SOLUTIONS TO CERETA ECONOMICS SEMINAR QUESTIONS 2017

1. (a) (i) A laissez-faire economy refers to an economy where allocation of resources is done by the forces of demand and supply without government interference

OR

Its an economy where there is private ownership of resources by firms and households without government interference.

(ii) Two demerits of a laissez-faire economy:

- It leads to economic instabilities /inflation/deflation.
- Leads to emergence of monopoly with its negative effects.
- Leads to income and wealth inequalities.
- There is consumer exploitation due to consumer ignorance.
- Consumer choices are distorted by persuasive advertising.
- Divergence between social costs and private benefits /over utilization of resources.
- Inability to cope with rapid structural changes.
- Inability to allocate resources for public goods.
- It leads to unemployment.
- It leads to duplication/resource misallocation /unnecessary competition leading to resource wastage.

(b) (i) $P_o = 12{,}000/=$

$P_n = 15{,}000/=$

$\% \triangle Q = {}^{-}40\%$

$$PED = \frac{\% \triangle Q\ dd}{\% \triangle P}$$

$$= \frac{{}^{-}40\%}{\frac{15{,}000 - 12{,}000}{12{,}000} \times 100}$$

$$= \frac{{}^{-}40\%}{\frac{3{,}000}{12{,}000} \times 100}$$

$$= \frac{{}^{-}40\%}{25\%}$$

$= {}^{-}1.6 \times {}^{-}1 = 1.6$

$\therefore$ PED = 1.6

(ii) Rice has elastic demand/DD is price elastic /High Elasticity of demand.

(c) (i) An operating cost refers to a cost /expense of a firm that varies with the level of output.

WHILE

An over head cost is an expense met by a firm regardless of the level of output produced.

(ii) Two overhead costs in an economy.

- Salaries of the top management.
- Cost on depreciation of machinery
- Cost on rent.
- Interest on loans
- Cost of machinery
- Insurance premium.

(d) (i) Industrial inertia is the tendency of an industry to locate or continue serving in an area where other industries exist even when factors which led to location of the industries are no longer applicable or existing.

(ii) Benefits of industrial localisation

- Easy provision of social services.
- External economies of scale.
- Development of specialized /skilled labour.
- Promotes linkages.
- Increased employment.
- Increased government revenue.
- Development of commercial institutions.
- Leads to urbanization.
- Leads to economic growth.
- Promotes competition.
- Encourages market research.
- Reduce average costs of production.
- Optimum utilization of resources.

(e) SAPS of IMF that Uganda has implemented include:

- Privatization/ expanding the role of the private sector.
- Liberalization of trade and foreign exchange.
- Restructuring of the public service/demobilization of workers/soldiers.
- Reduction of government expenditure on non-essential services.
- Devaluation of the currency.
- Tightening monetary and credit policies.
- Restructuring of tax administration.

(f) (i) Balance of payments refers to the difference between a country's receipts /income from abroad and expenditure /payments abroad during a given period of time.

OR

It's a systematic record of a country's receipts /incomes and payments/ expenditure in international transactions in a given year.

OR

It's the difference between earnings /receipts from abroad and payments abroad (visible and invisible trade and net capital transfer) of a country during a given time.

WHILE

Balance of trade is the difference between the value of visible exports and the value of visible imports.

(ii) Measures being taken to improve on the BOP in Uganda.

- Processing products for export.
- Manufacturing products for export.
- Improving quality of exports.
- Diversifying export markets.
- Diversifying products for export.

(g) How an economist expresses the burden of a public.

(i) Comparing the debt to current national income i.e.

$$\frac{\text{Public debt}}{\text{Current NY}} \times 100$$

The larger the percentage, the heavier the debt burden and vice versa.

(ii) Relating the debt to government revenue i.e $\frac{\text{Public debt}}{\text{Public revenue}} \times 100$

The larger the percentage, the heavier the debt burden and vice versa.

(iii) Relating the debt to the population of the country i.e. $\frac{\text{Pubic debt}}{\text{Total population}} \times 100$

The smaller the percentage, the heavier the burden and vice versa.

(iv) Relating the debt to the foreign exchange i.e. $\frac{\text{Public debt}}{\text{Foreign exchanges}} \times 100$

The smaller the percentage the heavier the burden and vice versa.

(v) The burden can be expressed in terms of interest payable.

$$\frac{\text{Public debt}}{\text{Total interest Payable}} \times 100$$

The higher the interest rate, the greater the burden and vice versa.

(vi) The debt burden can also be expressed in terms of repayment period. i.e.

$$\frac{\text{Public debt}}{\text{Repayment Period}} \times 100$$

The longer the repayment period, the higher the burden and vice versa.

(h) (i) Mild inflation is a type of inflation where prices are rising slowly but steadily and the percentage increase in the general price level is a one digit figure usually less than 10% per year.

WHEREAS

Hyper inflation is a type of inflation in which prices are rising at a very fast rate /rapidly and usually exceeding 10% per year.

(ii) Effects of mild inflation.

- Leads to increased incentives to hard work.
- Encourages optimal utilization of resources.
- Increases production and economic growth.
- Debtors/borrowers gain in real terms.
- Increases employment levels due to increased investment.
- Increases government revenue.
- It promotes savings.
- It encourages labour mobility.
- Promotes entrepreneurship as many people are encouraged to risk in business ventures.
- Helps an economy recover from a depression.
- Commercialization is encouraged in the economy.

(i) Features of Rowstow's drive to maturity stage:

- High levels of investment between 15 – 20% of GDP.
- High levels of industrialization.
- Use of highly skilled labour.
- Increased /high employment opportunities.
- High levels of infrastructural development.
- High levels of urbanization.
- High levels of monetization.
- High levels of saving between 15-20% of GDP.
- Existence of bureaucracy.
- High levels of technology.

(j) (i) Decentralized planning is one where economic decision making and implementation of plans in line with set targets is undertaken by local government authority instead of the central government i.e. Execution of plans from the grass roots.

(ii) Reasons why countries undertake decentralized planning.

- To ensure efficient use of local resources.
- To provide employment to the people of the region.
- To ensure efficient tax collection.
- To ensure regional development.
- To cater for the local interests and priorities of people.
- To encourage public commitment and support.
- To control rural-urban migration.
- To ensure equitable distribution of income.
- To reduce bureaucracy in planning.

(k) Features of economic development in Uganda.

- Reduced economic dependence.
- Political stability.
- Infrastructural development.
- Reduced level of illiteracy/increased literacy levels.
- Improved technology.
- Reduced cultural rigidities/social transformation.
- Expansion of the manufacturing sector.
- Expansion of monetary production / reduction in the subsistence sector.
- Creation of more employment opportunities.
- Low mortality rates.

(l) (i) Aggregate demand is the total demand for goods and services in an economy at a given period of time.

OR

Total amount of expenditure on goods and services by all sectors in an economy.

(**ii**) **Any three components of Aggregate demand in an open economy.**

- Consumption expenditure.
- Investment expenditure.
- Government spending on goods and services.
- Net foreign expenditure.

(m) (i) Foreign exchange rate control refers to where the stake/monetary authority regulates the rate at which the local currency exchanges for foreign currencies.

(ii) Any three objectives of foreign exchange rate control.

- To correct unfavourable B.O.P.
- To stabilize exchange rate/depreciation /Appreciation.
- To achieve price stability /control inflation.
- To encourage investment.
- To protect domestic industries.
- To control the importation and consumption of undesirable goods.
- To raise revenue for government.
- To encourage long term planning.
- To discourage speculation in forex market.
- To acquire foreign exchange for servicing the country's external debt.
- To ensure availability of foreign exchange to facilitate trade.
- To check capital flight /control capital outflow.

(n) (i) The law of comparative cost advantage states that given two countries and two commodities with a given amount of resources, one country can produce one commodity more cheaply/at a least opportunity cost than the other country.

OR

Given two countries and two commodities with a given amount of resources, a country should specialize in producing a commodity where it has the least opportunity cost than the other.

(ii) Assumptions of the law of comparative cost advantage.

- Assumes two countries.
- Assumes two commodities.
- Assumes constant technology.
- Assumes barter trade system exists.
- Assures absence of trade restriction /protectionism/existence of free trade.
- Perfect mobility of factors internally and immobility externally.
- Assumes no transport costs.
- Demand is elastic.
- Constant comparative advantage in both countries /opportunity cost ratio.
- Constant returns to scale/No diminishing returns.
- Homogeneity of factors of production.
- Full employment of resources in both countries.
- Tastes are similar in both countries.

2. (a) The role of price mechanism

- It ensures effective allocation of resources.
- It guides on what to produce.
- It provides an incentive for economic growth in cases where high prices encourage high production.
- It provides an automatic adjustment between demand and supply /how much to produce.
- It determines the type of technology to be used in production /how to produce.
- Ensures production of better quality products because of competition.
- Determines income distribution.
- It guides consumers when making choice.
- It determines where to produce /location of production unit.
- Determines when to produce i.e. when demand is high.
- Determines the distribution of goods and services i.e. for whom to produce.

(b) Implications of price mechanism

Positive implications

- It leads to increased employment opportunities.
- Encourages arbitrage which benefits producers.
- It encourages competition which leads to production of better quality goods and services.
- It promotes incentive for hard work leading to increased production.
- It reduces the costs of administration because of limited government control.
- It avails a wide variety of goods and services.

- It decentralizes economic powers i.e. individual households make their own decisions/consumer sovereignty.
- The profit motive encourages research, inventions and innovations.
- It leads to efficient allocation of resources and utilization of resources.

Negative implications

- It leads to consumer exploitation due to consumer ignorance /market imperfections.
- It leads to distortion of consumer choices through advertising.
- It leads to monopoly power where consumer's preference may be ignored.
- It leads to divergence between private and social benefits e.g. over exploitation of resources.
- It does not adjust quickly to structural changes.
- It fails to allocate resources in priority areas/ignores socially profitable ventures/disappearance of cheap goods.
- It leads to economic instabilities i.e. inflationary and deflationary tendencies /price fluctuations.
- It leads to wastage of resources due to wasteful competition – duplication of activities.
- Unemployment problem arises where inefficient firms are out competed.
- It leads to income/wealth inequality.

3. (a) Disposable income is the income available to individuals and households for spending or saving after personal income taxes and other compulsory payments have been deducted.

WHEREAS

Income per capita is income per person/head or average income of the population in the country in a given period of time.

(b) Limitations of using per capita income to compare standards of living between countries.

- It does not take into account differences in the nature of income distribution between countries.
- It ignores differences in the nature of government expenditure between countries.
- It ignores differences in the amount of leisure enjoyed between countries / working conditions.
- It does not take into consideration differences in the size of substance sector between countries.
- It ignores differences in requirements between countries due to climate differences.
- It ignores differences in tastes and preferences between countries.
- It does not consider differences in the quality of goods produced between countries.
- It does not consider differences in the nature/type of goods produced between countries. i.e. capital goods or consumer goods.
- Does not consider differences in price structures/levels/ rate of inflation between countries.
- It does not consider differences in the levels of employment between countries.
- It ignores differences in the level of taxation between countries.

- It ignores differences in political climate between countries.
- It does not consider differences in boundary of production and methods of compiling national income between countries.
- It does not put into account differences in the level of accuracy in data collection between countries.
- It does not consider differences in transport costs /costs of production between countries.
- It ignores differences in social costs between countries.

4. (a) The Role of Agriculture in the development of Uganda.

- It provides employment opportunities to the people.
- It ensures equitable income distribution since it is basically labour intensive.
- It supplies labour to other sectors of the economy.
- It provides revenue to government through taxation.
- It provides market to the industrial sector.
- Contributes towards the Gross Domestic product (GDP) of the country /promotes Resource utilization.
- It generates foreign exchange to the country.
- It supplies raw materials to the industrial sector.
- Encourage rapid development of infrastructure.
- Promotes balanced regional development.
- It is a source of food for the people.

(b) Measures to improve the Agricultural Sector in Uganda

- Land reform policies to make land more accessible.
- Provision of credit facilities to farmers to increase their capacity to exploit land.
- Carrying out research in all fields /new farming methods.
- Provision of extension service to farmers.
- Putting emphasis on Agricultural diversification.
- Mechanization of the Agricultural sector /introduction of new technology.
- Improvement of infrastructure.
- Industrialization within Agriculture.
- Development and /or revival of co-operatives.
- Provision of inputs to farmers / subsidization to farmers.
- Training of labour.
- Ensuring political stability.
- Market expansion e.g. through Regional Integration.
- Improving pricing policies e.g. through strengthening commodity agreements.

N.B: Suggestive answers e.g. should, can, may.

5. (a) Excess capacity of a firm is production below the optimum level
WHILE
Break-even point of a firm is a point where a firm is neither getting super normal profits nor incurring losses/earning normal profits i.e. where AR = AC.

(b) Why a firm may continue producing even if it is incurring losses.

- If it is a beginner firm in it's early stages of growth.
- If the firm in the short run can cover the vital costs, it can cover the fixed costs later
- The high costs experienced by a firm may be of seasonal nature.
- If the goal of a firm is not profit maximization.
- The firm may be a branch of an industry that is making profits as a whole so the losses made are compensated by the profits of the sister firms.
- The firm may be a state owned and offering essential services to the public.
- It may be a research unit firm that can continue operating even if it is incurring losses.
- Fear of losing contracts when a firm closes may force it continue operating even if it is incurring losses.
- Fear of the high costs of depreciation of fixed capital while re-opening (inability to sell fixed assets).
- Fear of losing skilled labour when a firm closes.
- Fear of loss of markets /good will.
- If a firm has prospects of securing a loan to help it cover its costs of production.
- If the firm hopes to change the management especially if it has been having poor management.
- It may be choice of the investor/owner.
- The MR may be greater than MC.
- Fear of loss of suppliers of raw materials when a firm closes.

6. (a) How price indices are computed.

- Select a suitable base year reflecting normal economic conditions.
- Select a basket of commodities to be considered.
- Collect prices of commodities in the base and current years.
- Compile a simple price index.
- Attach weights to the commodities.
- Calculate the weighted price index.
- Calculate average weighted index.

ILLUSTRATION

Commodity	**Weights**	**Base year price**	**Base year Index**	**Current year Price**	**Current year Index**	**Weighted price Index**
A	2	100	100	130	130	260
B	4	230	100	300	130.4	521.6
C	3	200	100	360	180	540

$$\text{Average weighted index} = \frac{260 + 521.6 + 540}{2 + 4 + 3}$$

$$= \frac{1321.6}{9} = \mathbf{146.84}$$

(**b) Why price indices may be unreliable indictors of costs of living.**

- Only few commodities may be considered.
- Prices may not be representative and are usually under estimated.
- Limited information or data.
- Appearance and disappearance of products from the market.
- Changes in tastes and preferences.
- Commodities in the basket may go out of fashion.
- Price levels may change due to other factors and not inflation e.g improved quality.
- It is difficult to have valid weights as spending patterns and tastes vary between societies.
- Quantities in the societies that use barter may be arbitrary so no standard.
- There are no standardized prices throughout the country.
- Areas are usually sampled and the whole country is not covered.
- Difficulty of getting a suitable base year.

7. (a) Trade unions are worker's associations instituted to safeguard the welfare interests of the members (workers). They are formed with the main aim of bargaining for higher wages and better working conditions for the trade union members.

   (b) Normally a trade union will be justified to demand for higher wages under the following conditions:

   - When the employer is earning abnormal profits and the workers feel cheated.
   - Where wages form only a small fraction of the total production cost.
   - If the demand for the finished products of the firm is price inelastic.
   - If the employer frequently promises to increase wages but has never done so.
   - When the cost of living has considerably increased due to inflation.
   - If the productivity of the workers is high or has increased, which could make the employer willing to increase workers' wages.
   - If there has been increased work load /hours of work.
   - If workers are being paid a wage less than the wages of other workers in other firms especially of the same industry.
   - If the current wage is less than the minimum wage legalized by the government.
   - If the level of unemployment in the industry or country is limited.
   - If trade unions are free to strike without any law forbidding such action.
   - If the work being done is risky to employees.
   - If workers have acquired additional skills/qualifications.

8. (a) Economic growth is the persistent quantitative increase in the volume of goods and services produced in an economy over time. It involves an increase in the productive capacity of the economy resulting from efficiency or increase in resources.

   WHILE

   Economics development is a multi-dimensional process involving a quantitative increase in the volume of goods and services produced in the economy accompanied by structural transformation and improvement in welfare of society. It is a quantitative and qualitative increase in goods and services produced in the economy.

(b) Factors necessary for enhancing growth of an economy.

- The stock of capital and rate of capital accumulation channeled towards productive investments increases output levels hence growth.
- Abundance of natural resources and the high level of their exploitation boosts productive capacity of the economy and accelerates economic growth.
- High level of science and technology promotes efficiency in production hence increased economic growth.
- Big population and a faster rate of growth boosts labour force and if backed by increased output. Similarly, a big population expands the domestic market if its purchasing power is high.
- High level of skills for available manpower also implies labour efficiency which can cause or enhance economic growth.
- Availability of social and economic infrastructure like schools, hospitals and transport infrastructure enhances growth in the economy.
- Political stability and existence of a sound democratic political system increases domestic investment and enhances economic growth.
- Good socio-cultural influences which improve peoples attitudes towards work increases productive capacity of the economy.
- Favourable government policies e.g. fair taxation, subsidization etc. encourage foreign and domestic investors which enhances growth.
- A large market size facilitates large scale production, thereby enhancing growth.
- Stable macro-economic environment such as low inflation rate etc.
- High level of capital inflow also enhances growth.
- Existence of many entrepreneurs who can spear head productive activities in the economy.

9. (a) The quantity theory of money states that the general price level is determined by the quantity of money assuming
that the velocity of circulations (V) and the level of Transaction (T) are constant.
Its expressed by Irving fisher's equation of MV = PT **OR** $P = \frac{MV}{T}$

Where

M = Quantity of money
V = Velocity of circulation.
P = General Price level
T = Level of transactions

OR

The Quantity theory of money is a theory predicting that the price level and the quantity of money vary in direct proportion to each other.

$P \propto M$

OR $P = kM$

Where P is the general price level
M is the quantity of money
K Is a constant.

(b) Limitations of the quantity Theory of money

- Only attempts to explain changes in value of money but not how the value of money is determined.
- There is no general price levels but rather a series of price levels.
- Ignores the influence of the rate of interest.
- Does not take into account the demand for money (only looks at money supply).
- An increase in money supply may result into higher savings if the MPS is high, this reduces the velocity of circulation and prices may fall.
- If a country has many unemployed resources, the increase in money supply leads to increase in out put of goods and services which makes prices fall or not change at all.
- Haggling between buyers and sellers to reach an agreeable price is not taken into account.
- Government control of prices is not covered by the theory.
- Does not take into account other causes of price increases/inflation e.g. cost push, demand pull etc.
- Just a truism –merely shows that M,V,P and T are related.
- Ignores barter trade.
- Considers only the transactions motive for holding money and ignores the precautionary and speculative motives.
- The four variables M, V, P and T are not independent of one another because a change in one induces in others.
- The theory assumes that velocity of circulation (V) and the level of transactions (T) are constant and this is not the case in real life.

10. (a) Fiscal policy is a deliberate policy under which government uses its expenditure and Revenue (Taxation) programmes to regulate the level of economic activities.

(b) Objectives of the Fiscal Policy

- To increase the rate of economic growth through influencing production levels
- To improve balance of payments/balance of trade position by discouraging imports and promoting exports.
- To protect infant/domestic industries by use of import duties.
- To reduce income inequality by taxing the rich and subsidizing the poor.
- To achieve balanced regional development by taxing already developed areas.
- To create more employment opportunities through promotion of investment /subsidization of products.
- To discourage consumption of demerit goods through high taxation.
- To ensure price stability through increased taxation and reduced government expenditure.
- To influence investment levels through tax relief.

- To achieve desirable political objectives e.g. through tax reduction, relief/exemption.
- To improve incomes and quality of life of the population by increasing government expenditure on social services.
- To raise government revenue through taxation.
- To control monopoly through taxation / subsidization of other firms.
- To influence resources allocation through tax holdings /relief.

11. (a) The Structure of industry in Uganda

- Small but growing gradually.
- The sector is dominated by Agro-processing industries such as sugar cane refineries, milk processing, soft drinks processing etc.
- The contribution of the sector to national income, tax revenue, employment and foreign exchange earnings is small.
- Most industries are small scale while others are medium scale and a few large scale industries.
- Indigenous Ugandans own mainly small scale industries while foreigners own medium and large scale industries. A few industries are owned by the government.
- The industries are un evenly distributed, mainly concentrated in urban areas and in certain regions.
- Uganda's industries are largely labour intensive and very few employing capital intensive techniques of production.
- Industries produce at excess capacity due to shortage of raw materials, spare parts and skilled man power.
- Raw materials are majorly imported especially for the non-agricultural processing industries.
- Industrial location is determined by power, market and accessibility as the main factors.
- Mining industry is limited by presence of few mineral deposits of economic importance.
- Power producing industry is dependent majorly on hydro-electricity.

(b) Factors affecting the development of the industrial sector in Uganda.

- Inadequate capital due to limited foreign exchange earning makes it difficult for development of industrial sector.
- Shortage of skilled manpower to manage and run industrial plants.
- Small market size which does not promote increased industrial output.
- Poor quality products from the industrial sector which affect terms of trade.
- Political instability in the country has negatively affected industrial development.
- Shortage of raw materials for some industries cause excess capacity, limiting development of the industrial sector.
- Poor transport and communication infrastructure makes it difficult to transport raw materials to plants and finished products to the markets.
- Entrepreneurship and management skills are lacking in the country which slows down the pace of industrial development.
- The problem of insufficient power supply in some places limits development of industry.
- Absence of easy credit on favourable terms for industrial development.

- Land shortage in some places especially urban areas does have an effect on industrial development.
- Unfair government policies of high taxes and limited subsidization to investors in industrial sector.
- Competition from high quality imported products limits market for products from local industries.

12. (a) Causes of open-urban unemployment in Uganda.

- Rural –urban migration which causes excessive strain on available job opportunities in town.
- High population growth rate which has over taken the rate at which urban job opportunities grow.
- Low level of industrial development such that not many people in the urban areas can get employment in industries.
- Privatization of public enterprises has left many without jobs.
- Retrenchment of civil servants and demobilization of soldiers has worsened open-urban unemployment.
- The use of capital intensive methods of production in urban establishments leads to laying off of some workers thereby causing open – urban unemployment.
- Theoretical and non-practical education acquired by some members of the urban population renders them in appropriate for available job opportunities.
- Low level of education and lack of skills required for particular activities in the urban areas.
- Seasonality of activities e.g. causal employment contracts in urban areas.
- Shortage of land in urban areas to enables the creation of more investments in industries leaves many people without jobs in urban centres.
- Physical and mental disabilities due to poor health care are also responsible for unemployment in urban areas.
- Poor manpower planning in the urban areas by government.
- Localization of industries and concentration of other economic activities in urban areas which forces people to move to urban areas hence open urban unemployment.

(b) Steps that can be taken to minimize open –urban unemployment.

- Policies bridging the gap between rural areas and urban areas may be formulated to reduce rural urban migration. i.e. integrated rural development.
- The policy of “go back” to the land can also be applied to force urban unemployed to go and till the land in rural areas.
- Provision of credit facilities to the unemployed to start income generating activities may also be useful in that direction.
- Promoting technical and vocational training in urban areas to equip people with basic skills so as to become job creators other than being job seekers.
- Creating small scale industries and encouraging development of other industries in urban areas.

- Controlling population both in the rural and urban areas is also vital and may go along way to reduce open urban unemployment.
- Encourage rural to rural migration as a policy may also reduce open-urban unemployment.
- Land reform policies especially in rural areas should be adopted to reduce crowding of population in towns.
- Rural-urban migration and open urban employment may be minimized by heavily taxing urban dwellers compared to rural dwellers to force the former who are unemployed to seek employment in rural areas.
- Changing the current school curriculum with a view to producing job makers and not job seekers.
- Providing a conducive investment climate to attract domestics and foreign investors so that more employment opportunities may be created.
- Proper man power planning to ensure that the demand for labour equates the supply for labour in urban areas.
- In service training and refresher courses and workshops may be organized for workers on a regular basis to update their skills.
- Subsidization of industries using labour intensive technology to enable them take on more people for employment.
- Diversification of labour skills to deal with issues of seasonality of employment in urban areas.

N.B: Suggestive answers by using words like may, can, should etc.

13. (a) An inflationary spiral is an inflationary situation in which one type of inflation sparks off another type of inflation. Thus it is a type of inflation which is initiated by a different type of inflation.

(b) To a small extent inflation in Uganda has been as a result of increased costs of production in the following ways:

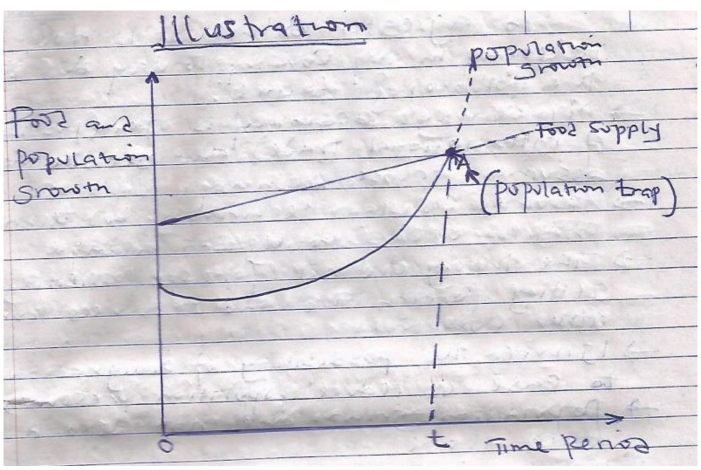
- Increase in prices of petroleum products (oil) increases transport and production costs which causes inflation.
- Increase in the price of raw materials has increased the cost of production hence inflation.
- Poor transport infrastructure has also increased production costs there by causing price hikes in the economy.
- Shortage of skilled technical personnel and employment of expatriates increases production costs and inflation.

- **However to a great extent, inflation in Uganda is a result of a variety of other factors, namely:**
- Printing of more money which increases money supply and causes inflation.
- Importation of many luxurious commodities whose prices keep rising.
- Shortage of entrepreneurs to under take investment for increased out put.
- Natural factors like prolonged droughts, weather hazards and pests and diseases cause shortage especially of food stuffs resulting into inflation.

- Announcement effect of increase in salaries and prices of agricultural products.
- Lack of well developed financial markets and low interest rate discourages saving and increases money hoarding in the economy
- Foreign capital inflow in the form of loans grants, tourist earnings etc increase money supply and some times causes inflation.
- Financing of government budget deficit increases liquidity injections in the economy, hence causing inflation.
- Political instability which majorly causes breakdown in production though this situation of recent has improved in Uganda.
- Shortage of foreign exchange in the country to import capital for increased domestic output.
- Poor investment climate accompanied by high taxation and limited subsidization by government leads to scarcity of commodities hence inflation.
- Numerous public holidays in the country which prompt excessive domestic expenditure cause inflation.

14. (a) Malthusian population theory says that where as population grows at geometric Rate, food production tended to grow at an arithmetic rate.
Malthus said that due to the above, population growth after a time would outstrip food production. (Population trap) and after such a time, there was a need to control the population through negative checks like moral restraint, celibacy etc otherwise positive checks like pestilence, wars, disease, famine etc would serve to reduce population growth, then population would equal food supply.

Illustration



(b) The theory to a lesser extent is applicable or relevant to my country in that:
- Land is fixed in supply and subject to the law of diminishing returns, this situation is experienced as Malthus envisaged.
- Natural family planning methods /control measures e.g. celibacy are his initiation.
- Positive checks (wars famine, epidemics etc) on population exist in Uganda today.

- Land problems /disputes are common in Uganda today.
- Some areas in Uganda face food shortages e.g. Teso, Northern Uganda and some districts in the West like Isingiro etc

To a greater extent, it is not relevant in my country today due to the following factors.

- My country's economy is open (possibility of international trade) and yet the theory assumes a closed economy.
- Assumes constant technology but technology progress occurs in Uganda today.
- The theory did not foresee possibility of getting foreign aid and resources from other countries.
- Ignored the possibility of emigrations to ease or reduce population pressure.
- Population growth does not depend on food a lone.
- Did not foresee labour mobility to ease pressure on land.
- Did not realize that rising living standards can cause a fall in birth rates and population.
- Assumed a subsistence economy but my countries' economy is going out of subsistence.
- Agricultural modernization is not foreseen by the theory/diminishing returns in Agriculture not wholly true.
- Did not foresee great improvement in transport.
- Ignored the deliberate and scientific methods of birth/population control/modern family planning methods.
- There is no mathematical relation as regards growth in food and population.

15. (a) Economic planning is the conscious government effort to influence, direct and control major economic variables to achieve predetermined objectives in a given time.

OR

It is the deliberate effort by the government to formulate decisions on how productive resources shall be allocated among different sectors of the economy in order to achieve certain objectives in a given time.

(b) Pre-requisites for effective planning in my country.

- Availability of skilled labour.
- Adequate statistical data.
- Availability of resources.
- Efficient and effective administration.
- Separate planning machinery/unit.
- Good objectives.
- Targets and priorities.
- Plan coordination.
- Support of the people.
- Political stability in the country.
- Political will among the citizens.

16. (a) Process of credit creation in Uganda:

- Receiving an initial deposit by the first bank from a customer e.g. shs. 10,000/=.
- Retaining part o the initial deposit as a cash ratio e.g. 10% of shs. 10,000/=.
- The commercial bank lends out the excess funds/remainder to a customer e.g. shs. 9,000/= (another bank say bank B).
- Bank B accepting shs. 9000/= as its new deposits retains 10% of that amount as its cash ratio (shs. 900).
- The remainder is lent out to a customer or another new bank say bank C shs. 8,100/=
- The process continues until the initial deposit diffuses in the system.
- Total credit created is a calculated using the formula.

Credit multiplier X initial deposit

$$= \frac{1}{\text{Cash ratio}} \times \text{initial deposit}$$

$$\frac{1}{10\%} \times 10000$$

(b) Factors that limit commercial bank's ability to create credit in Uganda.

- High cash ratio.
- High interest rate on loans.
- Small size of bank deposits /limited funds to lend.
- Restrictive monetary policy by the central bank or bank of Uganda.
- High level of liquidity preference among the population.
- Poor distribution of commercial banks /poor banking system i.e. mainly in urban areas.
- Limited number of credit worthy customers / low level of demand for loans.
- High level of corruption/low degree of accountability in commercial banks.
- Political instability in some parts of the country although this state of affair has improved in Uganda.
- Absence of collateral security by many customers.
- Low level of monetization of the economy/big subsistence sector.

(c)(i) Non-Banking financial institutions are those that receive deposits, given out long term loans but do not create credit /new deposits.

(ii) The role of commercial banks in the development of my country:

- Helping to implement monetary policy.
- Investing directly in economic productivities.
- Keeping safely customers' deposits.
- Providing employment opportunities to people.
- Provision of government revenue through taxation.
- Developing social and economic infrastructure like buildings.
- Providing loans for investment.
- Assisting potential investors by giving them advice on trade.
- Mobilizing savings from surplus spending units.
- Contributing to investment capital by purchasing shares.

- Assisting in international trade by providing letters of credit, discounting bills, acting as referees etc to traders.
- Providing diversified and specialized services that are necessary for development e.g. acting as trustees, having strong rooms for the safety of valuable documents of customers etc.
- Helping to monetize the economy hence leading to reduction of the subsistence sector.
- Helping to increase the inflow of foreign exchange in the country.
- Mobilizing savings and hence increasing the level of investment and rate of capital accumulation in the country.
- Foreign commercial banks in the economy are improving on the international relations with other countries.
- Playing a big role in rural development and modernization of agriculture.
- Urbanization has been faster because of the existence and establishment of commercial banks in the economy.
- Commercial banks normally embark on recruitment and training of local man power hence manpower development in the economy is achieved.
- Increasing industrialization in the economy by providing credit facilities to industrialists.

17. (a) A balanced budget is a financial plan /document where estimated government revenue is equal to the estimated government expenditure for a given financial year.

WHILE

Unbalanced budget is a financial plan/document where estimated government revenue is not equal to estimated government expenditure for a given financial year. This may be a deficit or a surplus budget.

(b) Role of the national budget in the development of my country:

- Creation of employment opportunities hence reducing the unemployment problem.
- Stabilization of prices /reduction of inflation through progressive taxation.
- Promotes economic growth.
- Reduction in income inequality through progressive taxation.
- Increases government revenue through tax and non tax sources.
- Promotion of investment by providing investment incentives e.g. lower taxes.
- Promotion of infant domestic industries by imposing heavy import duties.
- Correction of balance of payment deficit.
- Discouraging consumption of demerit goods by imposing heavy taxes on such goods.
- Mobilization of foreign resources through borrowing and soliciting for grants.
- Allocates resources to priority areas by providing incentives such as lower taxes in such areas.
- Correcting tool during both inflationary and recessionary periods.
- Making essential commodities available and affordable.

(c) Why government may deliberately plan for unbalanced budget:

(i) reasons for a deliberate surplus budget:

- Reduce a boom.
- To reduce aggregate demand that may lead to inflation.
- To reduce inflation by withdrawing money from circulation.
- To finance development projects.
- To accumulate reserves for future use.
- To finance government debts.
- To maintain a favorable balance of payments.

(ii) Reasons for a deliberate deficit budget:

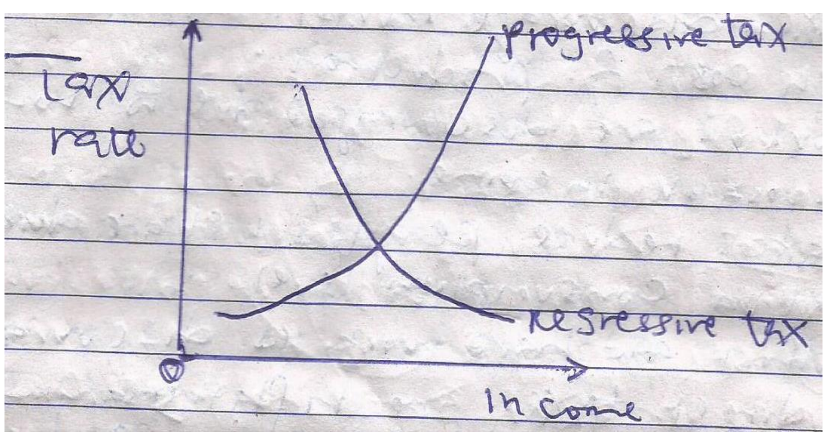
- To raise aggregate demand and stimulate the economy.
- To revive the economy by closing the deflationary gap.
- To increase people's disposable incomes in order to raise consumption expenditure.
- To win political support through reduction of tax levels.
- To reduce on the tax burden.
- To protect infant industries from foreign competition by offering them subsidies.
- To maintain high level of employment in the economy.

18 (a) A progressive tax is a compulsory levy to an individual or business firm by government whose tax rate increases as the income increases

WHILE

A regressive tax is a compulsory levy to an individual or business firm by government whose rate falls as the income increases.

Illustration



(b) Positive impact of taxation:

- Increases government revenue for servicing it's expenditures on development programmes.
- Promotes hard work especially indirect taxes.
- Improves income distribution hence reducing income and wealth inequalities especially the progressive tax system.
- Corrects balance of payment problem.
- Influences the allocation o resources in the economy.
- Promotes the development of domestic infant industries.
- Discourages consumption and production of undesirable goods.
- Controls demand pull inflation.
- Facilitates economic growth by ensuring stability of prices.
- Regulates monopoly power and it's negative effects by taxing monopolies heavily.
- Encourage forced savings with high taxation; people are forced to reduce their consumption.

Negative impact of taxation

- Taxes discourage investment due to high cost of production.
- Savings are discouraged due to low disposable income.
- Taxes reduce people's welfare due to fall in consumption levels.
- Effort and hard work is discouraged.
- Indirect taxes are inflationary.
- Promote wastage /diversion of resources.
- Taxes make the ruling government unpopular/create resentment among the people.
- Illegal activities such as smuggling are encouraged in order to avoid paying high taxes.
- Taxes reduce volume and benefits of trade.
- Regressive taxes (indirect taxes\ widen the gap between the rich and the poor.
- Discourage expansion/growth of industries or discourage investment by reducing the profits of companies.

19. (a) Devaluation refers to the legal reduction in the exchange value of the currency of a given country in relation to the value of other currencies.

WHILE

Currency depreciation is where the currency of a given country loses its exchange value in relation to other currencies in the money market.

(b) Why devaluation may fail to achieve the objectives intended for in the economy.

- The demand of exports may be price inelastic.
- The supply of exports may be inelastic.
- There may be existence of competitive devaluation.
- People in the devaluing country may have high marginal propensity to import.
- The exports of the devaluing country may be of poor quality and cannot compete on world markets.

- A country devaluing may be affected by inflation and cannot increase out put.
- Demand for imports in devaluing country may be price inelastic.
- The country's exports although now cheaper may be still at higher prices in other countries.
- There may be trade barriers between trading partners.
- There may be no efficient surplus disposal machinery e.g. infrastructure in the devaluing country.
- There may be corruption or no strong administrative machinery to co-ordinate and implement the devaluation policy in the devaluing country.

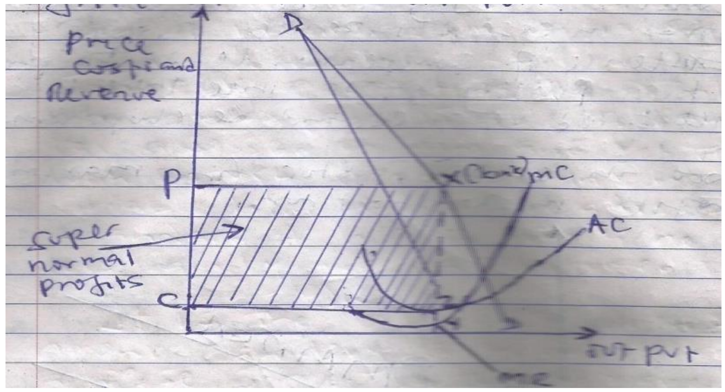
20. (a) (i) Features of an oligopolistic market structure:

- Few firms in the industry and many buyers.
- Homogenous products in perfect oligopoly and differentiated products in imperfect oligopoly.
- Restricted entry of new firms.
- Largest firm is the price leader.
- Mutual dependence or collusion of firms.
- Price maker since he has control over the market.
- Non price competition e.g. persuasive advertising, after sales services.
- Kinked demand cure because of price rigidities.
- Existence of cut throat competition or price wars.
- Characterized by uncertainty i.e. when one firm reduces its price, it will not be aware of the reactions of other firms.
- Firms are of different sizes. Some are small and others are larger.
- Firms aim at maximizing profits.

(ii) Advantages of an oligopolistic market to the consumers.

- Existence of competition leads to provision of efficient services to consumers.
- Provision of gifts or prizes to consumers like petroleum firms providing soap, books etc.
- Stable prices are changed.
- Consumers enjoy a wide variety of goods in case of imperfect oligopoly.
- Existence of competition leads to production of high quality goods since there is intensified research and development.

(b) How an oligopolistic firm maximizes profits in the short run.



A firm will maximize profits at point Y where MC = MR.
The firms earns <u>super normal profits = CPXZ</u>.
The MC and AC curves pass through the disjointed part of the MR curve.

(c) Forms of non price competition used by oligopoly firms in Uganda.

- Promotional offers.
- Provision of gifts /prizes.
- Provision of after sales services.
- Persuasive advertisement.
- Use of appealing brand names.
- Provision of credit facilities.
- Organizing trade fares and exhibitions.
- Delivery services offered free of charge.
- Product differentiation i.e. adjustment in style and quality.
- Sponsorship of sports events e.g. coca cola, MTN, Nile breweries etc.
- Proper parking spaces and other additional services like wash rooms to customers, mini-supermarkets etc.

21. (a) Objectives of the monetary policy in an economy:

- Ensuring price stability.
- Influencing B.O.P position.
- Ensuring stability of exchange rates.
- Influencing the levels and nature of investment.
- Encouraging growth of the financial sector.
- Influencing levels of economic growth rates.
- Influencing employment.

(b) Factors that limit the effective implementation of the monetary policy in Uganda are:

- Ignorance of the open market operation.
- Excess liquidity in banks.
- High liquidity preferences among the population.

- Large subsistence sector.
- Dominance of foreign commercial banks.
- Corruption.
- Political interference.
- Poor distribution of commercial banks.
- Under developed money markets.
- Conflicting government objectives.
- Limited effective use of commercial banks due to limited collateral security, existence of alternative sources of finance, poverty etc.

22. (a) Tax base is an economic entity on which a tax is levied. This base can be income, item or property.

WHILE

Taxable capacity is the extent to which a tax payer is able to pay the tax assessed on him and yet remain with enough disposable income to enable him or her live a descent standard of life to which he and his family are accustomed to.

OR

It is the extent to which government can levy taxes without causing adverse effects on the tax payer.

OR

The extent to which a nation can raise revenue from taxes without hindering the level of economic activities

(b) Advantages of relying on indirect taxes.

- They are comprehensive and therefore are more reliable source of government revenue.
- They are convenient because they are paid-when spending occurs.
- They act as a powerful tool of economic policies in that they can be used to protect home industries hence increasing employment opportunities.
- They help to check on consumption of harmful goods like cigarettes, alcohol etc.
- They are less felt and resented thus limiting conflicts between the tax payers and tax collectors.
- They are impartial i.e. they don't discriminate. All have to pay the same rate of tax.
- They are difficult to evade and avoid because payment is done before receiving the goods and services.
- They are more economical in collection since they are included in the price of goods and services.
- They are not a disincentive to effort and initiative so they encourage production.
- When selectively imposed they help in income re-distribution i.e. reduce income inequality.
- They are a source of government revenue for development purposes.
- They are used to correct balance of payments deficit.
- They are flexible i.e. the rate can be adjusted easily.

(c) Ways of improving tax collection in Uganda.

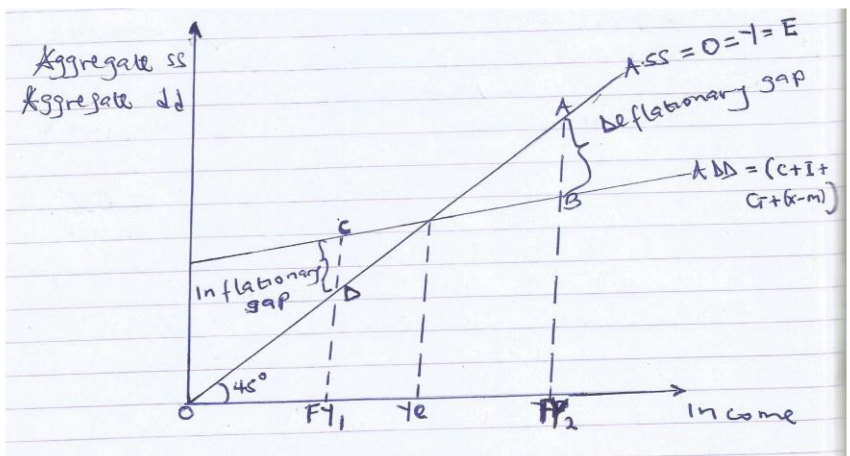
- Reduce or eliminate corruption.
- Sensitize the masses on role of taxation.
- Develop a tax payer friendly system of collection.
- Adopt principle of equity or fair assessment.
- Building up infrastructure to encourage economic activities.
- Training personnel to assess and collect taxes.
- Improve on implementation of the tax laws so as to avoid tax evasion and avoidance.
- Ensuring political stability.
- Widening the tax base by introducing new taxes.
- Proper and effective use of taxes. s

23. (a) A deflationary gap is where aggregate supply is greater than aggregate demand at full employment level of income. (It's also known as a positive out put gap).

WHILE

An inflationary gap is where aggregate demand exceeds aggregate supply at full employment level of income. (also known as negative out put gap).

ILLUSTRATION



(b) (i) Policies that should be adopted to close the deflationary gap:

- Fiscal policy, by reducing on taxes so as to increase consumption expenditure and investment in an economy.
- Government policy of increasing it's expenditure on social services and subsidizing those who can not afford.
- Income policy, by increasing salaries and wages of workers so as to increase their purchasing power.
- Trade policy, by discouraging importation of goods and services to enable people buy the domestically produced goods.
- Expansionary monetary policy, government through the central bank can under take this policy to increase the amount of money in circulation so as to achieve certain objectives e.g. reducing bank rate, buying securities from the public etc.

- Trade policy of increasing exports so as to increase earnings in the economy thus raising purchasing power and consumption level in the economy.
- Investment policy, by removing investment incentives from both local and foreign investors so as to reduce local production.

(ii) Policies that should be adopted to close the inflationary gap.

- Fiscal policy, by increasing taxes so as to reduce disposable income hence consumption expenditure and investment in an economy.
- Government policy of reducing its expenditure on projects or introduce cost sharing in the distribution of social services.
- Wages freez policy /income policy, legally hold the wages at their existing levels for a specified period of time so as to reduce aggregate demand.
- Trade policy, may discourage exports by raising duties on them.
- Price control measures, may use maximum price legislation.
- Encourage imports by buying products from cheaper sources to supplement domestic production.
- Restrictive monetary policy, to reduce the amount of money in circulation thereby reducing consumption i.e. increasing bank rate, selling securities etc to the public.
- Conducive investment policies to attract production by generating resources.

END