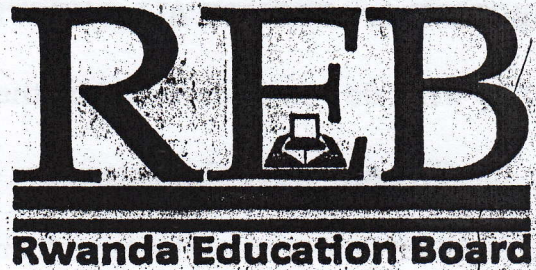


Economics II

018

13/11/ 2015 2PM – 5PM



ADVANCED LEVEL NATIONAL EXAMINATIONS, 2015

SUBJECT : ECONOMICS

PAPER II : APPLICATION OF BASIC PRINCIPLES OF ECONOMICS

COMBINATION(S): HISTORY- ECONOMICS-GEOGRAPHY : HEG

HISTORY- ECONOMICS-LITERATURE : HEL

LITERATURE- ECONOMICS-GEOGRAPHY : LEG

MATHEMATICS-ECONOMICS-GEOGRAPHY: MEG

MATHEMATICS-COMPUTER SCIENCE-ECONOMICS: MCE

PHYSICS-ECONOMICS-MATHEMATICS: PEM

DURATION: 3 HOURS

INSTRUCTIONS:

1. Do not open this question paper until you are told to do so.

2. This paper consists of **TWO** sections **A** and **B**.

Section A: Attempt all questions.

(55 marks)

Section B: Attempt **any THREE** questions.

(45 marks)

3. Use blue or black pen only.

SECTION A: ATTEMPT ALL QUESTIONS. (55MARKS)

- 1) (a) What do you understand by the term "wealth"? **(1mark)**
- (b) Give any three characteristics of wealth. **(3marks)**
- 2) (a) What is meant by the term "demand"? **(1mark)**
- (b) Show how the following affect the quantity demanded of commodity if it is a normal good:
- (i) Price of commodity **(2marks)**
- (ii) Taxation level **(2marks)**
- 3) (a) What is an industry? **(1mark)**
- (b) When all firms in an industry are earning normal profits, the industry is in equilibrium. Use a graph to show this. **(3marks)**
- 4) (a) Show the role of the market in the allocation of resources. **(5marks)**
- 5) What are the Key variables (components) of aggregate demand? **(4marks)**
- 6) "National Product" is equal to "National Income" which is equal to "National Expenditure". Explain the validity of the statement: **(7marks)**
- 7) (a) Demonstrate how a higher interest rate causes aggregate output to fall. **(3marks)**
- (b) Explain the influence of general price on the demand for money. **(2marks)**
- 8) (a) (i) What do you understand by the term "indirect taxes"? **(1mark)**
- (ii) Give an example of indirect tax in the Rwandan fiscal system. **(1mark)**
- (b) Direct taxes are not inflationary. Explain this statement. **(2marks)**
- (c) How can suppliers or producers shift the burden of taxes to consumers of their products? **(2marks)**

- 9) (a) Give the three positions of balance of payments of a country. (3marks)
(b) Explain how inflation causes balance of payments deficit. (2marks)
- 10) Explain 5 ways in which government intervenes in the economy. (5marks)
- 11) (a) What is International Monetary Fund (IMF)? (2marks)
(b) Identify any three of the objectives of IMF. (3marks)

SECTION B: ATTEMPT ANY THREE QUESTIONS.(45MARKS)

- 12) (a) Differentiate between deflation and disinflation. (2marks)
(b) Show how the decision of selling government bonds can contribute to the decrease of inflation. (3marks)
(c) Give five arguments to show the harmful effects of galloping inflation to any economy. (10marks)
- 13) (a) (i) Define the term "voluntary unemployment"? (1mark)
(ii) State three causes of voluntary unemployment. (3marks)
(b) (i) What is meant by the term "full employment"? (1mark)
(ii) Why is it difficult to attain full employment in any developing economy? (10marks)
- 14) (a) Distinguish between commercial and subsistence agriculture. (8marks)
(b) Why is it necessary to develop commercial agriculture in Rwanda's economy? (7marks)

15) (a) What is "rural urban migration"? **(1mark)**

(b) Briefly explain any four causes of rural urban migration in developing countries. **(8marks)**

(c) Explain the consequences of rural urban migration on the economies of developing countries. **(6marks)**

16) (a) Distinguish between Economic growth and Economic development. **(10marks)**

(b) Mention five disadvantages of foreign aid to a developing countries. **(5marks)**

ECONOMICS II MARKING GUIDE, 2015.

1. a) Wealth is the value of all the resources that are possessed by an individual or society.

b) Characteristics of wealth:

- ❖ **It has utility,**
- ❖ **It is limited in supply,**
- ❖ **It has money value,**
- ❖ **It is transferable,**
- ❖ **Wealth can be man-made or nature-given, it can be owned by individual, government or by community.**

2. a) Demand refers to the desire backed by willingness and financial ability to require a given commodity.

b) i) The quantity of commodity depends on its price:

The lower the price of commodity, the greater the quantity will be bought ceteris paribus and vice versa.

ii) The level of taxation affect the quantity demanded of a commodity:

High tax on goods will raise their prices and hence cause the demand to fall and vice versa.

3. a) An industry is a combination of many firms.

b) When all firms in industry are earning normal profit, the industry is in equilibrium. In this condition Marginal cost = marginal revenue, the industry has no tendency to expand or to contract. There are no new firms joining and no old firms leaving.

4. a) Market plays a great role in the allocation of resources:

- ❖ **In the market the interaction of demand and supply of goods and services determines how much of a good will be produced and the price that is charged for that good.**
- ❖ **Where demand is high for a good A there is increase of its production until equilibrium price between demand and supply of good A is reached.**

- ❖ Where there is excess supply, there is a need to reduce production till market equilibrium attained.
- ❖ Thus the market allows the production of goods and services where desired.

5. Key variables (components) of Aggregate Demand:

- ❖ Consumption expenditure,
- ❖ Investment expenditure,
- ❖ Government expenditure,
- ❖ Import spending minus Export earnings = net export

6. a) Definitions:

- ❖ National product (NP) refers to the value of final goods and services produced during a year. It is sometimes calculated by summing up of value added on output in all sector.
- ❖ National Income (NY) consists of remuneration paid in terms of money to the factors of production annually in country i.e it is the total sum of wages and salaries, rent, interests and a profits.
- ❖ National expenditure: Is the total sum of expenditure incurred on goods and services during one year in a country. (It includes the different items: private consumption expenditure (C), Gross domestic private investment (I), Government expenditure on goods and services (G), Net income carved from abroad (X-M), i.e $NE = C + I + G + (X - M)$)

b) From the above, we can conclude:

- ❖ National product and national income yield the same results because the final value of a commodity is always equivalent to the remuneration paid to factors of production in form of income hence $NP = NY$
- ❖ NP and NE give the same result because the total expenditure on a commodity is equivalent to the final value (total value added) of that commodity hence $NP = NE$
- ❖ The national income and national expenditure give the same figure because the total expenditure on goods and services is always equivalent to income earning. Hence $NE = NY$.
Therefore, since National Product = National Income National Product = NE, then $NP = NY = NE$.

7. a) High Interest rate discourages investment hence weakens the production process.
High Interest rate discourages borrowers, their undertakings should thus slow down or collapse, so the aggregate output falls.
b) The influence of general price on the demand for money.
When prices are increasing, the demand for money increases and when prices fall, demand for money also falls.

8. a) Indirect taxes are taxes levied on expenditure; the tax is paid when a person or a firm spends on commodities.

Example of indirect taxes in Rwanda: Value added tax (VAT), customs DUTIES, Sales tax / turn over tax, etc

b) Direct taxes are not inflationary: That is meant Direct taxes cannot cause inflation. They are taxes imposed on income, profit, and benefits and on wealth of individuals and companies; they cannot be directly shifted to commodities' prices so they cannot easily lead to inflation.

c) Suppliers or producers can shift the imposed taxes to consumers of their products by increasing prices of their products.

9. a) Three positions of balance of payment of a country:

- ❖ Balance of payment surplus
- ❖ Balance of payment deficit
- ❖ Balance of payment equilibrium

b) Inflation causes the balance of payment deficit:

- High inflation makes export expensive and makes the country less competitive on the world market and hence leads to balance of payments deficit.

10. The ways in which government intervenes in economy:

Government intervenes in economy by:

- ❖ Regulating the private sector so as to ensure proper use of national resources and protecting consumers from exploitation.
- ❖ Establishing laws and enforcing them to ensure an orderly business environment.

- ❖ Producing goods and services especially those which the private sector may not properly or adequately produce and supply.
- ❖ Stabilizing economy through the use of monetary and fiscal policies.
- ❖ Imposing taxes and providing grants and subsidies for purchase of goods and services from the private sector.
- ❖ Redistributing income among individuals, sectors and regions of the economy.
- ❖ Providing and maintaining infrastructure in form of hospitals, schools, roads dams and telecommunications.

11. a) International Monetary Fund (IMF) is an international financial organization that oversees the global financial system by observing exchange rates and balance of payments, and providing both financial and technical assistance to member countries.

b) Its objectives:

- ❖ To establish exchange rates,
- ❖ Promote free trade and remove all trade restrictions,
- ❖ Extend financial assistance in form of loans and grants to member countries which are adversely affected by BOP problems.
- ❖ Stabilize prices so as to increase the rates of economic growth and development among poor nations.
- ❖ To establish market oriented systems among under developed economies,
- ❖ To provide technical expertise to poor countries in pursuing economic policies and reforms.
- ❖ To increase global cooperation through participation in international trade.
- ❖ Harmonize policies pursued by different countries so as to create peace among member nations.
- ❖ To establish a mechanism of settling international debts.

12. a) Deflation refers to the continuous fall in the general price level while Disinflation is the decline in the rate of inflation.

b) If government sells bonds, private sector gives up deposits (money), the supply of money will be reduced. The small supply of money and large supply of bonds will cause bond prices to fall and

Interest rates to rise both will lead to reduction of investment which will consequently lead to reduction of aggregate demand and thus to reduction of inflationary pressure.

c) Galloping inflation or “run away” inflation or hyperinflation is the rapid rise in the general price level. It has the following harmful effects on an economy:

- ❖ **Farmers lose because prices of agricultural products lag behind inflation. Their savings, welfare and productivity decline.**
- ❖ **Workers also suffer because wages tend to be “sticky” downwards and therefore lag behind inflation.**
- ❖ **The standard of living of fixed income earners like pensioners those who survive on past savings declines**
- ❖ **It discourages savings since real value of money falls with time.**
- ❖ **It redistributes incomes from the poor to the rich, business people (who earn higher profit margin.) this reduces aggregate demand.**
- ❖ **It discourages lending since lenders fear to lose their real value of their money.**
- ❖ **It leads to balance of payments problem by encouraging imports and discouraging exports.**
- ❖ **It discourages production of exports: people devote resources to produce commodities to sell in the local market where prices are higher than in foreign market where prices may be lower.**

- ❖ **It encourages rural-urban migration. People rush to towns to engage in business and earn high profit margins. This eventually leads to urban unemployment, slums, congestion and crimes in town.**
- ❖ **It undermines the external value of the currency which calls for devaluation which can lead to increases in prices of imports and further inflation.**

- ❖ It leads to political instabilities, and strikes workers who demand for higher salaries due to increase in the cost of living.

13. a.i) Voluntary unemployment is a situation where jobs are available but labour force is unwilling to take the jobs at a given wages rates.

ii) Causes of voluntary unemployment:

- ❖ Desire for leisure by individual,
- ❖ Expectation of better paying alternative jobs,
- ❖ Existence of higher unemployment benefits from the state (for developed countries)
- ❖ Desire to live on existing wealth of the family,
- ❖ Unacceptable wages rate,
- ❖ Laziness of some workers,
- ❖ Unfavorable working conditions,
- ❖ Early retirement (early pension)

b.i) Full employment is a situation where there are more jobs than job seekers.

Or a situation where all people or factors willing to work can get work.

Or, when unemployment rate is about 3% or less.

Or a situation where everybody who is capable and willing to work at an acceptable wage is employed or only unemployment is frictional unemployment which should not exceed 3% of the working population.

ii) It is difficult to attain full employment in any developing economy because:

- ❖ Use of inappropriate technology,
- ❖ Urban unemployment due to rural-urban migration,
- ❖ High population growth rate in economy,

- ❖ **Heavy dependence on nature /seasonal unemployment,**
- ❖ **Large subsistence sector,**
- ❖ **Shortage/lack of co-operant factors e.g capital.**
- ❖ **Immobility of factors of production between Jobs/ geographical/occupational**
- ❖ **Planning preference for foreign expatriates.**
- ❖ **Inappropriate education system.**
- ❖ **Limited domestic and foreign markets/ low aggregate demand.**
- ❖ **Heavy capital outflows which limits investment.**
- ❖ **Structural changes in the economy may cause temporary unemployment.**
- ❖ **Trade unions restrict entry of new employees, which maintains the wages of the already employed people high.**
- ❖ **Social barriers e.g Discrimination in the labour market.**
- ❖ **Political instability.**

14. a) **Rural-urban migration is the movement of people from rural areas to urban areas.**

b) **Causes of rural urban migration:**

- ❖ **Localization of Industries: In town industrialization is more developed than in rural areas. In towns there is more employment opportunities than in urban areas.**
- ❖ **Wage - gap between rural and urban areas. Wage rate in urban areas is higher than in rural areas.**
- ❖ **There is a big gap of social services like roads, schools, hospitals, between rural and urban areas. They are more developed in urban areas.**
- ❖ **Political instability in some rural areas pushes people towards urban areas.**
- ❖ **Low prices of agricultural products force people to abandon rural areas.**
- ❖ **Low demand for commodities in rural areas leads rich people to shift to urban areas where demand for commodities is high.**
- ❖ **Political instabilities: Security organ is more developed in urban areas than in rural areas, this should attract people from rural to urban areas.**
- ❖ **Unfair land distribution in rural areas pushes people to shift to the urban areas.**

C) Rural urban migration has the negative effects on developing countries.

- ❖ It creates the high rate of unemployment in urban areas.
- ❖ It deprives rural areas of labour in agricultural sector.
- ❖ It increases prices of commodities, housing and transport in urban areas.
- ❖ It leads to insecurity and disorder in towns.
- ❖ It leads to prostitution, slums, gambling and idleness.
- ❖ It leads to rural underdevelopment since development is diverted to towns where influential people live.
- ❖ It leads to income disparities where rural people are left with less money because of low bargaining power, low prices for primary products and low wages.
- ❖ It increases "street children" as parents fail to look after them in towns.

15. a) Difference between monetary and subsistence agriculture:

Monetary / commercialized agriculture		Subsistence agriculture	
1	Uses hired or purchased inputs	1	Uses family labour and less hired or purchased inputs
2	Uses modern methods. E.g tractor	2	Uses backward technology e.g hand hoe.
3	Produces surplus for sale.	3	Almost no surplus for sale.
4	Aims at profit maximization	4	Aims at satisfying basic needs especially food.
5	There is specialization	5	No specialization
6	High productivity	6	Low productivity due to use of backward technology.
7	Large scale production	7	Small scale production
8	Production of high quality products.	8	Production of low quality products.

b) It is necessary to develop monetary agriculture in our economy because agriculture:

- ❖ **Is the source of food for the growing urban and rural population**
- ❖ **It provides income for rural farmers and urban traders**
- ❖ **It provides employment to rural farmers and urban traders**
- ❖ **It provides capital (money) for development of industry**
- ❖ **It provides tax revenue when income of those engaged in agriculture is taxed.**
- ❖ **It is the source of foreign exchange.**
- ❖ **It provides backward linkages to the industrial sector by providing market for industrial final and intermediate products e.g. hoes, fertilizers, insecticide.**
- ❖ **It provides forward linkages to the industrial sector by supplying raw materials and intermediate products to the industrial sector.**
- ❖ **It reduces income inequalities by providing income to many people.**
- ❖ **It releases labour to the industrial sector.**
- ❖ **It reduces balance of payments problem by increasing exports and reducing food imports.**
- ❖ **It reduces inflation by increasing food supply.**
- ❖ **It increases aggregate demand by increasing purchasing power of many people.**
- ❖ **It encourages the development of infrastructure like roads, schools, hospitals,**
- ❖ **If well developed, it leads to political stability by reducing food strikes.**
- ❖ **It reduces rural-urban migration by keeping many people busy in rural areas.**
- ❖ **It is the source of largest percentage of GDP.**

16. a) The difference between Economic growth and Economic Development.

	Economic growth	Economic development
01	Involves Increase in national income	Involves Increase in quantity and quality of National income.
02	Can be achieved with income disparities	Achieved with fair income distribution
03	Can be achieved even if the quality of goods and services does not change.	There is change in type and quality of goods and services.
04	Technology can remain the same	Involves change in technology.
05	Can be achieved in a short time	It is a long run achievement
06	Can be achieved when the quality of life is very low	There is a change in the quality of life of people in terms of nutrition, life expectancy, health and political stability.
07	Can be achieved when there is unemployment.	There should be increased in employment opportunities
08	Can be achieved with environment deterioration	Is achieved when there is minimum deterioration of environment.
09	Can be achieved with no or little changes in economic situations e.g . Banks, co-operatives	There must be changes in economic institutions.
10	Is rapid process	Is a slow process
11	If Can be achieved without integration of economic sectors and with economic dependence.	There is integration economic sectors and sectors and self-sustenance.

b) The disadvantages of foreign aid are:

- ❖ **Some governments are corrupt and money may go where it needs to go.**
- ❖ **Countries can become reliant on aid- increased dependency.**
- ❖ **Aid can help support authoritarian regimes.**
- ❖ **Aid can be wasted on glorifying the aid organizations.**

- ❖ **Aid can discourage development and hinder foreign investment. This is because the recipient country's currency exports become more expensive to foreign countries.**
- ❖ **Aid can hinder the emergence of an entrepreneurial class**
- ❖ **Aid discourages domestic saving.**
- ❖ **It may undermine development if it is given to countries that are unlikely or unwilling to make necessary political and economic reforms.**
- ❖ **Tied aid may oblige recipient country to use the aid in production of goods and services that promote the donor countries.**