Economics II
017
04 Nov.2011 13.30 pm - 16.30pm

REPUBLIC OF RWANDA

RWANDA EDUCATION BOARD (REB)
P.O.BOX 3817 KIGALI. TEL/FAX: 586871

ADVANCED LEVEL NATIONAL EXAMINATIONS 2011

SUBJECT : ECONOMICS

PAPER 2 : APPLICATION OF BASIC PRICIPLES OF ECONOMICS

COMBINATION(S): MATHEMATICS-ECONOMICS-GEOGRAPHY: MEG
HISTORY- ECONOMICS-GEOGRAPHY : HEG
PHYSICS-ECONOMICS-MATHEMATICS: PEM

DURATION: 3 HOURS

INSTRUCTIONS:

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

Section A: Answer **ALL** questions. **(55 marks)**

Section B: Answer **any THREE** questions of your choice. **(45 marks)**

SECTION A: Attempt all questions (55 marks)

1. (a) what is meant by the term economic dependence. **(1 mark)**
   (b) Discuss four ways in which a country may be considered economically dependant. **(3 marks)**

2.(a) Given that Gross Domestic product(GDP) is 848 billion Rwf, Gross national product (GNP) is 645 billion Rwf and Net National Product(NNP) is 380 billion frws.
Required
calculate the :
(i) Value of Capital Consumption. **(1 mark)**
(ii) Value of Net Income from abroad. **(1 mark)**

(b) Explain three uses of compiling national income statistics in your country. **(3 marks)**

3.(a) What do you understand by the statement 'beggar-my-neighbour policy'? **(1 mark)**
(b) State and explain any four tools used to restrict international trade. **(4 marks)**

4.(a) Define equilibrium price **(1 mark)**
(b) Given that QS=10 and QD=2P-6, Determine
(i) Equilibrium price.
(ii) Quantity demanded. **(2 marks)**
(c) State any two determinants of price in your country. **(2 marks)**

5.(a) What is excess capacity? **(2 marks)**
(b) Mention any three causes of excess capacity. **(3 marks)**

6.(a) Distinguish between Residual unemployment and technological unemployment. **(2 marks)**
(b) Give three reasons why is it difficult to attain full employment in the economy. **(3 marks)**

7. (a) What is an inflationary spiral ? **(1 mark)**
   (b) Explain two states of inflation a country may experience. **(2 marks)**
   (c) Under what circumstances may inflation be desirable in an economy ? **(3 marks)**

8. (a) Define the term liquidity preference. **(1 mark)**
   (b) Explain any four factors that determine the levels of liquidity preference in Rwanda. **(4 marks)**

9. (a) Distinguish between incidence of a tax and impact of a tax. **(2 marks)**
(b) State three problems Rwanda revenue authority has encountered in its bid to increase tax revenues in the country. **(3 marks)**

10. (a) Distinguish between currency appreciation and currency Depreciation. **(2 marks)**
(b) State three qualities of good money. **(4 marks)**

11. (a) What is a buffer stock ? **(1 mark)**
(b) State three problems encountered while administering buffer stocks. **(3 marks)**

SECTION B: Attempt any Three questions (45 marks)

12. (a) What is the accelerator principal? **(1 mark)**
(b) Explain the factors that determine the levels of investment in an economy. **(7 marks)**
(c) Examine the policies the government of Rwanda has taken to attract foreign investment. **(7 marks)**

14 (a) Explain the functions of commercial banks in an Economy. **(8 marks)**
(b) Examine the problems facing commercial banks in developing countries. **(7 marks)**

15. (a) Account for the persistent budget deficits in the developing world. **(8 marks)**
(b) Examine the negative consequences of borrowing to cover budget deficits in developing countries. **(7 marks)**

16. (a) Why is it necessary to carry out development planning in most developing countries? **(8 marks)**
(b) Examine the problems encountered in the formulation and implementation of development plans in LDCS. **(7 marks)**

MARKING SCHEME FOR ECONOMICS II 2011.

1. a) Economic dependence is the situation where an economy relies heavily on other economies. Or a country relying on a few economic activities. A country has no economic freedom (External resources dependence).

   b) Forms of dependence are the following:
   - Foreign aid dependence in Form of loans, grants from donors
   - Manpower dependence
   - Foreign capital dependence (private foreign, investment MNC's)
   - Technological dependence
   - Ideological dependence (capitalism ideology)
   - Economic resource dependence
   - Direct economic dependence (Donors, IMF, WB)
   - Sectorial dependence.

2. a) Data given : GDP = 848 billion

   GNP = 645 billions

   NNP = 380 billion

__Required__: i) value of capital consumption = GNP – NNP

= 645b – 380b = 265b Rwf

ii) Net Income from Abroad = GNP – GDP = 465 – 848 = (203)b Rwf

= -203b Rwf

b) – To measure the rate of Economic growth

- To understand economic analysis and planning purposes.
- To attract foreign aid
- To measure the standard of living of the people within the country.
- To compare the standard of living between countries
- To identify the major kinds of Economic development in the country.
- To show expenditure patterns in the economy

- To facilitate research
- To identify Macro economic problems
- To determine the effectiveness of tax collection
- Income distribution
- Resource utilization

3. a) Beggar – My – Neighbor policy is a policy adopted by a country to overcome its domestic problems at the expenses of other countries (economies) e.g. Devaluation, trade restriction, it is adopted to correct BOP problems and promote employment of home and protect domestic infant industries.

b) + <u>Tariffs</u> : These ate taxes imposed on goods entering into or out of the country.

+ <u>Import quotas / Export quotas</u>.

This is maximum limit on goods to be imported the into country or exported outside the country.

→ Devaluation this is Official Lowering of the value of a country's currency in terms of other currencies.

So, devaluation makes imports relatively more expensive thereby reducing the domestic demand in favour of locally produced goods.

→ <u>import licenses</u>, The government may limit the number of import licenses for a particular goods or issue costly licenses to discourage imports.

→ <u>Total ban or trade embargoes</u> : This is illegal prohibition of importation in the country of specified goods e.g. drugs, animal products from the country affected by diseases.

→ <u>administrative control</u> such as lengthy bureaucratic procedures in obtaining import or export licenses. Or regulation may be designed to discourage imports.

→ <u>Foreign Exchange control</u>.

The government may restrict or limit the amount of foreign exchange allocated for imports.

- Subsidization
- Preferential treatment
- Transport discrimination
- Procurement discrimination
- Standard requirement

4. a) Equilibrium price is the price level at which quantity demanded is equal to quantity supplied. Or P = Q' = Q.

b) <u>At equilibrium price</u> : $Qs = 2P - 6$

$Qs = 10$

i) $Qs = Qd$

$Qd = 2P - 6$

$2P - 6 = 10 \quad \blacktriangleleft 2P - 6 + 6 = 10 + 6$

$\blacktriangleleft\ 2P = 16$

$P = \frac{16}{2} = 8$

$\boxed{EP = 8}$

ii) <u>Quantity demanded Qd</u> = $2P - 6$

Since $P = 8$

$2P = 16 - 6 = 10$

$\boxed{Qd = 10}$

c) – Haggling

- Resale price maintenance
- Auctioning
- Fixing by treaties
- Forces of demand and supply.
- Government policy of price legislation
- Prouction costs
- Level of demand – level of supply.

5. a) <u>Excess capacity</u> : is a situation where a Firm or industry is operating below its optimum full capacity.

b) – Under utilization of resources
- Limited raw materials
- limited domestic and foreign market
- Inadequate of Cooperant and entrepreneurship skills
- Poor state of technology
- Poor infrastructure
- Lack of storage facilities

- Political instability
- High cost due to high taxes.

6. a) residual unemployment. This is form of unemployment resulting from physical or mental incapacitation of labour. E.g. deaf, blind while.
Technological unemployment.

This is form of unemployment caused by use of capital intensive technology (machines) which either reduce, the demand for labour or displace labour e.g. computer in bank, tractor in farming, robots etc.

b) – rapid population growth rate

- Inappropriate Education system
- Limited domestic and foreign markets
- Heavy dependence on Nature
- Poor manpower planning
- rampant political instability
- In appropriate technology
- Rural urban migration (RUM)
- Predominance of subsistence sector
- Inadequacy of cooperants factors
- Mental incapacity of labour
- Discrimination in the labour market

7. a) An inflation spiral is a situation where a persistent rise in prices leads to a demand for higher wage, which increase costs of production and leads in rise in price, which leads to demand for higher wage.

b) Two states of inflation.
Creeping inflation : This is a slow but steady rise in general price level in the economy and this state of inflation is not noticed by the public.
Hyper or Galloping / Run away inflation. This is key rapid rise in the general price level in the economy.

C) – Where there is a need to stimulate aggregate demand therefore expands the market for goods and services in an economy.

- When there is a need to stimulate and expand the market for goods and services in the economy.
- When there is a need to stimulate investments in the economy.
- When there is a need to stimulate employment opportunities.
- When it is used by the government as a tool to increase saving (Forced savings)
- Where there is existing excess capacity in plants, gradual inflation may be desirable to stimulate and increase output in the economy.
- Where the economy is experiencing a recession inflation may be desirable to revive the economy out of a recession.
- When there is a need to redistribute income for wage earners with low Marginal propensity to save (MPS) profit earners with low marginal propensity to save.

8. a) <u>Liquidity preference</u> is desire and willingness of people to hold money in cash rather than holding other assets.

b) The general price level :
- the level of investment in the country
- the duration of payment of wage in the economy
- The monetary policy in the country
- the investment climate
- The level of speculation in an economy
- The level of income
- The volume of transaction

9. a) The incidence of a tax is the final resting place of a tax i.e. who actually bears the money burden of the tax. While the impact of a tax is the immediate effect of tax on the person on whom it is imposed.

b) – narrow tax base
- High level of smuggling which results into loss of customs revenue.
- Tax evasion and Avoidance
- Limited manpower to properly asses tax payers and collect taxes.
- Poor and inadequate logistic such computers, vehicles used in tax administration.
- Low taxable capacity due to low income of the population.

10. a) **Currency appreciation** is an increase in the value of the country's currency in terms of other currencies under a floating exchange rate

While

Currency depreciation is the fall in the value of country's currency in terms of other currencies.

b) – Acceptability
- Divisibility
- Portability
- Durability
- Homogeneity
- Scarcity
- Fairly stable in value
- Recognisibility
- Difficult to Forge.

11. a) Buffer stock is the policy where government through marketing board buys surplus output during a bumper harvest, stores and resells during shortage on the market.

b) – Inadequate storage facilities
- poor transport facilities especially in rural areas.
- Inadequate funds to buy production.
- Perish ability of produce
- Inadequate statistical data.
- Corruption and embezzlement of funds
- Continuous surpluses every season and decline in commodity, price may lead to exhaustion of reserve funds and collapse of stabilization fund.
- The policies are expensive to operate and maintain in terms of funds of buying all produce and setting up storage facilities.

SECTION B.

12. a) <u>Accelerator principle</u> is the number of times initial change in consumption multiplies itself to give final change in investment.

b)- The size of the market
- The political climate
- Government policy
- The level of income
- Marginal efficiency of capital
- Social and economic infrastructures
- The level of invention and innovation
- Monetary and Fiscal policy
- The rate of interest.

c) – Provision of investment incentives such as tax holiday, trade licenses
- Macroeconomic stability i.e. stabilizing market, prices and the value of francs by curbing inflation.
- Liberalization of the economy
- Privatization of Government parastatals
- organizing investment board
- Provision of credit facilities such as soft loans to small scale investors.
- Establishment of institutions to facilitate investor such as Rwanda development board (RDB) and private sector Federation (PSF)
- Direct persuasion of investors
- Expansion of local market and Foreign market through regional integration such as COMESA and east African Community (EAC)
- Putting in place a predictable Fiscal policy
- Improvement and extension social and economic infrastructures in the country.
- Attaining and maintaining political stability in the country.

14. <u>Functions of commercial banks are</u> :

a) – They accept and safeguard money from the public
- They offer credit facilities
- They provide excellent main of payment such as ATM card
- Commercial banks act as custodian of values
- They acts as trustees

- They advise customers on investment decisions.
- They act as agents of stock exchange
- They facilitate international trade
- They assist central bank in implementing the monetary policy.
- They invent in other companies through purchasing securities.
- They provide Foreign exchange to their customers.

b) <u>Problems facing commercial banks in LDCs are</u> :

- Ignorance of public about the uses of banks limits the deposits in the banks
- Inadequate skilled manpower
- Inadequate credit worthy and customers
- Rampant corruption and Embezzlement of funds by bank officials
- Government interference in the running of commercial banks.
- Political instability
- Loss of public confidence in the banking sector as result rampant close of banks
- Unpaid loans
- Poor management of Fund by bank Officials
- High level of completion among banks
- Lack of collateral security limits lending by commercial banks.
- High rate of interest of central banks
- High rate of interest to potential borrowers
- Storage of Entrepreneurs to exploit the available investment opportunities
- Many commercial banks are owned by foreigners which led to high capital out flows.
- Many banks are concentrated in towns to enjoy economies of scale.

15. a) Persistent budget deficit in developing countries caused by :

- High population growth rate
- Unemployment problems
- Poor planning
- Price fluctuations e.g. Agricultural products
- Low saving and investments
- Heavy borrowing
- Mismanagement of funds
- Corruption
- Political instability
- Limited size of Enterprise
- Low taxable capacity
- Unfavourable terms of trade (TOT)
- High governmentexpenditures
- Uneven distribution of incomes
- Large substance sector.
- High rate of inflation
- Involvement in ambition projects
- Poor National global Economic performance
- debt serving which takes substantial proportion of the country's foreign exchange earmings.
- Natural calamities
- Rehabilitation and extension of physical infrastructures e.g. Road, railways
- Big size of cabinet which increase government expenditures.

b) - Transferring of debt burden to the future generation

- Worsening of country's BOP position through increased foreign exchange expenditures on debt servicing.

- Increased dependence on the economies
- Worsening income inequalities
- Increased poverty in country because of resources outflow in form of debt serving from LDCs to MDCs
- High taxes on individuals to repay the debt deprives them of consumption
- Debt repayment reduces expenditures on capital goods formation
- High administration costs especially for short term debts
- Measures used to cover internal debts are usually inflationary due to printing more money.
- Depriving the people of vital services such health and education.

16. a) <u>Development planning is necessary for most developing countries because of following reasons</u> :

- To solve unemployment problems through appropriate Manpower planning
- To attain price stability
- To mobilize foreign exchange by convincing the donors that the Aid is an integral ingredient of the plan and it will be put into a good use.
- To correct BOP problems
- To determine the rate of Economic growth
- To reduce expenditure
- To identify areas suitable for public and private investments.
- Development planning enables countries to achieve balanced development of all sectors of the economy.
- To ensure optimal allocation and use of scarce resources by identifying most production projects where the resources can be used effectively.
- To increase government participation in economic activities
- To reduce poverty and ignorance
- Defects in price mechanism can be reduced or corrected through planning.
- LDCs need appropriate measure through planning to reduce inflationary tendencies.
- Development planning is necessary so as to attract people to fully participate in economic development.

b) – Inadequate capital

- Inadequate statistical data
- Existence of large private sector
- Natural calamities
- Political instability
- Corruption and Embezzlement of plan fund
- Over reliance on foreign Aid
- Lack of adequate qualified personnel
- Limited political supporters by the people and government
- Over ambitions plan
- High inflation rate.