading to BOP deficit.
- **Effects of domestic inflation.** Uganda has had sustainable inflation for a long time. This has made the export of the country expensive thus less competitive in the foreign market. This has limited export revenue.
- **Political policies of MDCS.** The developed countries restrict the entry of product to their markets by fixing quotas and quality standards. This has further limited Uganda's exports worsening BOP deficit.
- **High population growth rate.** Uganda has one of the highest population growth rates in the world. This has reduced the country's export due to increased domestic demand. It has increased imports to sustain the rapidly rising population. This has led to BOP deficit
- **Internal supply rigidities.** Uganda has poor infrastructure which make production difficulties. In addition, agriculture which forms the built of the country's export depends on weather which is outside the control of the former. This caused instability is expenditure.
- **Heavy external debt servicing.** Uganda is many the most highly indebted countries in the world. This has led to increased foreign exchange outflow to service the accumulated foreign debts.
- **High prices petroleum products.** Uganda is an importer of petroleum products. Since 1970's the oil products have experienced sustained rise in price caused external expenditure.
- **Over reliance on expatriate man power.** Due to inappropriate education system, the country relies on developed country for technical skills. This had led to increased foreign exchange outflow because these expatriates are expensive.
- **Increased need for capital goods.** Uganda depends on developed countries for capital goods and spare parts. This has led to increased foreign expenditure.
- **Excessive expenditure by government.** Uganda has many diplomatic missions abroad which has caused high foreign expenditure. This has been worsened by frequent foreign travels by top politicians.

Measures Uganda should take to reduce BOP deficit.

- **Creation of stable political climate.** The government should establish peace throughout the country as a way to cut down her expenditure on military hardware. At the same time the preventing peace will encourage more production leading to increased foreign exchange earnings.
- **Adopt import substitution strategy.** The government should encourage establishment of industries at home to produce those goods that are imported, this will cut down her expenditure on imports.
- **Manpower development.** The government should train local skills to reduce the demand for expatriate. This calls for redesigning the curriculum from the current theoretical to technical education.
- **Import restriction.** The government should restrict importation to only essential commodities. It should fix quotas increase tariffs and ban importation of luxuries. This will reduce foreign expenditure.
- **Export production drive.** The government should encourage establishment of more industries to produce for export. This will lead to increased foreign exchange earning.
- **Restriction monetary policies.** The government should reduce the amount of money in circulation so as to reduce the level of aggregate demand and cut down demand for imported.
- **Devaluation policy.** The government should reduce the exchange value of the home currency in relation to foreign currencies to encourage more exports and reduce imports.
- **Income and wage policies.** The government should reduce the wages and introduce wage freeze to reduce expenditure on imports.
- **Debt manipulation.** The government should minimize expenditure on debts servicing through rescheduling payment or seek debt forgiveness.
- **External borrowing.** The government should borrow from donor institutions or governments.
- **Restrictive fiscal policies.** The government should increase tax to reduce disposable income.

Question 60. (a) Examine the conditions necessary for success of devaluation

(b) Why may devaluation fail to achieve its intended objectives?

Devaluation is the legal/official/deliberate reduction in the exchange value of a country's currency in relation to other currencies under the fixed exchange rate system

Conditions for success of devaluation

- **Demand for exports of devaluing country must be price elastic**. In this case any slight reduction in price of export will lead to large increase in the demand for export.
- **The demand for imports in the devaluing country must be price elastic.** A slight increase in the price of imports leads to a very big reduction in the demand, thus a fall in foreign exchange expenditure.
- **The supply of exports must be price elastic.** The devaluing country should not be at full employment. There has to be idle resources that can be exploited to increase production to meet the increased foreign demand.
- **There should not be counter devaluation.** Other countries should not retaliate by devaluing their currencies because this would erode domestic advantage of devaluation.
- **Devaluing country should not be experiencing inflation.** Inflation would reduce the competitiveness of a country's products in international market and would not make any gain from undertaking devaluation.
- **There should not exist trade restrictions.** The major buyers of the devaluing country's products must not impose protectionist policies against the exports of devaluing country.
- **The country should not under or over devalue.** Under devaluation leaves the country's products still more expensive compared to those of competitors while over devaluation may encourage retaliations.
- **The authority must have capacity to resist Trade Union pressures.** Trade unions may demand for age rise in response to increased cost of living caused by increase in import prices.
- **The government under taking devaluation must correct the structural imbalances in the economy.** This could be through replacing outdated machinery improving infrastructure etc. Unless this done, the devaluation may not succeed in improving a country's BOP.

Why devaluation may fall.

- **The demand for export of the country may be price inelastic.** A big reduction in export price may lead to very small change in quantity exported. The foreign exchange may instead reduce after devaluation.
- **The demand for imports in the devaluing country may be price elastic.** The people may have high marginal propensity to import. Increase price of imports may lead to rise rather that reduction in foreign expenditure.
- **The supply of export in the devaluing country may be price inelastic**. The country may be have attained full employment situation so that domestic production cannot be increased.
- **Other countries may have devalued at the same time.** This reduces the competitive advantage of the country's products because it will not be cheaper.

- **There may be trade restrictions**. If the major buyers of devaluing country's product fix Quotas or increase tariffs, exports may not increase.
- **There may be inflation in the devaluing country.** So that even after devaluation the exports of the country still remains more expensive compared to those of the competitors.
- **If there is weak administrative machinery in the devaluing country.** They may fail to coordinate and implement the policy correctly.
- **The exports of the devaluing country may be of poor quality.** This may reduce its competitiveness in the world market and even if prices fall demand may not rise.
- **There may have been under devaluation.** The country's exports may still be more expensive than those of other countries even after devaluation.

Question61 (a). Distinguish between floating exchange rate and fixed exchange rate

(b). examine the merits and demerits of floating exchange rate.

Floating/Flexible/Free exchange rate is the exchange rate between currencies that is determined by the market forces of demand and supply of foreign currencies in the foreign exchange market.

while

This is the system where the central authority fixes the exchange rate of a currency in relation to other currencies in the foreign exchange market at a specific value. This is a system in which the exchange rate in the foreign exchange market is held at a preannounced/determined fixed value.

Merits of Floating Exchange Rate:

It enables the government to generate adequate amount of foreign exchange for the country for transaction etc. i.e. it minimizes foreign exchange shortages.

It provides and guarantees an automatic mechanism for correcting trade imbalances and BOP problems e.g. if a country has BOP deficits, other things being constant, the country's currency should be depreciate. This would make exports cheaper thus increasing the export demand while making imports dearer or expensive and decreasing their demand. In this way the Bop will be brought back to equilibrium and the deficit corrected. Likewise a Bop surplus will be eliminated by an automatic appreciation of the currency which makes exports expensive and imports cheaper.

It enables a country to pursue an independent monetary policy i.e. it reduces the external influence on the economy.

It attracts and encourages investments into the country.

It does not require large official foreign exchange reserves to be kept by the central bank i.e. it eliminates the need to maintain large reserves to defend the currency and the exchange rate.

It discourages the emergence of parallel or illegal foreign exchange market.

It protects a country against inflationary pressure.

Its flexibility helps a country to off-set international trade shocks.

Demerits of floating Exchange Rate

It is characterized by uncertainty as the currencies change in value from time to time. There is no stable exchange rate.

The uncertainty induced by the floating exchange rate may discourage foreign investments.

Encourages speculation as sometimes the dealers set the rates in disregard of the market forces of demand and supply in anticipation of huge profits.

It requires closer supervision and monitoring by the authority in order to avoid cartel arrangements.

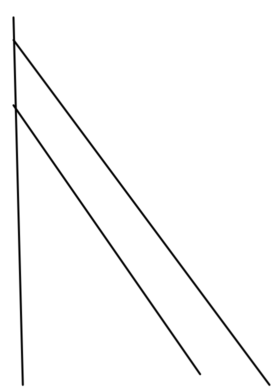
It encourages hoarding of foreign currencies in order to create shortages in the market so as to raise the profit margins.

SECTION A

218. Give any four factors that give rise to international trade.

- Uneven distribution of natural resources.
- Vent for surplus product argument.
- Desire for foreign exchange.
- Differences in tastes and wants beyond what the country can locally provide.
- Need to promote political relations.
- Lack of co-operant factors such as skills and capital for domestic exploitation of resources.
- Comparative advantage argument.

219. Study the figure below showing the production possibility frontiers (PPF) for countries P and Q and answer the questions that follow:



(i) What principle of cost in international trade is illustrated by the frontier?

(ii) In which commodity should country P specialize? Illustrate your answer.

A. (i) The principle of cost illustrated is the principle of comparative advantage because country P can produce both maize and sugar more cheaply than country Q.

(ii) Determining commodity P should specialize in involves calculating opportunity cost ratios. opportunity cost ratios.

Country P

Maize $\frac{15,000}{20,000} = ¾ = 0.75$

Sugar $\frac{20,000}{15,000} = 4/3 = 1.33$

Country Q

Maize $\frac{5000}{15,000} = ⅓ = 0.33$

Sugar 15,000 = = 3

(ii) Country P should specialize in production of sugar because it has comparative advantage over country Q ie it has lower opportunity cost of 1.33 compared to 3 of country Q

220. (i) State the principle of comparative advantage in international trade.

(ii) Give any three assumptions underlying the principle of comparative advantage.

A. (i) Comparative advantage principle states that countries should specialize in the production of goods and services is why the incur the least domestic opportunity international trade.

(ii) Assumptions.

- There are only two countries in the world.
- The two countries produce only two commodities.
- Tastes re preferences are similar in both counties.
- All labour units are homogeneous.
- Labour us the only factor of production.
- The supply of labour is fixed.

- Price of commodities is determined by labour cists.
- Exchange between the two countries is by use of barter.
- Technology is constant.
- Factors of production are perfectly mobile within the country but immobile between countries.
- There is free trade between countries.
- No transport cost in carrying goods between countries.
- All factors of prosecution are fully employed.

221. (i) What is protectionism.

(ii) Give any three forms of protectionism used by your country.

A. (i) Protectionism refers to the restrictions imposed on trade between countries.

(ii**) Forms of protectionism.**

- Fixing quotas.
- Imposing tariffs.
- Foreign-exchange control.
- Total ban/embargo.
- Special deposits on imports.
- Exchange rate manipulation.
- Preferential duties.
- Administrative regulation.
- Voluntary export reduction.

222. (i) Define the term commercial policy.

(ii) Give any three instruments of commercial policy.

A.(i) Commercial policy are the measures taken by the government to influence the direction and volume of trade.

(ii) Instruments of commercial policy.

- Tariffs.
- Devaluation.
- Total ban/embargo.
- Licensing.
- Foreign exchange control.
- Transport discrimination.

- Quotas.
- Subsidies.

223. (i) What are "infant industries"?

(ii) Suggest any three ways of protecting infant industries in Your country.

A.(i) Infant industries are the young or newly established industries which still operate at high costs.

(ii) **Ways of protecting infant industries in Uganda.**

- Reducing taxes to reduce their production cost.
- Providing them with subsidies.
- Providing the tax holidays until they have matured and able to compete.
- Increase taxes on imports to make them less competitive in home market.
- Imposing total ban/embargo on imports.

224. (i) Distinguish between barter term of trade and income terms of trade.

(ii) State any two causes of unfavorable terms of trade in your country.

A. (i) Barter terms of trade is the number of import items that can be exchanged for a given number of exports

Or

The relationship between price index of export and price index of imports

ie $\frac{P_x}{P_m}$

Whereas

Income terms of trade is the value of exports relative top the price index of imports.

Or

The import purchasing power of exports.

ie $\frac{P_x \text{ x } Q_x}{P_m} = \frac{P_xQ_x}{P_m}$

(ii) **Causes of unfavourable terms of trade.**

- Importation of expensive manufactured goods.
- Flooding of market with agricultural products.
- Poor technological base.
- Falling prices of exports.
- Inelastic demand for the products in the world market.

- Increased competition currency.
- Protectionist polices of MDCs.
- Production and export of poor quality precuts.

225. Mention any four effects of deteriorating terms of trade on an economy.

- Leads to BOP deficit.
- Leads to foreign borrowing hence debt burden.
- Discourages export.
- Causes budget deficit.
- Reduced imports.
- Reduces standard of living/economic welfare.
- Reduced domestic production.

226. (i) Define the term "Import Duty".?

(ii) State any three objectives of imposing import duty in your country.

A. (i) An import duty is a tax imposed on goods entering a country.

(ii) **Objectives of imposing import duty in Uganda.**

- To raise revenue for government.
- To protect domestic infant industries.
- To discourage importation of luxuries.
- To improve a country's BOP position.
- To prevent dumping of cheap goods into the country.
- To check imported inflation.
- It is a bargaining tool with other countries in international trade.

227. Mention four non-tariff barriers to trade in your country.

- Fixing quotas.
- Transport discrimination.
- Licensing.
- Embargoes/total ban.
- Foreign exchange restriction.
- Administrative regulation.
- Special deposit on imports.
- Voluntary import reduction.

228. (i) What is meant by terms of trade?

(ii) State three reasons why the Terms of Trade of developing countries are deteriorating.

A. (i) Terms of trade is the ratio of price index of exports to price index of imports.

Or

Rate at which exports can exchange for imports.

(ii) **Reasons for deteriorating TOT in LDCs.**

- Falling prices of exports.
- Importation of expensive manufactured goods.
- Increasing substitution of LDCs products with synthetic fibre produced by MDCs.
- Exportation of semi processed agricultural and mineral products.
- Over flooding of international market with agricultural products hence fall in export prices.
- Protectionist policies of MDCs.
- Weak bargaining power of LDCs.
- Invention of raw material saving technology by MDCs
- Low income elasticity of demand for exports.
- Low quality of exports.
- Unfavourable exchange rates in international trade.

229(i) distinguish between balance trade and balance payment.

(ii) Why has Uganda's balance of trade continued to worsen despite the NRM's strong and persistent stabilization efforts?

A.(i) Balance of trade is the difference between a country's receipts form visible exports and expenditure on visible imports in a given period of time.

While

Balance of payment is a record of a country's monetary transactions it engages in with the rest of the world in a given period of time usually one year.

(ii) **Why Uganda's balance of trade has continued to worsen.**

- Falling price of exports.
- High prices of petroleum.
- Internal supply rigidities.
- Increased inflow of capital goods.
- Protectionism of MDCs.

- Effects of domestic inflations.
- Political instability.
- Lack of competitiveness of LDC products.
- Deteriorating terms of trade.

230. (i) What is international trade organization and what are the main objectives.

(ii) How does the law of comparative advantage explain the failures of African countries to establish services and long lasting regional co-operation.

A. (i) International trade organization is a world wide organization for the promotion of trade e.g. GATT.
The main objectives are:

- Promotion of free trade among member countries.
- Reduction of tariffs and abolition of Quotas.
- Establishment of common markets like COMESA but to be outward rather than inward.

(ii) Comparative advantage explains the failure of African countries to establish serious regional co-operation because it emphasizes specialization on basis of opportunity cost advantage. However most African countries produce similar products making specialization difficult.

231. (i) Define the term "invisible export".

(ii) What are the components of your country's export-import trade.

A. (i) Invisible export refers to the export of services rather than tangible goods abroad.

(ii) **Component's of export – import trade.**

- Physical goods (visible).
- Trade in services (invisibles).
- Capital movements.
- Cash flows.

232. (i) What is meant by balance of payments.

(ii) State any three causes of disequilibrium in the balance of payments.

A. (i) Balance of payment is a record of a country's monetary transactions with the rest of the world in a given period of time usually one year.

Causes of BOP disequilibrium.

<u>Deficit.</u>

- Low volume of export.
- Low quality products, which reduce competition in the export market.

- High value of imports due to imported inflation.
- Fluctuations in the prices of agricultural products.
- High marginal propensity to import in LDCs.
- Effects of domestic inflation.
- High miscellaneous expenditures arising from money trips abroad buy government officials.

<u>Surplus.</u>

- Appreciation in TOT of a country.
- Increased capital inflow into the country.
- Reduction in import expenditure.
- Improvement in quality of product.
- Reduction in military expenditure.

233. Give any four effects of balance of payment deficit on an economy.

- Inflationary situation may arise.
- Retards economic growth.
- It encourages currency depreciation.
- High taxation levels may result.
- Shortage foreign exchange/depletion of foreign exchange reserves.
- Reduction in volume of imports.
- Limited employment opportunities.
- Disinvestment may result.
- Increases external borrowing.

234. How is BOP deficit corrected under.

(i) A floating exchange rate.

(ii) A fixed exchange rate.

A. (i) Floating exchange rate.

- Depreciation of the local currency.
- Export promotion drive.
- Man power development.
- Import substitution strategy.
- Creation of stable environment.
- External borrowing.

- Income policies such as wage freeze to reduce expenditures on imports.

(ii) Fixed exchange rate.

- Devaluation of the currency.
- Debt manipulations.
- Restriction fiscal policy.
- Import restriction.
- Restriction monetary policy.

235. (i) What is meant by devaluation?

(ii) Given that the exchange rate is ₤ = 1,000 Ug.shs. Calculate the new exchange rate after devaluation of the shillings by 20%.

A. (i) Devaluation is the official/legal deliberate reduction in the value of the domestic currency in relation to foreign exports and reducing imports. It is usually done under the fixed exchange rate system.

(ii) Assuming exchange rate = 1,000 Ug. Shs represent 100%.

After devaluation = 100% + 20% = 120%.

$$\frac{120}{100} \times 1000 = 1200 \text{ Ug. Shs}$$

New exchange rate is 1₤ = 1200 Ug. Shs.

236. (i) Differentiate between devaluation of currency and depreciation of currency.

(ii) State two merits of currency of devaluations.

A. (i) Devaluation is a deliberate reduction in the value of a country's currency relative to foreign currencies.

While

Depreciation of currency is the fall in value of home currency in relation to other currencies due to market forces of demand and supply.

ii) **Merits of devaluation.**

- Increases exports of a country.
- Corrects BOP deficit.
- Encourages investment in the country/capital inflow.

237. (i) Distinguish between under devaluation and over devaluation.

(ii) Mention any two effects of devaluation in an economy.

Under devaluation is a situation where price of commodity of the competitors after devaluation.

While

Over devaluation is a situation the devaluing country makes a very big reduction in the value of her currency in relation to other currencies. The commodity of the devaluing country becomes much cheaper compared to those of the competitors.

(ii) Effects of devaluation.

- Worsens BOP problems especially if demand for imports and exports are price inelastic.
- Worsens domestic inflation.
- Encourages smuggling.
- Leads to capital inflow.
- Discourages savings.
- Discourages investments.
- Appreciation of foreign exchange.
- Leads to deficit on the budget.

238. State ay four effects of currency depreciation.

- May lead to inflation in the country.
- Encourages imports into the country.
- Discourages exports due to increased prices.
- Leads to BOP deficit.
- Leads to unfavoruable TOT

239. (i) Define flexible exchange rate system.

(ii) Mention any three merits of a flexible exchange rate system.

A. (i) Flexible exchange rate is where the market forces of demand and supply of foreign currencies in the foreign exchange market determine the exchange rate between currencies. It is also known as floating or free exchange rate.

(ii) **Merits of flexible floating/free exchange rate system.**

- Helps a country off-set international trade shocks.
- Enables the government to generate adequate amount of foreign exchange.
- Provides automatic mechanism for correcting BOP problems.
- Enables a country to pursue an independent monetary policy/reduces foreign influences in the economy exchange market.

240. (i) Differentiate between managed exchanged rate system and fixed exchange rate system.

(ii) State any two advantage of managed exchange rate system.

A. (i) Managed exchange rate is the type of fixed exchange rate mechanism where the government allows the forces of demand and supply to determine the exchange rate but still comes in the manipulate the exchange rate. It is also known as dirty float.

While

Fixed exchange rates is where the central authority fixes the exchange rate of a currency in relation to other currencies in the foreign exchange market at a specific value.

Advantages of managed exchange rate system.

- Protects a country against external pressure.
- Attacks investment in the country.
- Its flexibility helps a country offset international trade shocks.
- Provides automatic mechanism for correcting BOP deficit.
- Reduces external influences in the country.

241. (i) Distinguish between pegged exchange rate and dual exchange

(ii) Give two reasons for setting dual exchange rate system.

A. (i) Pegged exchange rate is the exchange rate mechanism where a country sets a fixed rate of exchange then guarantees to buy or sell any amount of the foreign currency at this rate.

While

Dual exchange rate is when there are two exchange rates fixed with one set for the essential or priority sectors and the other for non-priority sectors.

(**ii) Reasons for setting dual exchange rate.**

- To encourage importation of priority goods.
- To discourage importation of luxuries.
- To make foreign exchange readily available to all categories of imports.

242. (i) Distinguish between appreciation of currency and depreciation of currency.

(ii) Merits of fixed exchange system.

- Reduces uncertainty in the foreign exchange market.
- Increases investment.
- Minimizes effects of speculation.
- Discourages hoarding of foreign currencies.

243. (i) What is meant by Special Drawing Rights (SDR).

(ii) What are foreign reserves?

A. (i) SDRs are facilities issued by IMF to member countries in proportion to their Quotas and represent claims or rights which are honoured by other members and by IMF itself. By joining the scheme, a member country accepts an obligation to provide currency when designed by the fund to other participants in exchange for SDRs. However, it is not obliged to accept SDRs to a greater total value than three times its own allocation.

(ii) Foreign reserves refers to the reserve of gold and foreign currencies maintained by the central bank of a country.

244. (i) What is meant by economic policy.

(ii) State and explain two arguments in favour of exchange control.

A. (i) Economic policy is a set of measures adopted by a country to regulate economic activity so as to achieve economic stability. It is both monetary and fiscal policies.

(ii) **Arguments in favour of exchange control.**

- It encourages importation of priority goods.
- Makes foreign exchange available to all categories of importers.
- Eliminates speculation in foreign exchange market.
- Promotes stability of exchange rate.
- Removes uncertainty in the market.

245. (i) What is meant by foreign direct investment.

(ii) What are the merits of foreign direct investment.

A. (i) Foreign direct investment is the transfer of production resources/ capital by foreign individuals companies and multifunctional corporations in the by foreign individuals companies and multifunctional corporations in the form of business operation.

Merits.

- Promotes the use of idle resources in the country.
- Leads to ration of job opportunities.
- Provide revenue to government through taxation.
- Facilitates development of local skills.
- Helps fill the savings – investment gap.
- Leads to increase output hence economic growth.
- Fills foreign exchange gap.
- Facilitates development of infrastructure.
- Promotes international cooperation therefore increasing volume of goods traded.
- Encourages innovations and inventions.
- Facilitates production of wide variety of quality goods.

- It facilities technology transfers.

ECONOMIC INTEGRATION

Question 62. (a) Distinguish between trade creation and tarred diversion

(b) What are the implications of your country joining economic integration?

Trade creation is a situation where trade shifts away from high cost non-member sources to low cost member sources after formation of economic integration.

Whereas

Trade diversion is a situation where trade shifts away from the lost cost non-member state sources to high cost member source after formation of integration.

- **Trade creation effect** i.e. trade shifts from high cost non-member sources to low cost member states. Welfare of the people is improved due to low prices charged on the goods produced within the integration.
- **Expansion of manufacturing.** Due to large markets, large scale industries are established leading to industrial development and more employment opportunities.
- **Provide vent for surplus output through widening market.** The country is able to sell her surplus in the regional market. This encourages exploitation of formally idle resources.
- **Promotes specialization.** This reduces the cost of duplication as each country concentrates on production of a particular commodity. This increases gain from free trade.
- **It creates easy access to foreign resources.** Lending institutions are more willing to lend to integrated countries than to a single nation.
- **It allows joint research and collection of information.** Research is expensive venture and can be difficult for a single country. When countries combine they can pool resources and carry out research at low costs.
- **Encourages competition.** Many firms will be set up in the region thus better quality products will be produced.
- **Increases bargaining power of the member states.** Since countries specialize, each country will have high bargaining power for its products in the regional market thus improved TOT.
- **Development of infrastructure.** Countries share common services e.g. air services, railways etc. leading to infrastructure development in the region.
- **Promote the use of common currency.** This eases trade in the region, as there will be no need for exchange of currencies. Through the use of common currency trade is eased.
- **Promotion of political cooperation and mutual understanding between countries.** This minimizes the possibility of interstate conflict. In this way regional peace is promoted.

- **Increased employment opportunity.** Due to free mobility of the factors of production people are free to move across borders in search of employment.
- **Increased volume of goods.** Large sale firms will be established due to large market. The increased availability of goods increase standard of living.
- **Provision of low priced goods.** The high competition in the region leads to reduction of prices. This benefits consumers.

Negative implication

- **Loss of customs revenue.** Due to abolition of tariffs on the goods of member states, the government loses revenue it dearly needs for financing public expenditure.
- **Development of growth poles.** Movement of goods may be one direction, thus stronger country benefit at the expense of others.
- **People within the integration consumer poor quality products.** Since the industries in the region are sheltered against foreign competition, they may produce poor quality goods.
- **Countries may be producing similar goods.** This limits specialization and trade because none would buy from the others.
- **Trade diversion i.**e. trade shifts from low cost non-member countries to high member states. This leads to exploitation of domestic consumers.
- **Sacrifice of national interests.** Each country acts in the interest of the whole region and the national interests are sacrificed.
- **Increased dependence i.**e. it leads to loss of self-sufficiency as countries become dependent on one another, this may lead to crisis in case of conflict.
- **Poor distribution of industries.** i.e. distribution of industries may be at the expenses of economies of scale due to need of equitable distribution of projects and benefits. This leads to high production costs.
- **Unequal regional development hence regional imbalances may result**

Question 63. (a) Examine the stages of economic integration.

(b) Explain the conditions necessary for formation of economic integration.

Stages of Economic Integration

- **Preferential Trade area (PTA)** i.e. countries reduce tariffs among themselves for selected commodities.
- **Free Trade Area (FTA**). Involves elimination of all tariffs among member states, but each state maintain different external tariff on non-member states.
- **Customs Union (CU).** Involves elimination of all tariff among members, common external tariff on non-member states.

- **Common market (CM).** – involves free movement of goods and service between member states, common external tariff on goods coming from non-member countries and free movement of factors of production between the member's states.
- **Economic Union (EU) –** involves free movement of goods and service between member states, common tariff on good coming from non-member states, free movement of factors of production, joint economic institution, joint economic planning by member states and provision of jointly operated common services.
- **Monetary Union (MU) –** Involves adaptation of common monetary system.

Conditions necessary for formation of economic integration

- **Geographical nearness.** Countries intending to form regional integration should be close to each other. They should share common boundaries so that trade between them can be easy.
- **Common infrastructure.** Countries intending to integrate should be sharing common infrastructure. Such as roads, railways etc. to facilitate movement of goods and services between them.
- **Similar political ideology.** The countries should be pursuing similar political ideology so that there are no ideological conflicts between them.
- **Production of different commodities**. The countries involved should not be producing similar commodities if specialization is to be introduced. If the countries are producing similar goods, the no country will import from the other.
- **Some stage of economic growth**. The countries intending to integrate should be at nearly the same stage of economic development to avoid unequal distribution of the benefit of the integration.
- **Common language**. There must be a common language used by all the countries intending to integrate. This will facilitate communication and trade among the people in the region.
- **Some population size**. The countries should have nearly the same market sizes to be able to consume goods of the others.

SECTION A

171. State any four conditions necessary for the success of regional economic integration

- The countries should be geographically close to each other.
- The countries should be at the same stage of economic development.
- The countries should be producing different commodities.
- There must be similar political ideology.
- They must be sharing common infrastructure.
- Should have nearly same population size.

- There must be a common language spoken in all the countries.

172. (i) Distinguish between trade diversion and trade creation.

(ii) Mention two disadvantages of trade diversion.

A. Trade diversion is a situation where trade shifts away from a low cost non-member state sources to high cost member state sources of the integration.

While

Trade creation is the shifting from high cost member state sources to low cost member state sources due to formation of economic integration.

Disadvantages of trade diversion.

- Leads to exploitation of domestic consumers.
- May encourage smuggling.
- Loss of revenue from taxing imports.
- Domestic consumers may be compelled to consume poor quality products at high price.

173. Give any four objectives of economic integration.

- To promote trade liberalization by encouraging free trade.
- To increase specialization among the countries and benefits arising from it ie economies of scale.
- To improve on the welfare of the nationals.
- To raise the efficiency of the member states.
- To attain full employment situation or full capacity utilization of resources.
- To enlarge the market for the products of member states.
- To increase employment opportunities.
- To promote close political ties among member states.

174. Outline the stages of economic integration.

- Preferential Trade Area. (PTA)
- Free Trade Area. (FTA).
- Customs Market. (C.M)
- Economic Union (E.U)
- Economic community.

75. Give any four effects of trade diversion.

- Consumers are forced to consume highly priced goods.
- Growth of infant industries in the member states.

- Consumers are denied variety of goods and services.
- May lead to retaliation from non member countries of the integration.
- Loss of tax revenue to government.
- Poor quality products due to limited competition.
- Regional self-reliance is enhanced.

AGRICULTURE AND INDUSTRY

Question "To achieve faster rate of growth LDCs should promote agriculture rather than industry". Discuss.

ARGUMENTS IN FAVOUR OF AGRICULTURE.

Source of food:-It is the major source of food for the growing population

Provision of Market:-It boosts the incomes in the economy thereby raising the level of aggregate demand and hence market for goods and services in the economy.

Source of Raw materials:-Agriculture is the main source of raw materials for the industrial sector. Most of the Ugandan industries are agro based.

Government revenue:-Agriculture provides a major source of government revenue through taxation because agriculture widens the tax base of the country.

Source of labour supply:-As agriculture develops, it releases labour to the other sectors especially industry.

Major source of foreign exchange source:-The major export earnings of the country is agriculture which account for a big share of the export revenue.

The most dominant activity:-Agriculture is not only the major activity but also a way of life for most people. It constitutes the biggest percentage of the country's national income.

Provision of employment opportunities:-It provides job opportunities as the majority of the population are employed in the agriculture sector.

Income redistribution:-labour intensive agriculture that guarantees employment redistributes income as many people will be receiving incomes.

Promotes rural development:-It is instrumental in the development of rural areas through development of the rural roads, better facilities etc. this reduces rural urban migration.

Source of capital -As more amounts of money become available to the general public, more savings and investments are undertaken.

Determining standard of living:-Since agriculture is both an economic activity and a way of life, it determines the standard of living of the country.

Short comings of agriculture:-

Price fluctuation: Agricultural commodities are associated with price fluctuations i.e. prices are never stable.

Subject to the law of diminishing returns:-Agriculture production which depends on limited land is always affected by the law of diminishing returns.

B.O.P. Problems:-Since agricultural products fetch low revenues, relying on it results into BOP problems for the country.

Poor TOT:-Agricultural products sell at very low prices compared to manufactured goods leading to less foreign exchange in flow.

Low incomes to farmers:-Producers of agriculture products earn low incomes from their activities which reduce the level of aggregate demand in the country.

Seasonal unemployment:-Agriculture is associated with seasonal employment especially during dry seasons when the farmers are idle.

Income inequality:-Agriculture leads to income irregularity in the country due to low incomes which accrue to the farmers compared to high incomes of industrial workers. This widens the income gap.

Rural Urban Migration:-Agriculture causes rural urban migration for the frustrated farmers who move to the urban areas to look for better incomes.

Low standard of living:-Agriculture leads to the low living standards for the farmers due to the low incomes and purchasing power.

Low levels of investments:-Agriculture commands low levels of permanent investments which reduces the job creation opportunities.

Arguments for industrialization in LDCs

Greater Complimentarity:-Industrialization has more complementary features than agriculture to the development of various sectors of the economy through forward and backward linkages with other sectors.

Increased Production:-The returns are very high with industrialization because it increases production and offers a wider scope for development on modern lines.

Employment opportunities:-Industrial sector creates more employment opportunities through the numerous linkages it has with other sectors.

Favourable terms of trade (TOT):-Industrial output yields more foreign exchange earnings because they face favourable TOT.

Stable prices:-The prices of industrial products are more stable than agricultural products so it helps in stabilizing the producers' incomes.

Favourable BOP:-Export oriented industries improve the BOP of the country through increased export earnings.

Provides Government revenue:-it is a main source of government revenue through taxation.

Encourages Specialization:-Industrialization permits specialization within the sector which increases returns

Structural changes and diversification:-Industrial permits structural changes in the economy e.g. Transition from subsistence to monetary economy, rural to urban settlement etc and also encourages diversification of the economy.

Provides training facilities:-Industrial development leads to increased training facilities for skilled labour force.

Promotes infrastructural development:-Industrialization leads to rapid development of socio-economic infrastructure in the country

High quality goods:-Industrial products are usually of high quality leading to better standard of living.

Promotes economic stability:-Industrial development increases economic stability of the country and reduces dependence on external factors.

(a) Import substitution industries

This is an inward looking industrialization strategy that aims at establishing industries at home to produce goods that were previously imported.

Arguments (merits) for import substitution industries

(i) Conservation of foreign exchange:-

It saves the scarce foreign exchange which was being spent on imports, since similar commodities are now produced at home.

(ii) Provides employment opportunities to the local population:-

The establishments of these industries in the economy create several job opportunities which help reduce unemployment problems.

(iii) Promotes self reliance:-

The establishment of the industries enables a country to produce all her essential needs. This reduces foreign dependence.

(iv) Encourages use of local resources:-

It facilitates the exploitation of locally available resources which would have otherwise remained idle.

(v) Leads to expansion of manufacturing sector:-

The setting up of numerous industries promotes the development of the manufacturing sector in the country.

(vi) Helps control of imported inflation:-

The establishment of these industries, safeguards a country against imported inflation because there will be no need to import from other countries**.**

(viii) Encourages technology transfer:-

The establishment of industries facilitates technological transfer from MDCs to LDCs.

(ix) Source of foreign exchange to the country:-

In the long run the industries turn to be export promotion industries after the domestic market has been satisfied and the industries have grown out of the infant stage.

(x) Promotes development of infrastructure:-

It facilitates the establishment of infrastructure to support these industries. This leads to infrastructural development in the economy.

(xi) Leads to increased incomes:-

The establishment of industries generates employment opportunities which increase people's income.

(xii) Promotes economic growth:-

Establishment of these industries leads to increased output, thus economic growth.

(xiii) Solves BOP problems:-

It offers a long term solution for correcting the BOP problems of LDCs as it cuts down on import expenditure and brings in foreign exchange through export of industrial products.

(xiv) facilitates capital inflow:-

The multinational corporations that invest in these industries bring in foreign capital into the country in form of foreign investments.

(xv) promotes linkages in the economy:-

The establishment of the industries facilitates development of agricultural sector to provide the industries with raw material. In addition service such as transport and insurance to support the industries are established. This leads to backward and forward linkages.

(xvi) Widens a country's tax base. The many industries established in the economy pay taxes to the government. This leads to increased revenue to the government.

Limitations of ISI in LDCs

(i) Limited domestic markets:-

Due to low incomes, the markets in LDCs are too small to sustain import substitution industries.

(ii) Production of Poor quality products:-

Most import substitution industries are sheltered against foreign competition. This makes them monopolies in the local market, thus production of substandard goods. This explains why people in LDCS prefer imported goods to locally available substitutes.

(iii) High cost industries:-

Due to use of imported raw materials, technology and labor, the final products of ISIs are more expensive than the imported substitutes. This limits their appeal to the local consumers.

(iv) Shortage of raw materials:-

The raw materials needed to sustain the ISIs are inadequate in LDCs. This limits their expansion and sustainability.

(v) Impose heavy burden on the government:-

The survival of ISI requires protection from the government in form of subsidies which sometimes strain the budget.

(vi) Limited Capital:-

The capital and technology needed to establishment of ISI is lacking in LDCs. this has led to reliance on multinational corporations for these resources, thus exposing LDCs to income drain through profit repatriation.

(vii) Unreliable sources of funding:-

(viii) Limited skills:-

Due to inappropriate education system, LDCs experience shortages of skilled manpower needed to manage the ISI.

(ix) Poor infrastructure:-

Roads and other communication facilities in LDCs are poor and cannot support the ISI.

(x) Poor Choice of Priorities

ISIs are short lived because LDCs set up among industries.

(xi) Political Instability:-

The political instability of LDCs discourages the setting up and expansion of the ISI.

(xii) Demonstration effects:-

In LDCs, the population have a high propensity to import and prefer imported products to the locally produced ones.

(xiii) Foreign Interference:-

The establishment of ISIs in LDCs is hampered by foreign dictates e.g. the intervention of international standard of bureau, patent rights. Etc ban on certain technology transfer etc.

Demerits of import substitution industries:-

(i) High domestic prices:-

it leads to establishment of high cost industries which produce expensive goods thus the final products are very expensive for the local consumer:

(ii) Poor quality goods:

ISIs encourages the production of substandard inferior substitutes to the imports

(iii) Resource wastage:-

The limited domestic markets in LDCs and limited export opportunities for the locally produced goods leads to under utilisation and wastage of resources.

(iv) Unemployment:-

The tendency to use capital intensive techniques of production results into unemployment for the loans.

(v) Profit repatriation:-

By being usually managed or owned by foreigners ISI makes capital flight in the form of profit repatriation more likely.

(vi) Limited variety of goods:-

ISI limits the variety of goods available in the economy leading to low standard of living.

(vi) Production of consumer goods:-

ISI is biased towards the production of consumer goods instead of capital goods.

(viii) Monopoly tendencies:-

Monopoly tendencies are promoted through too much protection offered to the ISIs in the local market.

(ix) Dependence on imported inputs:-

Instead of saving foreign exchange as always intended. ISIs lead to increased foreign exchange out flow through importation of raw materials and other inputs.

(x) Limited linkages:-

ISI is a never a planned process and often occur without proper planning thus the industries lack linkages.

(xi) Loss of comparative advantage:-

ISI leads to establishment of industries for which the country may not be best suited and the opportunity cost is very high thus, the benefits of comparative advantage are lost.

(xii) Limited duration:-

Substitution industries are only of a limited duration and will inevitably come to an end once all the consumer goods industries which the local market can support have been set up.

(xiii) High management costs:-

Government usually sign very expensive management contracts for the ISIs.

(xiv)   Slow economic growth:-

ISI allows the rate of economic growth by reducing the rate of savings through the consumption liberalisation with which it is associated.

(b) Export promotion industrialisation

This is an industrialisation strategy that emphasises production for exports or foreign markets i.e. it is a deliberate policy to expand the volume of manufactured goods for exports in order to earn foreign exchange.

Requirements for export promotion strategy

(i)   Availability of raw materials:-

There should be sufficient quantities of raw materials to enable consistent production

(ii) Availability of skilled labour:-

This should be available to facilitate production of commodities that can compete at the international market.

(iii) Power adequency:-

There should be sufficieney power to enable production to take place non stop.

(iv) Infrastructure development:-

It requires good infrastructure like transport facilities, for quick movement of finished goods to the market with ease etc.

(v) Market research:-

There should be an effort to establish the marketability of the goods produced.

(vi) Export Promotion institution.

Institutions that facilitate and promote exportation of goods should be put in place e.g. export promotion council, EPADU etc.

(vii) Trade Promotion institutions:-

The strategy calls for extensive advertising and promotional activities to expose the availability of the goods.

(viii) Provision of incentives:-

The government should provide credit and fiscal incentives like tax holidays, subsidies etc to enable the exports cut down on costs so as to make their products competitive in the market,

(ix) Regional Integration:-

The strategy calls for trade agreements and economic co operations so as to encourage trade.

Merits of export promotion strategy

(i) Employment opportunities:-

The strategy expands employment opportunities because of increased production especially when labout intensive methods are used.

(ii) Economic growth:-

It facilitates increased economic growth through the increase in output.

(iii) Diversification of exports:-

It promotes economic diversification of export goods, markets etc instead of relying on agricultural commodities or one product only.

(iv) Improved BOP position:-

The enhancement of foreign exchanged earnings solves the BOP deficits of LDCs.

(v) Promotion of manufacturing sector:-

The setting up of industries promotes the expansion of the manufacturing sector

(vi) Promotion of international trade:-

It fosters international trade by reducing geographical concentration of trade.

(vii) Improves international relationships:-

It promotes international understanding among the trade partners.

(viii) Economies of scale:-

The increased market fosters industrial output to expand leading to emjoyment of economies of scale.

(ix) Facilitates commercialisation:-

The strategy encourages monetisation of the economy as production is geared towards cash economy for export.

(x) Widens tax base:-

The taxable activities in the economy increase from which government can raise revenue.

(xi) Infrastructural development:-

It encourages the development of infrastructure like roads, airport, storage facilities etc.

(xii) Resource utilisation:-

It encourages increased utilisation of domestic raw materials through expansion in out put.

(xiii) High quality outputs:-

The products tend to be of high quality as even agricultural products are added value

((xiv) Promotes efficiency:-

It promotes the efficiency of the firms through increased competition in the market.

(xv) Improve TOT:-

It enables the country's exports to sell at a high value.

Short comings of export promotion strategy

(i) Massive capital requirements:-

The strategy is associated with the need for high capital investments which is beyond the ability of LDCs.

(ii) High Marketing expenditure:-

The strategy requires heavy expenditures on market research and extensive advertising in the foreign markets yet LDCs lack funds for such.

(iii) Poor Quality Products:-

LDCs produce poor quality products which cannot compete in the world market.

(iv) Highly priced goods:-

LDCs establish high cost industries which produce expensive products that cannot compete.

(v) Trade restrictions of MDCs:-

Commercial policies of MDCs tend to discriminate and limit market for the products from LDCs.

(vi) Depletion of resources:-

It leads to quick depletion of the natural resources of LDCs.

(vii) Wastage of resources:-

Industries may run on a loss if foreign markets are hard to break through and may lead to resource wastage if all output is not bought.

(viii) Lack of viable natural resource base:-

LDCs lack economically exploitable natural resources that can sustain consistent production for a long time

(ix) Synthetic substitutes:-

The existence of synthetic substitutes limits the exportability of products from LDCs.

(x) Structural shortages:-

The promotion of exports of LDCs may lead to shortage of goods in the domestic market due to structural rigidities.

SECTION A

246. Give any four characteristics of agriculture in LDCs.

- Production is mainly at subsistence level.
- Low productivity due to inefficient methods used.
- Limited capital input.
- Use of family labour.
- Dependence on few crops.
- Abundant supply of land.
- Small holdings ie production is at level of peasant production..
- Uneven distribution of cash crops.
- Limited land market.
- Mixed framing g ie livestock rearing are carried out along side crop cultivation.
- Pastoralism for semi arid areas.

247. Mention any four agricultural goals in your country.

- To increase and diversify production of agricultural export commodities.
- To increase production of food to ensure food security.
- To improve storage facilities at all levels.
- To ensure self sufficiency in food production
- To boost production of agricultural raw material for domestic agro-based industries.
- To provide employment opportunities in the agricultural sector.
- To improve marketing of the agricultural products..

- To promote establishment of agro-based industries.
- To promote rural development.
- To provide credit faculties through credit institutions.

248. (i) What is meant by land tenure system.

(ii) Give any three types of land tenure system in Uganda.

A. (i) Land tenure system refers to how land in the country is owned and used.

(ii) **Types of land tenure system.**

- Private/individual ownership such as lease hold land and mailo land.
- Customary tenure/communal ownership of land.
- Public/government ownership.
- Limited land market.
- Mixed framing g ie livestock rearing are carried out along side crop cultivation.
- Pastoralism for semi arid areas.

251. (i) Distinguish between agricultural modernization and agricultural diversification.

(i) Give any two benefits of agricultural diversification.

A. (i) Agricultural modernization refers to the adaptation of modern farming methods which include technical change like crop variety pest and disease control etc so as to improve farming methods and techniques.

While

Agricultural diversification is the introduction and growing of various crops at the same time e.g. cotton tea, maize, coffee beans etc.

(ii) **Benefits of agricultural diversification.**

- Minimizes risks and uncertainties.
- Increases farmer's income by selling variety of crops.
- Reduces seasonal unemployment.
- Promotes economic growth since output in the economy expands.
- Generates government revenue by expanding tax base.
- Improves BOP position through increased export earning.
- Expansion of domestic market due to increased incomes.
- Increased available of raw materials thus industrialization of the economy.

- Redistribution of income.
- More foreign exchange is earned through export of various crops.
- Reduction of rural-urban migration.
- Elimination of food scarcity.

252. Mention any four factors limiting agricultural mechanization in your country.

- Topography of some areas is hilly.
- Poor land tenure system.
- Shortage of capital.
- Shortage of skilled manpower.
- Shortage of land to undertake large scale farming.
- High over head maintenance cost for machines like tractors.
- Low crop yields.
- Some crops do not permit use of machines e.g. trees do not permit use of tractors.

PUBLIC FINANCE AND FISCAL POICY

Question 64. (a) What is meant by the term public finance?

(b) What is the role of public finance in your country?

Public finance is the science which studies methods used by the government to obtain revenue and the principle on which government expenditure are to be based. Public finance is made of:

- **Public revenue**. Is total income of government and specifically looks at methods of raising public revenue.
- **Public debt**. Total amount of money borrowed by the government (both local and public authorities) and study methods and causes of public borrowing and management of public debt.
- **Financial administration**. Study of how the budget is prepared and implemented.
- **Fiscal policy.** Study of the use of taxation and government expenditure to bring about stability and development of the economy

Roles of public finance in Uganda

- **Reduces income inequalities.** The process of raising public revenue and expenditure equitable distribution of income is achieved by adopting progressive tax system such as

PAYE, the high income earners are taxed more and the revenue realized can be spent on providing services that benefit the poor such as UPE and USE.

- **Can be used to control inflationary tendencies**. Through its tools such taxation, public finance can be used to control inflationary tendencies. High taxes can be imposed on consumers thus reducing aggregate demand, and achieving domestic price stability.
- **Protects local industries**. Public finance through the budget can plan surplus budget so that high tariffs can be imposed on imports. This helps shelter domestic industries and employment, by making imports less competitive in the local market.
- **Influences level of Investment.** Through public finance the government can raise revenue through taxation and borrowing. These amounts can be used to carry out investments in infrastructure, industry etc.
- **Efficient use of resources**. In its efforts to raise public revenue, the government can influence efficient use of scarce resources. High taxes can be imposed on luxuries and production of essential commodities subsidized. This will force producers to switch resources from production of luxuries to producing essential commodities, thus minimizing resource wastage.
- **It is a means of raising revenue**. Public finance through taxation and borrowing is a means of raising revenue necessary for recurrent and development expenditure it can be used for maintenance of infrastructure etc.
- **Control consumption of undesirable commodities**. Through its focal tools, public finance can be used to regulate consumption of harmful commodities, increased taxes on cigarettes and alcohol can make then expensive and reduce their consumption.
- **Improves on the BOP position**. By increasing import tariffs and subsidizing local producers, public finance can be a very effective tool in reducing BOP deficit by reducing expenditure on imports and increasing revenue from exports.
- **Determines level of employment**. Imposition of taxes on import may protect domestic industries and protect home employment. In addition the revenue realized can be spent on many projects that generate employment in the country.
- **Facilitates process of economic growth**. Through its tools and policies, public finance can be used to regulate economic activities so as to achieve sustained growth. Taxation and public expenditure can be used to achieve price stability and increased economic activities.

Question 65. (a) Distinguish between incidence of a tax and impact of a tax.

(b) Explain why your country imposes taxes.

Incidence of a tax refers to the final resting place of a tax burden. When a tax is imposed on a producer, such a firm may pass the whole incidence or bear all or share with the consumer depending on elasticity of demand for the products upon which the tax has been imposed.

Whereas

Impact of a tax is the initial resting place of a tax burden. The impact of tax may be on one person but the incidence on another depending on elasticity of demand for the commodity

Why Uganda imposes tax

- **To raise revenue**. Uganda needs funds to cover the cost of general defense and the social services provided by the state. Taxes are considered a major source of public revenue.
- **To achieve fairer distribution of income**. Taxes are imposed to ensure equality in the distribution of income. Pay As You Earn (PAYE) takes more from the rich than the poor, and its percentage rises with increase in income. The amount collected can be used to improve welfare of the poor. IN this way taxes help achieve equality in income distribution in the country.
- **To maintain economic stability**. It is the responsibility of the government to ensure macro-economic stability by maintaining price and BOP stability. During inflation the government imposes more taxes in order to discourage the unnecessary expenditure of individuals. Similarly during deflation taxes are reduced in order to enable individuals to spend more money. In this way. The increase or decrease in taxes helps to check the big fluctuation in prices.
- **To achieve optimum allocation of resources**. Taxes are imposed allocate the resources of the country to more productive projects to achieve maximum possible out put in a given circumstances.
- **To protect domestic industries.** Uganda like other LDCS have young industries which operate at high average cost. To shelter these firms against foreign competition the government imposes tariffs on imported goods so as to protect home employment.
- **To restrict consumption of harmful commodities.** There are some commodities whose consumption is hazardous to health or social undesirable. This explains why Uganda heavily taxes and alcoholic drinks to reduce their consumption.
- **To pay for public goods and services.** There are some goods and services provided by the state such as roads, defense, and education among others. These goods and services have the characteristic of non excludability in consumption. The only way to cover the cost of these goods and services is by imposing taxes
- **To improve balance of payment BOP position.** Taxes are fiscal tools for improving BOP position. This is why Uganda imposes high taxes on importation of goods as a way of discouraging their consumption so as to minimize government expenditure abroad.
- **To encourage hard work.** Individuals are obliged to work hard so as to meet their taxes obligations while at the same time increase their profit margin. This leads to high output.
- **To control inflation.** Taxes are used to regulate the amount of money in circulation in general and peoples disposable income. Hence taxation helps a country to check inflation.

- **To return from an individual the surplus he/she derived from society.** Society sacrifices a lot of things such as roads, water, electricity, minerals, etc to help individuals get rich. The only way such individuals can return something to society is by paying taxes.
- **To benefit low income groups.** The poor highly benefit from government expenditure such as free education, clean water, health services etc. Such expenditure is financed by revenue from taxation.

Question 66 (a) Examine the problems faces by tax authority in LDCS.

(b) What steps should LDCS government to take to improve tax collection?

- **Shortages of qualified personal.** Due to illiteracy and defective education system, people with required skills to effectively asses and collect taxes are few. There is severe shortage of accountants, economists and other personnel with relevant skills in tax administration.
- **Low taxable capacity.** The majority of people in LDCS are poor with limited capacity to pay taxes. In addition few people keep records of their incomes and out put making it difficult for tax collectors to assess activities to determine taxable capacity.
- **Scattered nature of tax payers.** The few people in LDCS who have some incomes that can be taxed are scattered over wide areas making it expensive to collect taxes.
- **Hostility of tax payers.** Majority of people in LDCS oppose tax payment and also due to failure of government to provide social services to the people.
- **Wide spread smuggling.** Smuggling across national borders is a very common practice in LDCS. Government loses a lot of revenue in import tariffs on goods entering the country illegally. It is expensive to curb this practice because of the long border line.
- **Rampant tax evasion and avoidance.** Due to weakness in the tax system and law, many tax payers escape their tax liability by under declaring incomes or deliberately refusing to pay. This leads to low income revenue.
- **High inflation rate.** Most LDCS are inflation prone. This implies that by the time all the expected revenue is realized, It will have lost value.
- **Frequent changes in jobs.** The work force in LDCS is dominated by unskilled and semiskilled labour. These are mainly employed on contract basis and frequently change occupation. This makes it difficult to for tax authorities to track tax payers for income tax purposes.
- **Political insecurity.** MOST LDCS are politically unstable due to civil wars. This makes it difficult for tax authorities to reach certain places for tax assessment and collection. In addition, political insecurity disrupts economic activities that basis of the tax.
- **Poor transport and communication net work.** Due to underdevelopment, most LDCS have poor infrastructure. The road net work and other communication networks are in bad state making it difficult and expensive to tax payers and collect taxes

- **Language problem.** Most LDCS are heterogeneous societies with many ethnic groups. This makes it difficult to carry out tax assessment and education.
- **Large subsistence sector.** In majority of LDCS, the traditional sector is still predominant. Output from this sector can hardly be taxed because it has no monetary value. This leads to tax revenue.
- **Narrow tax bases.** The tax system in most LDCS is not comprehensive because activities to be taxed are few. This is majorly due to limited industrialization.
- **Wide spread corruption and embezzlement by tax officers.** Much of the revenue realized end up in the pockets of tax officers. Many are easily bribed by tax payers who want to evade taxes.

Steps which should be taken to improve tax collection.

- **Minimize income inequality.** The LDCS governments should adopt comprehensive poverty eradication program that aim at increasing the incomes of the majority poor. This will reduce the income gap and increase the taxable capacity of the majority.
- **Improve investment climate.** LDCS governments should provide favorable investment climate in their economies so as to encourage both local and foreign investments. These will through the multiplier effect generate more employment opportunities and widen tax base.
- **Strengthen the tax authorities.** The LDCS should build strong and competent tax authorities with capacity to efficiently identify tax bases assess and collect taxes. This will minimize tax evasion and avoidance.
- **Diversification of the economy.** Government should encourage more economic activities in agriculture, trade, industry, etc so as to increase range of economic activities in the economy. This will create wide tax bases.
- **Introduction of land tax.** In most LDCS valuable and productive resource majority of people derive their income and livelihood from land. Land tax can generate revenue to government.
- **Impose reasonable tax rates.** Realistic tax rates should be imposed to minimize smuggling and tax evasion.
- **Introduce comprehensive taxes.** LDCS government should introduce taxes with wide coverage which can touch wide range of tax bases. This will bring greater yield to state treasury.
- **Provide tax education to the public.** Majority of the people object to tax payment because they do not understand why and how taxes should be paid. To improve tax collection LDCS should sensitize the public on the need to pay tax.

- **Maintain political stability.** Government should ensure political stability to make it easy for tax authorities to rich tax payers in all corners of the country. In addition, stable political climate can encourage economic activities leading to wide tax bases.
- **Improve infrastructure.** LDCS should improve the state of their existing infrastructure and build new ones to make it easy for tax authorities to reach tax payers for assessment and collection
- **Minimize corruption.** LDCS should enact strict laws against corruption. Those found guilty of the act should be severely dealt with to give lesson to the rest. This will encourage transparency and minimize revenue losses through fraud by tax officials.

Question 67 (a) Distinguish between tax avoidance and tax evasion.

(b) Why does your country rely more on indirect taxes.

Tax avoidance refers to a situation where a tax payer escapes paying tax by taking advantage of the loopholes in the tax. It is also referred to as mitigation.

Where as

Tax evasion is an illegal step taken liability by either under declaring his income or deliberately refusing to by the tax payer to escape his tax.

Why Uganda relies on indirect taxes.

- **High level of unemployment.** Majority people in the country are not in formal employment making it difficult to raise payee. Indirect taxes that focuses on expenditure becomes the only reliable source of government revenue.
- **Low incomes.** Majority of people in Uganda are poor and unable to contribute to government revenue by way of income tax.
- **Large subsistence sector.** In Uganda the traditional sector is still predominant. The out put from this sector is not monetized and therefore difficult to tax. It is also characterized by traditional low productivity.
- **Fear of political unrest.** Many people are not willing to pay direct taxes and high direct taxes can cause resentment. To maintain popularity with citizens, the government prefers indirect taxes.
- **Lack of reliable statistical data about people's income.** Uganda does not have adequate skilled personal to identify and assess all sources of income. This forces government to prefer expenditure taxes.
- **Small and weak manufacturing sector**. In Uganda industrial sector is still small and weak thus they can not pay adequate corporate tax to the government.
- **Indirect taxes are rarely resented.** This is because the tax payers pay the taxes as they buy commodities or services. They do not even know they are paying taxes.

- **Indirect taxes are easy to collect.** They are included in the prices of goods and services and the producers are expected to remit to government. The cost of tax collection is therefore lower than direct taxes.
- **Indirect taxes can be used for other purposes other than raising revenue.** For example they can be used to protect infant industries against foreign competition or to regulate consumption of certain commodities.
- **Wider coverage.** Indirect taxes cover variety of tax bases. Therefore generate more revenue than direct taxes.
- **Less evasion of tax.** Since taxes are included in the prices of commodities, all people buying the goods have to pay the tax.
- **Less harmful to effort.** Since taxes are not linked to earnings, there is little disincentive to effort and initiatives.
- **Protects the country against dumping.** Indirect taxes can prevent dumping of cheap goods into the country. Thus promote domestic investment.

Question 68 (a) Distinguish between a deficit budget and surplus budget

(b) Examine the roles of a budget in your country.

A surplus budget is a budget in which proposed government expenditure is less than the expected revenue from taxes and other sources ion a given financial year.

Where as

A deficit budget is a budget in which proposed government expenditure is greater than expected revenue from taxes in a given financial year.

Roles of a budget.

- **Raises revenue for the government.** Through the budget the government can raise revenue using various fiscal resources out lined in the budget. This can be used to improve social services and pay old debts and other obligations.
- **Protect home industries.** Through the budget the government can increase imports duties. This makes imported goods expensive and gives advantage to home industries in the home market.
- **Maintenance of high level of employment.** By using the revenue realized through the budget the government can carry out investment or for subsidies to investor This creates more employment opportunities in the economy
- **Used to fight inflation.** A Surplus budget that aims at collecting more than the government intends to spend can help reduce aggregate demand and check inflation.
- **Helps to achieve equitable distribution of income.** Through the budget progressive taxes such as PAYE can be used to correct income inequalities.

- **Regulate the consumption of undesirable goods.** Through the budget high taxes can be imposed on commodities such as cigarettes and alcoholic beverages to minimize their consumption.
- **Helps to stimulate investment in the economy.** The budget can be used as an instrument to uplift the economy from recession through the deficit budget. It fights deflation and boost the economy by raising the aggregate demand.
- **Maintains favorable balance of payment.** Budget is used to correct balance of payment deficit by imposing high taxes on imports to discourage their demand and subsidize exports.
- **Promote rapid growth and development.** Through the budget allocation of expenditure can be channeled to in the productive sectors and projects leading to economic growth.
- **Regulates government expenditure.** The budget can be used to determine the extent and regulate government expenditure.
- **Instrument for negotiation for a loan.** Through the budget the government can determine her need for external support in form of aid.

Question 69 (a). Distinguish between the recurrent expenditure and capital expenditure in a budget.

(b) Account for persistent budget deficit in your country.

Recurrent expenditure refers to the government expenditure on daily consumption of goods and services in order to carry out administrative activities like the maintenance of law and order through out the country.

Where as

Capital expenditure refers to government expenditure on investments in sectors like agriculture industry, infrastructure etc.

Causes of budget deficit in your country.

- **Limited revenue from taxation.** In Uganda due to low incomes and limited range of economic activities, the tax base is low. Thus persistent budget deficit.
- **High level of tax evasion and avoidance.** In Uganda people are not willing to pay taxes and always look for loopholes in the tax law to evade tax payment.
- **Rising prices for petroleum.** Uganda is a net importer of petroleum products. The rising prices of these products in the world market distorts domestic prices causing budgetary deficit.
- **Persistent inflation in the country.** Costs of government expenditure are rising due to falling value of money. Thus frequent adjustment must be made to cater for this.
- **Wasteful government expenditures.** The government has got unnecessary expenditures for example the large number of MPS and ministers. This strains the budget causing deficit.

- **Political instability in the country.** The endless wars in the country are imposing further strain on the budget. The government is in constant need of money to finance the war.
- **Rampant corruption in the country.** This is so common in the revenue authority. Much of what is corrected ends in the private hands. Thus persistent budget deficit.
- **High population growth rate.** Uganda has among the highest population growth rates in the world (over 3.2). This calls for high government expenditure.
- **High wage demand in the country.** Over the years the government has been increasing the wages and salaries of the civil servants. The huge wage bill has led to persistent budget deficit.
- **The need to service domestic debts.** Debts from the domestic institutions and individuals are usually financed through the budget this increased domestic borrowing has led to persistent budget deficit.
- **Occurrence of the natural disasters.** The need to provide relief to people hit by the natural disasters further distorts government budget causing deficit.
- **Increasing government expenditure to subsidize private investors.** This also increases the magnitude of government expenditure and worsening deficits.

Question 70 (a) Examine the causes of the public debts in Uganda.

(b) What are the implications of the public borrowing to LDCS?

- A public debt is the total amount of money a country owes to its various creditors both internal and abroad. It includes the national debts (amount borrowed by the central government) and the debt incurred by the local authorities. The causes of the borrowing by the LDCS include.
- **Rising prices of the petroleum products.** Most LDCS are net importers of oil products. Since early 1970s petroleum products have experienced sharp rise in the prices. This has led to BOP deficit for LDCS, due to heavy borrowing to finance oil imports.
- **Effects of the world recession.** The recession in the developed world have reduced demand for the raw materials and semi manufactured goods produced in the developing countries. The result is that the developed countries import less of the raw materials from LDCS. This led to further borrowing.
- **High inflation in the LDCS.** Developing countries experience high inflation rates. This makes exports expensive to foreign importers, thus leading to reduced export revenue LDCS resort to borrowing to meeting their import requirements.
- **Limited revenue from taxation.** In LDCS incomes are so low that the taxable capacity of the individuals is very limited. As a result, LDCS are forced to borrow in order to finance their projects.
- **Unfavorable terms of trade.** The deteriorating TOT against LDCS means that they are unable to finance their imports by export revenue. The prices of agricultural raw materials

which form the bulk of exports of LDCS have for decades experienced fall in prices. This has forced LDCS to borrow in order to domestic obligations.

- **Need to avoid adverse effects of taxation.** Taxes, especially if they are too high affect the incentive to work hard leading to low savings and investment.
- **Low productivity coupled with high population growth rate.** This has led to reduced exports because the domestic out put is used to meet domestic consumption. The reduced export revenue and the raising import needs to sustain the rising population has sustained increasing borrowing.
- **Increased interest rates.** International financial markets charge high rates of interest on their monies. This has forced LDCS to borrow funds in order to service their accumulated debts.
- **Convenience of debts**. LDCS find borrowing a convenient source of development finance because it comes in lump sum and its payment can be rescheduled to the convenience of the borrowing country. In addition, there is the possibility of being forgiven.
- **Ambitious development plans of the LDCS.** LDCS have broad and ambitious development projects which cannot be financed using the local revenue. This forces them to borrow in order to accomplish such plans.
- **Need to fill the man power gap.** Due to inappropriate education and high proportion of illiteracy, LDCS are deficient in skills. This has led to increased borrowing to import skilled personal from abroad.
- **Need to regulate the money supply.** Government uses borrowing as a monetary policy tool to draw money away from the population e.g. through the sell of the treasury bills during inflationary periods.
- **Need to finance emergency expenditures.** LDCS borrow to finance relief and rehabilitation programs arising from natural disasters such as earth quakes, El Niño etc.
- **Wasteful government expenditure.** Most LDCS are involved in wasteful expenditures and extravagancy by the politicians. For instance maintaining many foreign missions and frequent foreign travels by the politicians. Domestic revenue cannot be sufficient for such massive expenditures.
- **Need to fill the foreign exchange gap.** Due to low foreign exchange earnings, LDCS are foreign exchange deficient. This compels them to engage in borrowing so as to finance their import needs.

Positive implication of debts.

- **Earns interest to the lenders.** Where as taxes are compulsory transfers for which an individual citizen does not obtain compensating benefits. Loans are voluntary transfers on which the individual expects some returns in the form of interest in the case of internal loans.

- **Loans help a country to avoid negative effects of taxation.** Taxes may discourage hard work, savings and investment. Loans may instead encourage them.

- **With the external loans there are no fixed dates of payment.** The government only has obligation to pay the interest. In case of the external loans the payment of the interest does not represent costs to the community; nor is it an additional burden to the tax payers.
- **There is the possibility to borrow and pay old loans.** In case of the dated loans, the government can borrow to repay the loan without imposing burden on the tax payers.
- **There is the possibility of being forgiven.** Loans can some times provide free funds to LDCS when the donors decide to write off the debts.
- **Loans bring in large sums of money.** Some of the big projects which government undertake would not take off if they are to rely on the merger revenue from the taxes.
- **Loans help to fill the budget deficit.** The loans from the other counties can be used to fill the gap created between the finance needed for development and the finance available internally form taxation and voluntary savings in order to assist development.
- **Loans supplement the foreign exchange earnings needed for economic growth.** If the loans are properly used and invested in productive activities then repayment will not cause undue problems.
- **Borrowing shifts the burden to future generations.** If the loan is invested in long term projects the future generation who benefit from such projects will be the ones to repay.
- **Supplement revenue from taxes.** Due to low taxable capacity, the tax revenue in the LDCS is insufficient. Loans help to supplement the little revenue.
- **Loans may accelerate economic growth.** If the amount borrowed is invested in the productive ventures there will be increased out put of goods and services hence economic growth and development.
- **Borrowing is politically acceptable compared to taxation.** In LDCS due to illiteracy people resent tax payment. Loans minimize possibilities of riots and hostilities from tax payers.

Borrowing can be used to correct temporally BOP deficit.

Negative implications.

- **Facilitates resource out flow.** An external loan leads to transfer of resources to a foreign country to service the debt. This may worsen the BOP problems or deficit.
- **Widens income and wealth disparity.** Locally raised loans are repaid with revenue from taxation. This distributes income from the poor to the rich because the rich receive interest from the loan lent to government.

- **Borrowing shifts burdens to future generations.** The burden of repayment is shifted to future generations who may not benefit from the loans especially the dead weight debt.
- **May encourage extravagancy.** The easy way of raising funds through loans may make leaders more extravagant. This leads to resource wastage.
- **Debt servicing limits capital accumulation.** All the resources of the country may be directed to servicing of debts. This reduces capital accumulation and investment in the country.
- **May lead to inflation.** Borrowing from the central bank can lead to excessive printing of money. External borrowing leads to inflow of foreign currency which must be exchanged for the local currency. All these lead to increase in money supply causing economic instability.
- **Reduces welfare in the country.** Debt servicing leads to foregoing current consumption especially the social services and infrastructure will stall.
- **Encourages dependence syndrome.** The creditors may become increasingly reliant on the donors. This will promote external interference in the internal affairs of the recipient country.
- **High interest rate.** Due to competition by LDCS for loans and the limited financial resources of lending, lenders charge high interest rates on loans to LDCS. This worsens the debt burden.
- **Encourages the misuse of the tax revenue.** The possibility of raising loans may encourage the government to spend the revenue on unproductive ventures.

Question 71. (a) Explain the objectives of fiscal policy in an economy.

(b) Examine the limitation of fiscal policy in your country.

Fiscal policy is package of economic measures that use public finance particularly taxation and government expenditure through the budget to bring about economic stability desirable for rapid economic progress. It intends to achieve the following objectives.

- **To maintain price stability.** This is achieved through regulating money supply. During inflation taxes are raised and the government expenditure cut. This helps to reduce excess money in circulation, aggregate demand and prices. In periods of deflation taxes are lowered and government expenditure increased.
- **To redistribute income and wealth.** This is done by levying progressive taxes and subsidizing the poor. In this way the gap between the rich and the poor is substantially reduced.
- **To shelter domestic infant industries.** By increasing the import duties and subsidizing domestic industries, domestic firms are protected against competition from well established foreign firms. This helps to protect domestic employment.

- **To improve the BOP position.** By increasing import tariffs the price of the imports would increase. This discourages imports thus reducing expenditure on imports. This helps to reduce deficit on BOP.
- **To reduce unemployment.** By increasing government expenditure on investments, decreasing taxes and subsidizing private investors, more investment will be under taken in country. These generate more employment opportunities in the economy.
- **To improve the infrastructure.** The amount raised through taxes can be spent on building roads, schools, hospital etc. These help raise pace of economic growth.
- **To provide social services.** The revenue realized by the government can be spent on education and provision of health services to the people. This helps to raise labour productivity.

To encourage private investments. By providing the infrastructure and subsidies to private investors, more private investments will be attracted both foreign and local.

Limitation of fiscal policy in Uganda.

- **High rate of tax evasion and avoidance.** In Uganda tax payment is not a culture. Majority of the people resist tax payment. This partly explains the rampant smuggling across national borders.
- **The dominance of the traditional sector.** In Uganda subsistence sector is still large leading to low taxable capacity. This reduces government revenue and limits the operations of fiscal policy.
- **High debt burden.** External borrowing to cover government expenditure drains resources from the country to service the debt.
- **Low taxable capacity.** In Uganda the majority of people are poor. In addition, the economic activities that can be taxed are few. This limits revenue from taxation which in turn reduces government expenditure.
- **Political instability.** This has limited government expenditure in productive sectors. It has also made is difficult to collect taxes in some parts of the country. For example Northern part of the country has been politically unstable for the last twenty years. This reduces revenue necessary to finance government expenditure.
- **Taxation may be counter productive.** In effort to raise revenue high taxes may increase production cost and rather than reduce prices, may instead escalate the prices. It may also discourage investments and cause unemployment. For example in 2006 Uganda government increased tax on cigarettes causing BAT to close its plant in Jinja rendering hundreds of employees unemployed.
- **Lack of accurate statistical data.** Due to shortage of skilled man power and facilities such as computers. Uganda lacks accurate statistics on incomes, economic activities etc. This

makes government borrowing, taxation and expenditure difficult because the policy requires planning to be effective.

SECTION A

176. (i) Define the term public finance.

(ii) Give any three branches of public finance.

A. (i) Public finance is the science which studies methods used by the government to obtain revenue and the principles on which government expenditure are to based.

B. (ii) **Branches of public finance.**

- Public revenue ie the total amount spent by the government and the effects of such expenditure.
- Public debts ie the causes and effects of debts borrowed by government, local authorities and public corporations for various reasons.
- Financial administration ie the preparations and operation of the budget.
- Fiscal policy ie the use of public finance especially taxation and the budget to bring about economic stability.

177. Give any four functions of public finance.

- Provision of public goods and services.
- Influencing resource allocation and industrial efficiency.
- Subsidizing the production of goods and services.
- Achieving equitable distribution of income.
- Provisions of social security transfer payment to the less privileged.
- Regulation of economic activities.
- Expansion of the public sector.

178. Give any four roles public finance in development.

- Influences the level of investment.
- Reduces inequalities in income distribution.
- It is a means of obtaining revenue for recurrent and development expenditure.
- Controls consumption of undesirable products.
- It is used to maintain price stability/control inflationary tendencies.
- It determines employment levels in the economy.
- Improves the country’s BOP position by regulating import export trade.

- Facilitates economic growth through its tools and policies.
- Protects local industries and domestic products.

179. Give any four non-tax sources of public revenue.

- Licenses.
- Fees on government rendered services.
- Fines on law breakers.
- Rates.
- Gifts and grants.
- Market dues.
- Compulsory savings.
- Disinvestment/privatization of state owned enterprises.
- Treasury bills.
- Deficit financing/printing money to finance deficit.
- Loans/borrowing internally and externally.
- Surplus from gambling.
- Government investment.
- Rent on government property.

180. Give any four reasons why your government imposes taxes.

- To raise revenue necessary to finance public expenditure.
- To achieve equitable distribution of income through progressive taxes.
- To protect domestic infant industries by imposing heavy taxes on imports.
- To fight inflation.
- To correct BOP deficit.
- To discourage dumping.
- To control monopolies.
- To promote savings.

181. Mention any four characteristics of a good tax system.

- Comprehensive ie covers wide range of tax bases.
- Imposes minimum burden on the tax payer.
- Efficiency ie the cost of tax administration should be low.
- Optimality, ie must ensure balance between revenue collected and services rendered by

gov't

- No doubt taxation ie a tax payer should not be taxed more than once on the same tax base.
- Flexibility/buoyancy ie revenue from taxes should change with changes in taxpayer's income.

182. (i) Distinguish between horizontal equity and vertical equity.

(ii) Cannons and characteristics of a good tax.

A. (i) Horizontal equity refers to equal treatment of equals for tax purposes ie tax payers in a similar position/situation are treated equally.

While

Vertical equity is when tax payers who are in unequal situations are treated differently e.g. the rich are taxed more than the poor.

(ii) Cannons are qualities which a particular tax must satisfy so as to justify its imposition .While

Characteristics are general qualities that must be applied to the tax system and throughout its administration ie assessment and collection.

183. (i) Distinguish between proportional tax and progressive tax.

(ii) Give any two effects of progressive tax.

A. A proportional tax is the type of tax where every tax payer pays the same proportion/percentage of income as tax.

Or

(i) A tax which is levied on a uniform percentage regardless of the level of income.

While

Progressive tax is the type of tax whose percentage rate increases with increase in the tax payers' incomes ie the burden is more on the rich than the poor.

(ii) **Effects of progressive tax.**

- Redistributes incomes in the economy/reduces income inequality.
- Raises more revenue to the government.
- Discourages work and effort among the high income groups.
- Reduces the level of savings and investment in the economy.
- Encourages tax to avoidance and evasion in the economy.

184. (i) Distinguish between regressive tax and digressive tax.

(ii) Give any two effects of regressive tax.

A. (i) regressive tax is a type of tax whose percentage rate reduces as incomes increases its burden falls more in the poor than the rich.

While

Digressive tax is a type of tax which has progressive elements at lower levels of income but whose amount paid remains uniform at higher levels of income e.g. graduated tax is regressive at higher incomes.

(ii) **Effects of regressive tax.**

- Leads to exploitation of the poor.
- Widens the gap between the poor and the rich.
- Reduces standard of living of the poor by limiting their consumption.
- Encourages tax evasion by the poor.
- Leads to social tension and unrest in society.
- Encourages hard work in the society especially by the poor.

185. (i) What is the difference between taxable income and tax base.

(ii) Give any two reasons for narrow tax base in your country.

A. (i) Taxable income is the income liable to taxation. It is also known as tax threshold.

While ‘tax base refers to items or range of activities on which tax is imposed e.g. income.

(ii) **Reasons for narrow tax base in Uganda.**

- Existence of many target workers.
- Inadequate skilled personnel to identify and assess the tax base.
- Small manufacturing sector that can pay corporate tax.
- Tax allowances and concessions given to foreign investors.
- Large proportion of the population still at school.
- Political instability disrupting economic activities.
- High levels of unemployment which limits the number of people who can pay tax.
- Existence of large subsistence sector which is hard to assess.

186. (i) Define the term taxable capacity.

(ii) Mention three reasons for low taxable capacity in LDCs.

A. (i) Taxable capacity of a person refers to the extent to which a tax payer is able to pay the tax assessed on him/her and still remains with sufficient disposable income that can enable him/her to live a descant standard of living which he/she has been accustomed to.

Taxable capacity of a country is the percentage of GDP that be realized in taxes.

(ii) **Reasons for low taxable capacity in LDCs.**

- Low level of incomes/poverty due to predominance of subsistence sector.
- Low level of monetization ie most transactions are based on barter exchange.
- High income inequality ie taxes are imposed on very few rich persons.
- Dominance of the agricultural sector.
- Regressive tax system ie it tends to be heavier on the poor who are least able to pay the tax.
- Wide spread unemployment.

187. (i) Distinguish between tax evasion and tax avoidance.

(ii) Give any two reasons for tax evasion.

A. (i) Tax evasion is an illegal step taken by the taxpayer to escape tax liability by understating or refusal to declare income which reduces income tax liability.

While

Tax avoidance is a legal step taken by the tax payer to escape his/her tax liability fully or in part by exploiting the loopholes or weaknesses in the tax system e.g. refusing to consume taxed commodity. It is also known as tax mitigation.

(ii) **Reasons for tax evasion.**

- Unfair tax assessment.
- Discontent with the provision of services by government.
- Lack of adequate information about taxes.
- Low income levels.
- Laxity in the tax system.
- Desire by tax payer to retain all earnings.
- Political sabotage by opposition politicians.
- Unpopularity of government.

188. What is meant by the following terms as used in taxation?

(i) Tax transformation.

(ii) Tax capitalization.

(iii) Tax rebates.

(iv) Tax holidays.

A. (i) Tax transformation refers to the substitution of a taxed commodity, with the production of non-taxed one to avoid the effect of tax. It is a form of tax mitigation by a producer.

(ii) Tax capitalization is the artificial increase in the value of capital employed by the company by the amount of tax liability.

Or

A situation where a firm converts profits into capital by raising capital value in order to pay less tax.

(iii) Tax rebates is the official refund of part of the tax paid by the tax payer.

It occurs when a tax payer has been over taxed.

(iv) Tax holiday is a grace period given to an investor during which he/she does not pay tax.

189. Distinguish between:

(i) Forward shifting and backward shifting of tax.

(ii) Formal incidence and effective incidence of tax.

A. (i) Forward shifting of tax is when the tax is passed on to the consumer by increasing price by the amount of the tax.

While

Backward shifting is when tax is passed on to the producers of raw materials in terms of reduced prices by the amount of tax paid for the raw materials used in the production process.

(ii) Formal incidence refers to the first impact of a tax which is suffered by the person who actually pays the tax due to the authorities.

While

Effective incidence is the ultimate impact of the tax which is borne by the person who suffers reduction in his/her disposable income.

190. (i) distinguish between incidence of a tax and impact of a tax.

(ii) Give two demerits of a regressive tax.

While

A. (i) incidence of a tax refers to the final resting point of a tax in terms of money.

Or

The ultimate bearer of the burden of the tax.

While

Impact of a tax refers to the initial/first resting place of a tax

Or

The person or company who immediately bears the burden of a tax as soon as it is imposed.

(ii) **Demerits of regressive tax.**

- Adversily affects the low income earners than the rich/income inequalities.
- It is a disincentive to effort, savings and investment.
- Low income earners are subjected to poor standard of living.
- Low tax revenue is realized due to tax avoidance.
- Leads to social unrest/political discontent.
- It may adversely affect demand hence leading to unemployment.

191. Determine the incidence of a tax when demand is:

(i) Unit elastic demand.

(ii) Inelastic demand.

(iii) Perfectly elastic demand.

(iv) Elastic demand.

(v) Perfectly inelastic demand.

A. (i) Unit elastic demand.

(ii) Inelastic demand.

(iii) Perfectly elastic demand.

(iv) Elastic demand.

(v) Perfectly inelastic.

192. (i) Distinguish between a tax and a fee.

(ii) Explain why indirect taxes are said to be convenient.

A. (i) A tax is a compulsory payment made to the government or fiscal authority and the person paying the tax expects nothing directly in return.

Whereas a fee is a payment for the services rendered by the government.

(ii) **Why indirect taxes are convenient.**

- A tax payer pays as he consumes a commodity.
- It is paid through agency.
- Rarely resented because a tax payer may not know he/she is paying tax.

193. (i) Distinguish between:

(i) Income tax and capital tax.

(ii) Estate duty and capital gain tax.

(iii) Inheritance tax and gift tax.

(iv) Sur tax and poll tax.

A. (i) Income tax is a tax levied on individuals who receive income over and above certain amounts in a given period of time.

While

Corporate or company tax is the tax imposed on profits of companies or trading organization.

(ii) Estate duty/death tax is a tax assessed on wealth or estate of a person at a time of his death.

While

Capital gain tax is a tax imposed on the increase in the value of an asset when it is sold at a higher price than the acquired value.

(iii) Inheritance tax is a tax on the act of inheriting property. It is different from death duty which is assessed on a deceased's property.

While

Gift tax is a tax payable on the assessed wealth of a person at a time of transfer to another person.

(iv) Sur tax is a tax imposed on very high levels of income at very high rates.

While

Poll tax is a regressive tax which is paid at a fixed rate irrespective of income level.

194. (i) Clearly differentiate between income and consumption tax.

(ii) Which of the two types of taxes is ideally a better tax?

A. (i) Income tax is tax levied on income/earnings of individuals and companies for example PAYE, Corporate tax, graduated tax etc.

While

Consumption tax is the tax imposed on consumption of commodities. It is an indirect tax.

(ii) **Consumption tax is ideal because ;**

- It is rarely resented.
- Cost of collection is low.
- Convenient to tax payer.
- Comprehensive ie covers many items.
- Difficult to evade.
- Regulates consumption of dangerous commodities.
- Can be used for other purposes other than raising revenue such as protecting home industries.

195. Distinguish between the following:

- **Specific tax and advalorem tax.**
- **Custom duty and excise duty.**
- **Sales tax and VAT**
- **Sumptuary tax and Octroi tax.**

A. (i) Specific tax is a tax levied per unit of out put or commodity.

While

Advalorem is a tax levied as per a percentage of the volume of the commodity or weight of the commodity moved across national boundary of a country. It is made up of import duty and export duty.

While

(ii) Excise duty is a tax imposed on productive activities in a country or on home produced goods.

(iii) Sales tax is a tax on sales which should normally be borne by the seller. However if the elasticity of demand is inelastic the buyer meets the tax.

While

VAT is a tax charged on the activities at every stage of production process. It is charged on the value added at every production stage. It is output tax minus input tax.

(iv) Sumptuary tax is a tax on the consumption of goods or commodities. It is usually imposed to discourage consumption of particular goods considered harmful.

While

Octroi tax is a tax levied on goods in transit from one state to another through the territory of another state.

196. Give any four merits of VAT.

- It is an avoidable taxation.
- It is difficult to evade.
- Brings efficiency in business management because it encourages proper book keeping.
- Encourage exports as taxes on exports are refundable.
- Leads to increased government revenue because it is comprehensive.
- It is economical in terms of administration and collection.
- Reduces corruption since it is paid through bank.

197. Give any four problems of taxation in Uganda.

- There are many illegal activities which are unknown to fiscal authorities.
- Poor record keeping by tax payers which makes it difficult to assess the tax.
- Rampant tax evasion and avoidance.
- Rampant smuggling across borders.
- Hostility of tax payers.
- High cost of tax collection due to high transport cost and of some places.
- Insufficient skilled manpower to assess and collect tax.
- Language barrier.
- Insecurity in some areas which hinder tax assessment and collection.
- Scattered nature of the tax payers making it expensive to collect taxes.
- Large subsistence sector reduces tax base.

198. Give any four reasons for low tax revenue in Uganda.

- High rate of tax evasion and avoidance.
- Low level of economic activities due to political instability.

- Low tax base due to large subsistence sector.
- Government tax incentives to private investors limits revenues that could have been collected.
- High rate of tax exemptions given to potential tax payers.
- High rate of corruption by tax officials.
- Large size of the informal sectorLow taxable capacity due to poverty.
- Lack of proper information about people's income.
- High costs of tax collection and administration which reduces revenue.

199. (i) Define the term "public expenditure".

(ii) Give any three categories of public expenditure.

A. (i) Public expenditure is the total amount of money spent by the state on defense, education, provision of social services, interest on the national debt etc.

(ii) **Categories of public expenditure.**

Recurrent expenditure. This is the money spent by the government on daily consumption. Of goods and services in order to carry out administrative activities and to maintain law and order throughout the country.

Capital/development expenditure. This involves government expenditure on investments in sectors like agriculture, industry, power buildings, machinery, infrastructure etc. They are non- recurring expenses.

Transfer payments. This is money government spends on emergences, like relief and other types of disasters. it includes grants and pensions, scholarships, bursaries etc.

200. Distinguish between:

(i) Compensatory spending and pump priming expenditure.

(ii) National debt and public debt.

A. (i) Compensatory spending is spending for the purpose of compensating a decline in private investment ie any decline in private investment expenditure is off set by public expenditure on public works and relief measures.

While

Pump priming is expenditure on state investments undertaken for the purpose of stimulating demand in order to reduce unemployment

(ii) National debt is the debt owned by the central government both to its nationals and outsiders but does not include the debts incurred by local authorities.

While public debt is the total debt incurred by the central government plus the debts of local authorities and public corporations.

201. What is meant by the following terms?

(i) **Reproductive debts.**

(ii) **Dead weight debts**

(iii) **Funded debt.**

(iv) **Unfunded debts.**

(v) **Floating debts.**

A. (i) Reproductive debt is the self liquidating debt which incurred for the purchase of real assets. For example loan obtain to build an industry. Such debt can pay off itself, hence does not impose burden on the citizens.

(ii) Dead weight debts are non self liquidating debts which are not covered by purchase of any real asset. For example loan obtains to finance war. Such debts impose heavy burden on the citizens. The benefit of such debt is the peace enjoyed by the citizens.

(iii) Funded debts are debts which have interest attached to them but with no fixed date of repayment. The holder continues to receive interest on the face value until the debt is repaid at a time convenient to the taxpayer e.g. bonds with no definite repayment date.

(iv) Unfunded debts are debts with fixed maturity periods e.g. 10 years, 20 years etc.

(v) Floating debts are short term debts by government e.g. treasury bills and other advances by the central bank to the government.

202. Give any four ways in which an external public debt may be cleared.

- By borrowing from cheaper sources to pay off old debts.
- By seeking grants and donations from friendly countries.
- Asking for debt rescheduling.
- Seeking for debt relief.
- Requesting for debt cancellation/forgiveness.

203. (i) What is public debt management.

(ii) Mention three objectives of public debt management.

A. (i) Public debt management is the action of monetary authority to regulate the size and structure of out standing debts ie the type of debts, short term, long term etc.

Or

The ways and means of how the public debts are administrated ie how they are obtained, controlled, serviced and later repaid.

(ii) **Objectives of public debt management.**

- To influence prevailing rate of interest.
- To make investment attractive

- To mobilize external resources.
- To ensure that debts are serviced or repaid.

204. (i) What is meant by government budget?

(ii) State three objectives of a government budget.

A. (i) A budget is a statement of government revenue and expenditure estimates for a given period of time usually one year.

(ii) **Objectives of a government budget.**

- To maintain high level of employment.
- To achieve equitable distribution of income.
- To stimulate economic growth.
- To maintain price stability/control inflation.
- To maintain favourable BOP.
- To raise revenue for the government.
- To regulate government expenditure.
- To protect domestic infant industries.
- To stimulate investment.
- To lift the economy out of depression.

205. (i) Distinguish between a domestic debt and external debt.

(ii) Give two problems of an external debt.

A. (i) A domestic debt is the amount owned by the government to people and institutions with its own borders.

While

External debt is the amount owned by the government to external creditors.

(ii) **Problems of external debt.**

- May encourage extravagancy by government.
- Puts pressure on BOP position due to debt servicing.
- Shifts the burden of repayment to future generation.
- It encourages dependency on other governments and international institutions that lend.
- It leads to transfer of resources to a foreign country and this imposes burden to the whole society.
- Debt servicing limits capital accumulation.
- Availability of loans encourages government to use revenue on unproductive expenditure.

- Debt servicing leads to foregoing present consumption.

206. (i) What is meant by public revenue?

(ii) Give any three sources of public revenue.

A.(i) Public revenue refers to amount raised by governments from taxation and other sources to finance public expenditure.

(ii) **Sources of public revenue.**

- Taxation.
- Borrowing internally and externally.
- Market dues.
- Compulsory savings like insurance payment and social security funds.
- Grants and donations.
- Gifts.
- Fines on law breakers.
- Rent from government owned property.
- Profits of parastatals.
- Fees on government rendered services.
- Privatization/disinvestments.

207. (i) Distinguish between a balanced budget and deficit budget.

(ii) State any two ways of financing a deficit budget.

A. (i) A balanced budget is when the planned government expenditure is equal to the estimated revenue in a given period of time.

While

A deficit budget is when planned government expenditure is greater than the estimated revenue in a given period of time.

(ii) **Ways of financing a deficit budget.**

- Borrowing from the public through sale of goverment securities.
- Borrowing from external sources like IMF.
- Drawing from past savings.
- Sale of assets/privatization.
- Grants from the nations.
- Drawing from consolidated fund or reserve funds accumulated from past savings.

208. (i) What is a surplus budget.

(ii) Give any three reasons for a surplus budget.

A. (i) A surplus budget is a type of budget in which planned government expenditure in a given fiscal period usually one accounting year is less than the estimated government revenue .

(ii) **Reasons for surplus budget.**

- To reduce a boom in the economy.
- To reduce aggregate demand in the economy.
- To reduce inflation by withdrawing money from circulation.
- To raise money to finance projects/investments.
- To accumulated reserves for future needs.
- To raise money to pay accumulated public debts.

209. Give any four functions of a budget.

- Indicates the estimates of revenue from the various fiscal sources.
- Indicates estimates of recurrent and development expenditure of the government.
- Outlines the economic and social policies whose implementation requires government expenditure.
- Stabilizes the economy through fiscal tools.
- It regulates the government expenditure and programmes.

210. (i) Differentiate between fiscal policy and monetary policy.

(ii) Mention two instruments of fiscal policy in Uganda.

A. (i Fiscal policy is a deliberate policy under which government uses its expenditure and revenue (taxation) to regulate the level of economic activities.

While

Monetary policy refers to deliberate attempt by central bank to regulate the amounts of money in circulation. So as to attain the objectives of development such as price stability, sustained economic growth etc.

(ii) **Instruments of fiscal policy.**

- Taxation.
- Subsidization.
- Government expenditure.
- Public borrowing.
- Licensing.
- Fees.

- Fines.
- Debit repayment.