NATIONAL INCOME

National income refers to the total monetary value of all final goods and services produced in an economy per period of time, usually one year.

Or It is the measurement of the total monetary value of all final goods & services which arise from the productive activities of a nation in a given period of time, usually one year.

National income is a flow of goods & services which is a continuous process measured over time, usually one year.

National income includes goods and services. This is because the production of goods and services is an economic activity which leads to the creation of utility in goods and services so as to satisfy human needs. For this reason, people are prepared to pay the price.

It is measured in monetary terms such as dollars, shillings, pound sterling, euros, rupees, Japanese yen etc. However, it is the monetary value of the final goods & services which is important & not the goods & services themselves.

National income (figures) excludes the earnings/incomes from illegal activities (e.g. gambling, prostitution, smuggling, etc.)

Only the market prices of final goods & services are considered. This is for the purposes of avoiding double counting since production involves many stages before reaching the final consuming units.

Income should be derived from goods and services arising out of the productive activities over time. This means that incomes received for no work done should be excluded when estimating national income. (e.g. students pocket money, pensions, unemployment benefits, bursaries, gifts from friends, & organizations (transfer payments) etc.

The concepts/terms used in National income

1. Personal income. This refers to the payment received by an individual, or house hold arising from productive activities in an economy over a given period of time
2. Disposable income. This refers to the payments/incomes available to an individual, or house hold for spending after the deduction of taxes and other compulsory payments (such as savings, taxes, National Social Security Fund, etc.).

Thus symbolically, Y_d = Gross income – taxes – compulsory payments

3. Nominal national income. This refers to one expressed in monetary terms.

4. Real national income. This refers to the purchasing power of nominal national income.

It is the amount of goods and services that the nominal national income can purchase at a given period of time

It is one expressed inform of physical commodities.

5. Nominal Gross Domestic Product. This refers to GDP/one /national output valued at current year prices

6. Real Gross Domestic product is one valued at base year prices.

5. Transfer payments. This refers to the payment made to individuals or institutions without any corresponding economic activity done .donations, gifts, pocket money, pension, unemployment benefits etc.

6. Percapita income. This refers to the average income per head in an economy at a given period of time, usually one year.

Thus percapita = $\frac{Ttal\ National\ Income}{Total\ population}$

7. Real national income percapita. This refers to the average real goods & services enjoyed by an average resident of a country in a given period of time.

It is calculated from: $\frac{Nominal\ income\ percapita}{consummer\ price\ index}$

8. Nominal national income percapita

9. Depreciation/capital consumption allowance. This is the rate of wear and tear of capital asset used in the production process overtime.

Or it is the loss in the value of capital/asset/machinery/equipment due to use over time.

10. Gross Domestic product (GDP). This refers to the monetary value of all final goods and services within the territorial boundaries of an economy by both nationals and foreigners in a given period of time, usually one year (including the value of depreciation)

Symbolically, GDP = C + I + G

Where (C) denotes consumption by households sector

(I) denotes investment /business sector, &

(G) denotes government/public sector

It considers a closed economy i.e. an e conomy without any international transactions (exports & imports).

1. Gross National product (GNP). This refers to the monetary value of all final goods and services produced by the nationals within and outside an economy and the net earnings from abroad in a given period of time, usually one year.

Thus symbolically, GDP = C + I + G + (X - M).

Where (X - M) denotes the net income

12. Net property income (NPY). Is the difference between the property (factor) incomes earned by country's nationals from abroad & the property incomes paid by the nationals abroad.

Thus NPY = GNP - GDP

13. Net Domestic Product (NDP). Is the monetary value of all final goods and services produced within an economy by both the nationals and foreigners in a given period of time, usually one year.

Thus NDP = GDP - Depreciation

14. Net National Product (NNP). Is the monetary value of all final goods and services produced by nationals living in and outside a given country in a given period of time, usually one year excluding the value of depreciation.

Thus NNP = GDP – Depreciation

Given that a country's GDP is shs. 400 billion, net income from abroad is shs. 40 billion and depreciation is shs. 20billion. Calculate the net National product (NNP).

Solution

NNP = GDP + Net income from abroad–Depreciation

= Shs.400 billion + 40billion – 20billion

= Shs. 420 billion

15. Gross Domestic Product at market price (GDP_{mp}). This refers to the monetary value of all final goods and services produced within an economy by both the nationals and foreigners in a given period of time, usually one year including the value of depreciation, valued at current market prices of goods and services.

Thus $GDP_{mp} = GDP_{fc}$ + Indirect taxes – subsidies

Given that a country's GDP at factor cost is shs 100 billion, subsidies is shs 150 billion, outlays is shs 20 billion. Calculate her GDP at market price.

16. Gross domestic Product at factor cost (GDP_{fc}). This refers to the monetary value of all final goods and services produced within the economy by both nationals and foreigners in a given period of time, usually one year, including the value of depreciation, valued at price of the factors of production

Therefore, $GDP_{fc} = GDP_{mp}$ + subsidies – indirect taxes (outlays)

Given that a country's GDP at market price = US$ 820, outlays = US$ 170, subsidies = US$ 30, find the country's GDP at factor cost.

Given that a country's GDP at market price is $700millions, net indirect taxes are $ 300millions, and subsidies are $250. Compute the country's GDP at factor cost.

17 Gross National Product at market price (GNP_{mp}). This refers to the monetary value of all final goods and services produced by nationals living within and outside the country in a given period of time,

usually one year, , including the value of depreciations, valued at current market prices of goods and services.

Thus GNP_{mp} =

18. Gross National Product at factor cost. This refers to the monetary value of all the final goods and services produced by nationals living within and outside the country in a given period of time, usually one year including the value of depreciation, valued at prices of factors of production

Thus $GNP_{fc} = GNP_{mp}$ + Subsidies – Indirect taxes (outlays).

19. Net Domestic Product at market price (NDP_{mp}).This refers to the monetary value of all final goods and services produced within the country by both nationals and foreigners in a given period of time, usually one year, excluding the value of depreciation, valued at current market prices of goods and services.

Thus $NDP_{mp} = NDP_{fc}$ + outlays – subsidies

20. Net National Product at market price (NNP_{mp}). This refers to the monetary value of all final goods and services produced by nationals living within and outside the country in a given period of time, usually one year, excluding the value of depreciation, valued at current market prices of goods and services.

Thus $NNP_{mp} = NNP_{fc}$ + indirect taxes – subsidies.

21. Net National Product at factor cost (NNP_{fc}). This refers to the monetary value of all final goods and services produced by nationals living within and outside the country in a given period of time, usually one year, excluding the value of depreciation, valued at prices of factors of production.

Thus $NNP_{fc} = NNP_{mp}$ + subsidies – Indirect taxes or

$NNP_{fc} = GNP_{fc}$ – Depreciation

22. National income at market price (NY_{mp}). This refers to the value of national product in terms of money actually spent on the goods and services It represents the final value of goods and services produced in a country at the current market prices.

However, this valuation misleads as the prices of many articles usually includes

indirect taxes on expenditure and subsidies. The taxes do not create incomes to the producers since they are paid to the government and thus cannot be used to purchase factors of production

Adjustments in National income figures.

- From Gross to net figures, subtract depreciation value (capital consumption allowance)
- From net to gross figures, add depreciation value.
- From domestic to national, add net property income from abroad
- From national to domestic, subtract net property income from abroad
- From factor cost to market price, add indirect taxes and subtract subsidies
- From market price to factor cost, subtract indirect taxes and add subsidies.

The determinants of national income

- The level of capital stock. The availability of capital informs of machines & equipment increases the level of output. This is due to the increased productivity/& efficiency of capital thus leading to high level of national income. The presence of limited capital stock lowers production. This is as a result of low productivity/efficiency of capital stock thus leading to low level of national income
- The level of entrepreneurial ability. The presence of individuals who can organize and mobilize other factors leads to an increase in production & hence increase in National income. This is due to increased managerial capacity of the entrepreneurs in the production process. However, the absence of individuals with entrepreneurial skills who can mobilize & organize other factors of production discourages production. This is as a result of low managerial capacity/inability to mobilize & organize the other factors of production. This results into low level of national income.
- The level of technological progress. The use of better and efficient /improved methods of production increases output. This is due to increased efficiency/increased speed /reduced average costs of production. Whereas the use of poor methods of production reduces output. This is attributed to inefficiency/low speed/increased average costs of production. This thus leads to low level of national income in an economy.
- The size & quality of the labour force. The presence of a big & skilled labour force increase production of goods & services. This is due to increased efficiency & productivity of the labour force. While the presence of a small unskilled labour force discourages production. This is associated with reduced efficiency & low productivity of the labour force thus resulting into low level of national income
- The degree of economic climate. A country which experiences stable prices of final goods & services encourages investments/production. This is associated with stable money value. While a country which experiences unstable prices of final goods & services (inflation) discourages investments/production. This is attributed to fall in money value. This thus results into low level of national income.
- The market size within & outside: The presence of large markets encourages investors to produce more goods & services. This is due to increase in sales/profits. The existence of small market size discourages investments/production. This is due to reduction in sales/profits/revenue. This leads to low level of national income. The level of monetization of the economy. The high level of money supply in an economy encourages increased investments/production. This is due to increased level of economic activities. However, a large subsistence sector discourages investments/production. This is due to reduce d economic activities/supply of money in an economy.
- The level of specialization in production. The existence of high level of specialization & division of labour in an economy results into increased output. This is as a result of increased productivity/efficiency of labour. But the existence of low level of specialization/division of labour in an economy results into low level of output. This is due to reduced productivity & efficiency of labour. This thus leads to high level of national income.
- The level of exploitation & utilization of the available resources. The increased exploitation of natural resources in an economy results into high level of production. This is as a result of increased productivity. However, the low level of exploitation & use of natural resources leads to

a low level of output. This is due to the low level of productivity & thus low level of national income.

- The degree of political climate. The presence of political stability encourages investments/production. This is because of the confidence for life & property of investors. This leads to setting up of enterprises & thus increase in national income. However, the presence of political instability discourages investments/production. This is because of fear of life & destruction of property. This thus leads discourage setting up of enterprises & low level of national income.
- The level of investment. Increased level of both domestic & foreign markets results into increased output. This is due to the increased use of resources/induced economic activities. This thus leads to increased level of national income. However, the absence of both domestic & foreign markets results into low levels of investments/production. This is due to reduced levels of economic activities.
- The level of infrastructure. The presence of good communication network, power supply, etc. encourages increased production/investments. This is due to the ease /low cost of transportation, distribution & marketing of goods & services. Whereas the absence of good communication network, power supply, etc. discourages e production/investment. This is due to high cost/the difficulties of transportation, distribution & marketing of goods & services.

Estimation of National income statistics

(The methods/approaches of measuring National income)

There are three methods of estimating national income, namely; income, expenditure, & output/value added approaches.

(a). The income approach.

Here national income is arrived at by adding up together all the incomes or payments to the factors of production earned in the economy by the owners of the various factors during the course of the year.

Therefore, such incomes as rent, wages,/salaries, profit, interest, & dividends received by the house holds (C), firms (I), the government (G), & net income earning from abroad (X-M) are added.

National income = Wages, (W) + Rent (R) + Interest (i), + profits (π).

Under this approach, we only add up incomes which are received by providing either goods or services. All forms of taxes & transfer payments are excluded under this approach.

The problems/limitations of using income approach

- Inadequate information. This is because most individuals have different sources of incomes

Which are not known to the government. Many are self-employed & are unwilling to declare their incomes accurately. This makes it difficult to measure national income.

- Transfer payments. These are difficult to identify. And hence leading to double counting. eg pensions, students pocket money, sick benefit, unemployment benefits, grants, etc.

- Capital gains. These are received by individuals owning such assets but these gains do not correspond to the output of goods and services produced.
- Depreciation. The allowances set aside for the repair & maintenance do not usually appear as income payments to anyone. Yet it forms part of production cost to firms
- Incomes from abroad. This is difficult to estimate as many people are involved in foreign trade. Besides, there exists a lot of illegal trade across borders
- Inadequate funds. This makes it difficult for statisticians to collect, analyze, and store information.
- . Inadequate personnel. There are few qualified personnel to undertake national income computation. This is due to the poor education system that does not match the requirements of the job market.
- Unpaid for services. This is because they are not monetized. This makes it difficult to value the unpaid for services such as own house, house wives work, etc.

(b).The expenditure approach.

Under this approach, we add up all the expenditures on final goods and services produced by the various sectors of the economy during the course of the year.

The national income = C + I + G + (X + M) That is, the expenditure by the households (C), investment expenditure by the firms, (I), expenditure by the .government (G), expenditure by the foreign sector/on exports respectively (X), and expenditure by nationals abroad/on imports respectively, (M).

The expenditure is on final goods and services. This helps to avoid the problem of double counting of expenditures.

The problems/limitations of expenditure approach.

- Final and intermediary expenditures. This is because it difficult to differentiate between an intermediary & final expenditures. Hence leading to double counting of expenditures.
- Inadequate information. It is difficult to obtain data on personal consumption & private investment expenditures due to poor record keeping, & management. This makes it difficult to estimate national income.
- Expenditures on imports. The total expenditures that take place with in a country are too large since it includes spending on domestic & foreign produced goods & services
- Transfer payments. This is because it is difficult to distinguish between expenditures arising out of transfer payments & payments arising out of productive economic activities..
- Inadequate personnel. This is due to the poor education system. This makes it difficult to collect, analyze, & store data from the various sectors of the economy.

(c) The product/output/value added approach.

Using this approach, the value of the output of all the individual enterprises in the economy are added up at the final stages of production.

Therefore, NY = (C) + (I) + (G) + (X – M) that is, value addition by the households (C), value addition by the business firms (I), value addition by the government (G), & net value addition by the foreign sectors respectively by each sector is considered so as to avoid the problem of d

Under this method, the value addition includes the value on what has been produced during the year. Therefore, the value on raw materials produced during the previous years is excluded from the value to be added.

Under this method, the value added on the final product by each sector is considered so as to avoid the problem double value addition/counting.

Note.

- ✓ Value added is the worth that a sector contributes to intermediary products, measured from the market value of the sector's sales & the market value of intermediary products purchased.
- ✓ Double counting is the failure to distinguish between final & intermediary products thus resulting into the double inclusion of its value added.

The problems/limitations of value added/output/product approach.

- Inadequate information on what is produced by all the enterprises or sectors within a year in an economy. This is attributed to the poor record keeping about the output produced. This makes it difficult to collect, analyze, & process information.
- The problem of double counting. This is due to the failure to distinguish between intermediary goods & final goods. This results into counting the value of the item more than once hence over estimation of national income.
- The problem of inventories. This is because of poor record keeping & management of value of the goods produced. The value of the goods produced but not sold in the previous years are t not supposed to be included when estimating the national income of the current year
- The presence of intermediary & final goods. This is because it is not always clear whether a good is an intermediary or final product. Hence double counting is likely to arise.
- Timing of production. It is difficult to determine the output produced in an economy during the year. This is because crops may stay in the field for more than a year & there is likely hood of counting them twice.
- Inadequate personnel.

Why most developing countries prefer to use the product approach.

- Data on output is readily available. This is because most people depend on agriculture as a means of both commercial & subsistence production.
- Individuals are willing to reveal information on output than on incomes & expenditures. This is due to the existence of conservatism & negative cultural beliefs
- Eliminates the problem of double counting. This is due to the consideration of value addition under this approach.
- It is not affected by the problem of transfer payments. This is because incomes and expenditures are not involved under this approach.
- It does not include the effects of illegal activities

  The importance of National income statistics
- National policy analysis. This helps the government to determine the direction in which the industrial output, investments & savings change so that proper measures can be adopted to match population & economic growth.

- Research purposes. This is through making use of the data about the country's incomes, and expenditures obtained from national income accounts. This helps to determine & predict relationships between economic variables.
- Determination of standard of living. This is a good indicator of economic welfare of the people. This helps to give direction on how to improve the welfare of the citizens.
- Determination of the nature of income distribution. It helps to show income distribution among sectors & regions of an economy. This is by using the data relating to wages, rent, interest, and profits. This enables the government to come up with corrective measures to reduce income disparities
- International comparison. It is used for comparing the growth rates of different sectors, regions, & countries.
- They are used to show the contributions made by the different sectors to economic development (especially when the output method is used) This helps to identify which sectors are lagging behind so that appropriate policies are designed to improve on their performances.
- Helps to show the level resource utilization in an economy. This is through taking into account the level of growth rates in output.
- Helps to attract foreign investments in an economy. This is because the national income figures are an indicator to the outside world about the performance of the economy. High and increasing national income figures encourage foreigners to invest in an economy
- They show the patterns of expenditures by the private & government sectors. This helps in making national budget where there is need to balance between government & private sectors.
- It is used to solicit for foreign aid. This is because donor countries & other financial organizations base on national income figures to give foreign assistance
- It is used for effective national development planning and budgeting.

Note:

- ✓ Standard of living. Is the level of economic welfare enjoyed by a person, family, or a national which is achieved by consuming a variety of goods & services including leisure, security, accommodation, employment, freedom, self-esteem and human rights
- ✓ National budget. Is a financial statement showing the estimated/planned/projected/anticipated government revenue and the estimated/planned/projected/anticipated government expenditure in a given financial year
- ✓ Foreign aid refers to

The problems involved in the estimation of national income statistics in an economy

- Inadequate & unreliable statistical data. This is due to limited facilities such as computers, & inadequate record keeping. This makes it difficult to compile relevant information on incomes, expenditures & output.
- Poor infrastructure. This limits the movements of statisticians & mobilization of information/data. Thus making it difficult to compile national income statistics.
- The existence of political instabilities (in some parts of an economy). This creates fear for life and destruction of property of the statisticians. This thus discourages gathering of information/data in regard to incomes, expenditures & outputs.
- The difficulties of determining the boundary of production. This is attributed to some goods staying in production for more than one year; the failure to define some services eg whether child

labour or the services of a house wife should be included or excluded from the estimation of national income statistics

(The difficulties of determining the boundary of production is concerned with which items should be included or excluded in the estimation of national income)

- Timing of production. This is because it is difficult to determine the output produced in a country during a particular year. This is true for agricultural output in which it becomes hard to decide whether to consider the time of production or the time of harvesting when estimating national income.
- It is difficult to determine the actual value of public utilities. This is because they are usually subsidized by the government.
- Omitted market transactions. This is because not all transactions are included in the estimation of national income. Omission of transactions leads to under estimation of national income figures.
- Inadequate skilled & qualified personnel. This is attributed to the existence of defective education system. There exists few accountants, economists & statisticians to collect, analyze, interpret, compute & store national income statistics data.
- It is difficult to measure the net income from abroad. This is because imports and exports are carried out by many people/companies with little data available to verify the amount imported & exported by private firms/companies & individuals.
- It is at times difficult to identify smuggled goods. In addition, some nationals stay abroad & take up jobs illegally. This makes it difficult for the government to determine their actual contributions to national output.
- Difficulties of measuring depreciation. This makes it difficult to determine the net income because firms use different methods of measuring depreciation
- In adequate facilities & equipment used for collecting, analyzing, interpreting & storing data. This makes it difficult to carry out national income computation exercise.
- The existence of inflation. This is because price level changes affect the value of national income. During inflation national income statistics show an increase yet the real production of goods and services might have reduced. Hence over estimation of national income
- Non-marketed output/activities. It is difficult to estimate the monetary value of goods & services which are not put onto the market. Such values have to be imputed for inclusion in the national income estimation. e.g. Services of a house wife, owner occupied houses, leisure forgone, when income when income is earned, subsistence output etc.
- Double counting. This is as a result of failure to distinguish properly between final & intermediary goods. It also occurs when gifts & pensions which should be excluded are included in the computation of national income.
- Difficulties of identifying incomes from illegal activities.eg. prostitution, smuggling, gambling, etc. such incomes are not supposed to included when computing national income.

<u>Note.</u>

- ✓ Double counting. Refers to the counting of the value of an item more than once when estimating national income. It is the due to the failure to differentiate between final & intermediary goods
- ✓ *Inventories refr to
- ✓ Boundary of production refers to what should be included or excluded when estimating national income e.g. child labour, services of a house wife etc.

The circular flow of income and expenditure in an economy

This describes the way incomes & expenditures in an economy move backward & forward between households & firms/business sectors in a two sector model. Or

It is a model of the economy that illustrates how funds move through the capital, labour, & product markets between households, firms, the government, & the foreign sectors.

The incomes may be in the forms of wages, interests, or profits.

Each time something is produced and sold, it is observed that:

(i) Its value is equal to the consumers expenditure on it (Expenditure approach)
(ii) The same amount of the expenditure is received as income by the various people who contribute to its production. (Income approach)

(iii).And the same value added of the expenditure is as a result of the value added at the various/successive stages of production (value added/product/output approach)

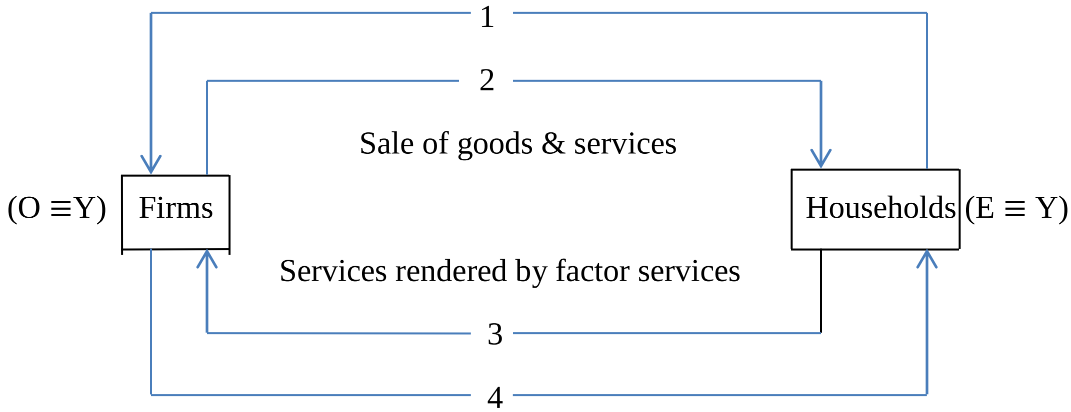
(iv).Therefore, the three approaches i.e. Output (O), expenditure (E) & income (Y) yield identical results when estimating/measuring the level of national income. Thus $E \equiv Y \equiv O$.

The assumptions of the circular flow of incomes and expenditures

(i) There are only two sectors in an economy i.e. the household /consumers and business/firms/producers.
(ii) There are no leakages (withdrawals), and injections (additions) in an economy.
(iii) The households are the owners & suppliers of factors/(services) of production.
(iv) The firms/business enterprises are the producers of goods and services
(v) All the outputs produced by the firms are sold in the market to the households
(vi) There is full employment of factor services/production

In a closed economy, assuming there is no government intervention, the circular flow for the two sectors can be illustrated as below:

Receipt from the sale of final goods & services (O ≡ E) Expenditure on final goods & services.



Expenditure on factors of production/services (≡Y≡) Factor income payments

<u>Foot note:</u>

≡ Denotes identical to.

O Denotes output approach

E denotes expenditure approach

Y denotes income approach.

<u>The measures for increasing the national income of an economy.</u>

- Improve labor skills. This is through reforming the education system, provision of on job training, etc. so as to transmit the required marketable labour skills. This encourages increased output in an economy.
- Develop techniques of production. This is through research, inventions & innovations. This leads to increased national output.
- Improve entrepreneurial skills. This is by vocationalising/changing the education system from theoretical to practical one so as to suit the required entrepreneurial skills in the labour market for effective managerial & allocation of resourcess. This leads to increases national output.
- Provide (tax) incentives to investors. This is by reducing taxes, providing subsidies, tax and holidays to investors. This encourages increased national output.
- Develop infrastructures. This is through the construction, rehabilitation, & maintenance of the communication networks. This eases the transportation, distribution & marketing of goods & services & thus increased national output.
- Stabilize prices/control inflation. This is through the use of restrictive monetary policies. This leads to increased output in an economy.
- Fight conservatism. This is through sensitization. This encourages increased national output

- Stabilize the political atmosphere. This is by conducting peace talks with rebellious groups, maintenance of good governance/democracy, & granting amnesty to rebellious groups. This gives confidence for life, & safety of property leading to increased national output.
- Diversify the economy/develop the industrial sector. This is through introducing various sectors such as small scale industries, fisheries, tourism, etc., in an economy. This increases national income.
- Liberalize the economy. This is by removing unnecessary barriers to trade so as to enable people to trade freely. This leads to increased volumes of trade/incomes.
- Encourages savings. This is through increasing interest rates on savings/deposits in the financial institutions. This encourages investments & hence increased national income.
- Provide affordable credit/loans for investments. This is through reduced interest rates to investors. This encourages increased investments and thus increased output in an economy.
- Monetize the economy. This is through increasing money supply in an economy. This encourages increased levels of investments and hence increased national income
- Control population growth rates. This is by using family planning methods. This reduces dependence burdens & increase in national income.
- Promote the utilization of idle resources. This is through the use of better techniques of production. This encourages increased national income
- Widen market(s). This is through joining regional integration, market research, trade fairs, exhibitions, bursars etc. This leads to increased national income.
- Modernize agricultural sector. This is by using modern techniques of production, use of reistent crops, & animals, agricultural research, extension services etc. This encourages increased production.
- Privatize inefficient public enterprises/assets. This is by transferring the ownership, & management of public assets, and enterprises. This leads to increases volume of goods and services in an economy.
- Encourage proper accountability. This is through proper record keeping, strict supervision, & transparency in resource exploitation & utilization. This encourages increased national output.
- Change the land tenure system. This is through reforming the communal ownership of land to individual ownership which can easily be accessed by investors. This encourages investments and hence increased national output.

The Percapita income and index of welfare/standard of living

Percapita income refers to the average income of the individuals in of a given country in a particular year.

Or it is the income per head in a country in a particular period or overtime, usually one year.

It is given by dividing the country's total National income by its total population.

Thus percapita income $= \frac{Total\ National\ Income}{total\ population}$

The percapita income of any given country is determined by:

- The size of the national income of the country

- The population level of the country in a given period of time

As an index of welfare, income percapita is convenient because it is easy to calculate.

It is also available for almost all countries since all countries do have information about population and National income.

Where income percapita is high, the standard of living is said to be high, and where the percapita income is low, the standard of living is said to be low

Standard of living refers to the level of economic welfare enjoyed by a person, family, or a nation which is achieved by consuming a variety of goods and services, including leisure, security, accommodation, employment, freedom, sunshine, self-esteem, and human rights.

It is the minimum of the necessities of life which a person or a group may be accustomed to.

Since income percapita indicates the volume of goods and services available to an individual in a given period of time, it is used to measure the standard of living of citizens in a particular country.

It is also used to compare the standard of living between countries. However, there are many limitations in using percapita income to measure the standard of living in a given country.

The limitations of using percapita income figures in measuring the standards of living in a given country

- It does not reveal the nature of distribution of income. The percapita income may be high when there is high degree of income inequalities in the economy. The high income figures may be as a result of few rich individuals yet the majority of the population is poor.
- It may be low due to the presence of large subsistence sector. Output from this sector is not included when computing national income, and yet the goods & services produced under this sector contribute to the welfare of the citizens.
- It does not reflect the quality of goods and services produced in a nation. The percapita income figures may be high yet the quality of the products produced in the country is low
- Price structures: High income percapita may be as a result of increase in the prices of goods and services in the nation due to inflation. This does not necessarily show an improvement in standard of living
- Income percapita may be high due to underestimating the population figures of a given country. This, therefore, does not necessarily imply high standard of living
- Income percapita does not reflect the level of unemployment in a country. It may be high as a result of using capital intensive techniques of production yet the majority of the citizens have no jobs
- It does not consider the other factors which contribute to the standard of living of people. It may be high when there is high level of pollution, accidents, & wars in a given nation.

- It does not consider the amount of leisure available to the citizens in a nation. Increased output may be as a result of over working the labor force which does not reflect a high standard of living

- Income percapita may increase due to the production of capital goods at the expense of consumer goods which do not improve directly the standard of living of the citizens.

- It does not show the degree of freedom, security, & self-esteem enjoyed by the citizens. It may be high when the majority of the population have no freedom and have low self-esteem.

- It does not consider the political climate over time. Income percapita may be high due to high expenditure on military hard wares which does not directly relate to welfare

- Limitations of using percapita income in comparing the standard of living between countries

- Differences in tastes and preferences overtime. The income percapita of a country may high when the goods and services produced do not meet the tastes and preferences of the citizens. This does not imply better welfare in a country.

- Differences in the production and transport costs. The income percapita may be high when a country is experiencing high production and transport cost. This does not mean better standard of living as the percapita income figures does not show the variations in production and transportation costs. (Countries may produce the same quantity and quality of goods and services but at different production and transport costs)

- Variations in income distribution. The income percapita does not reflect the nature of distribution of income per head yet there exists high level of income inequalities between countries.

- Variations in the levels of employment. The average income may be high in a country when there exists high level of unemployment as compared to the other. This does not mean better standard of living in that country. This because the percapita income figures do not show the variations in the levels of employment between countries.

- Variations in population and national income figures. A country's percapita income figures may be high as a result of under estimation of the population figures and over estimation of national income figures. This does not necessarily mean a better standard of living between countries

- Differences in social services. One country's average income percapita may be high when social services are either of poor quality or inadequate. This does not mean better standard of living in that country.

- Variations in the boundary of production. Percapita income may be high in one country due to the inclusion of certain items when calculating the national income and yet they are excluded from another. This does not imply high standard of living in that country where they are included

- Variations in political climate between countries. The income percapita may be high in a country when she is experiencing political instabilities. This is because she incurs more expenditure on military hard wares and equipment. This does not mean better standard of living

- Variations in the composition of goods and services consumed. Percapita income figures may be high in a country that produces capital goods which does not directly contribute to the welfare of the citizens

- Differences in the methods used in measuring national income. The income percapita figures may be high when the country uses the expenditure approach instead of output approach. The high expenditure figures may be as a result of the high prices of goods and services which does not reflect high standard of living.

- Variations in the levels of prices. Percapita income may be high when the general price levels of goods and services in one country are high. This does not necessarily mean better standard of living but high cost of living.

- Differences in currencies. Countries use different currencies and therefore their percapita income figures appear in different values. A country may have high percapita income figures when their exchange rate value of its currency is low in comparison to another country. This does not imply high standard of living.

- Variations in the amount of leisure enjoyed in the two countries. A country may have a high income percapita figures at the expense of leisure. This leads to a low standard of living

- Variations in the non-material things enjoyed by the people. The percapita income figures may be high when the citizens in one country are not allowed to freely express themselves, belong to the religion and party of their interest etc., This does not necessarily mean a better standard of living

- Differences in the concepts and definitions of national income. Some countries value subsistence output while others value commercial output. Others use GDP at factor cost while others use GDP at market prices etc. This makes it difficult to compare the standard of living between countries using the percapita come figures.

- It ignores the various requirements in different countries. In a cold country, percapita income figures may be high because of heating expenses. This does not mean that people in those countries are well off than those who live in hot countries where it is not necessary to heat rooms

Cost of living

This refers to the amount of money required to purchase goods and services to sustain a given standard of living.

Or it is the payment incurred by an individual for the goods and services he needs for sustaining his life in a reasonable average social status / a given standard of living

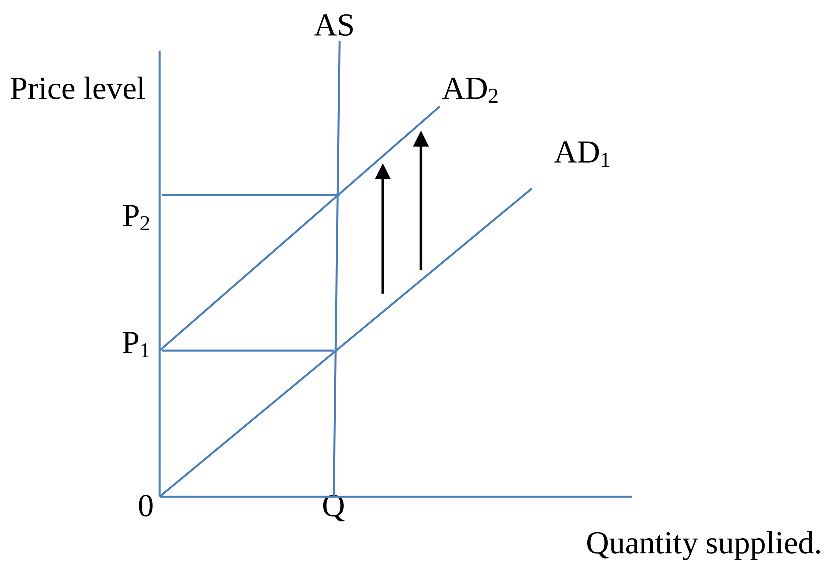
The cost of living, in most cases, determines the standard of living of citizens in a given country or region. This is because if prices of goods and services are high and incomes are relatively low, the citizens will not be able to purchase goods and services so as to have a better standard of living

When the cost of living is rising but the incomes are constant, the standard of living is deteriorating citizens

When the cost of living is reducing with constant or rising incomes, then the standard of living is improving

The rising cost of living in a country may be as a result of any of the following factors:

- Persistent inflation (demand pull inflation) i.e. when AD in an economy exceeds the AS at full employment of resources). Hence prices of goods and services are pulled up by excessive AD in relation to SS. This leads to increased cost of living.



'AS' cannot go beyond (OQ) as all resources have been employed up.
Any increase in the 'AD' may result into an increase in the general price level

Note:

- ✓ The low supply may be as a result of a breakdown in the distribution of goods and services, or war which stops production, floods, & vagaries of weather.
- ✓ Unemployment, in the economy which leads to low output or low incomes
- ✓ Increase in the cost of factor of production or raw materials.
- Increase in the cost of factor inputs. This is attributed to high taxes imposed on resources. This increases the prices of the products produced thus leading to high cost of living.
- Improper costing of commodities/pricing of goods and services e.g. of imported goods and services. This is attributed to increased taxes, transport costs, ware housing etc. This increases the prices of goods & services thus increased cost of living.
- Rampart mass unemployment. This is attributed to deficiency in aggregate demand & services produced as a result of low incomes. This leads to failure to purchase goods, services & resources; thus high cost of living
- Improper planning in the production of goods and services urgently needed.
- Unfavorable government policies on production/investment. This is through high taxes imposed on incomes, goods and services. This results into increased prices of goods & services & hence cost of living.

- Improper distribution of resources. This is because of the existence of poor infrastructure. This leads to rising prices of goods & services & thus high cost of living.
- Unfavorable wage policies. This is due to the high taxes imposed on incomes. This leads to low disposable incomes, reduced purchasing power & thus high cost of living.

Measurement of cost of living

- This is undertaken to show the changes in the cost of living of people in regions, towns, or cities over time.
- The government uses the result of this measurement for making socio–economic policies in a given country
- The commonest methods used for measuring cost of living are price index (simple index or price relative) and consumer price index.

The price index

- Index numbers are variations in certain variables from one period (base year) to another. The variables may be prices, GDP, etc.
- The commonest used index number in Economics is the price index
- The price index is one which measures the relative changes in the prices of goods and services from one period to another (or the average percentage variations in the prices of goods and services from one year to another
- When it is used to measure changes in prices of consumer goods, it is called the consumer price index (CPI)
- When it is used to measure variations in the prices of basic needs of a group people, it is called cost living index (CLI)
- When it is used to measure changes in retail prices, it is called retail price index (RPI)
- The magnitude/size of the percentage change in the price of commodities from the base year to another indicates a fall or rise in the cost of living index

The types of price indices

- Consumer price index. Is one which measures the relative changes in the prices of consumer goods and services used by people. It indicates the real value of money between the base year and the current year

- Cost of living index. Is one which measures the relative changes in the prices of basic needs of people from base year to the current year.
- The percentage change in the prices of basic needs of people between the base year and the current shows a change in the cost of living
- GNP index (GNP deflator). Is one used for converting the nominal GNP at current market prices to real GNP at base year prices.
- The deflation of national income figures gives real national income figures. This is because inflation exaggerates the national income figures. Therefore, the price index can be used to make adjustments so as to get the actual (real) value of the national income
- Deflation is a price index that covers virtually all the goods & services produced within the economy & used to change nominal national income figures to real national income
  This enables the comparison of prices while accounting for inflation in two different periods. (Current & base years)

Nominal value is one measured in monetary terms/units.

Real value is what the nominal value can buy.

Thus GNP deflator $= \frac{Nominal\ GNP}{Real\ GNP}$

$= \frac{Price\ indexc\ of\ current\ year}{Price\ index\ of\ base\ year}$

But price index of base year $= 100$

This implies that $\frac{Nominal\ GNP}{Real\ GNP} = \frac{Price\ index\ of\ currrent\ year}{100}$

The Real GNP $= \frac{Nominal\ GNP}{Price\ index\ of\ current\ year} \times 100$

Q. (a) what is meant by Real Gross domestic product?

(b) Given that a country's nominal Gross domestic product is shs. 150,000,000,000/=; and the consumer price index is 105. Compute her real gross domestic product.

Real GDP $= \frac{Nominal\ GDP}{Price\ index} \times 100$

$= \frac{150{,}000{,}000{,}000}{105} \times 100$

= shs. 142,857,142,857.14/ˉ

<u>Some of the concepts used under the measurement of cost of living</u>

1. Price relative (PR). Is one which measures the relative changes in the prices of a single commodity between the base year and the current year.

It relates the prices of one year to the base year prices.

It is computed by determining the percentage change in the price of each commodity from the base year to the current year.

Thus Price relative (PR) $= \frac{\text{Average price in the current year}}{\text{Average price in the base year}} \times 100$

2. Base year. Is one in which prices were stable compared to the other years.

The base year is given an index of 100 which is used as a reference figure to indicate whether there has been a fall or rise in the price of a particular commodity.

3. Simple price index (Average price relative). Is a figure which measures the relative changes in the prices for a number of commodities between the base year and the current year

Thus Simple price relative (SPR) $= \frac{\text{sum of price relatives}}{\text{Number of commodities}} = \frac{\sum \text{PR}}{\text{N}}$

4. Weight. This refers to the importance attached to a commodity. The weights may be in terms of the quantities or values of the consumed, or the figures attached to the commodities

5. Weighted price index. This refers to the product of the price relatives and the weights attached to the commodities showing their degree of importance.

Thus the weighted price index $=$ (Price relatives $\times$ Weights)

The weights are used to show the relative importance the consumer attaches to the various commodities (basket of goods & services) consumed. This is because the simple price index or the average price relatives do not reveal much about the relative importance attached to a commodity

6. Average weighted index. Is the ratio of the sum of the weighted indices to the sum of the weights.

Thus average weighted index $= \frac{\text{sum of weighted indices}}{\text{Sum of weights}}$

<u>How price indices/cost of living are computed in an economy</u>

1. Selection of the base year. This is the year in which prices of goods and services were relatively stable as compared to other years. The base year should be given an index of 100
2. Selection of basket of goods and services (representative sample) consumed by a typical family i.e. majority of the people.
3. Collection of data. This through interviewing households , getting information on branded goods where prices are written on packets/containers, undertaking personal visits to retail shops by government statisticians and local authorities e.g. data on rent, rates etc.

The data to be collected includes information on the quantities and prices of essential goods and services consumed in both the base year and current year.

5 Attachment of weight. This is by assigning relative importance to each commodity chosen as a representation. This shows how important or less important a commodity is to consumers/households.

1. Valuation of the basket of goods and services selected. This is done by assigning a value of 100% to each item.
2. Calculation of price relatives for each commodity. This is done by the use of the formula: Price relative $= \frac{\text{Current year price}}{\text{Base year price}} \times 100$
3. Calculation of weighted index for each commodity. This is by using the formula' Weighted index $=$ Price relative $\times$ Weight.
4. Calculating the average weighted index. This is by using formula: Average weighted index $= \frac{\text{sum of weighted indices}}{\text{Sum of weights}}$
5. Tabulation of data. This done through the representation of the collected information on a table

Tabulation: An illustration of how to compile price index/cost of living index

Commodity	Price in 2000 in shs (Base year)	Simple index for the year 2000	Prices in 2015 (Current year)in shs	Weights
Fish	2500	100	3000	5
Rice	4000	100	5000	1
Beans	8000	100	10,000	6
Salt	700	100	1000	2
Simsim	2000	100	2500	3
Millet	1000	100	1500	4

a) Price relative (PR) $= \frac{\text{Current year price}}{\text{Base year pric}} \times 100$

Fish $= \frac{\cancel{\text{Shs}}.2500}{\cancel{\text{shs}}.3000} \times 100 \quad = 120$

Rice $= \frac{\cancel{\text{shs}}.5000}{\cancel{\text{shs}}.4000} \times 100 \ = 125$

Beans $= \frac{\cancel{\text{shs}}.10{,}000}{\cancel{\text{shs}}.8000} \times 100 \ = 125$

Salt $= \frac{\cancel{\text{shs}}.1000}{\cancel{\text{shs}}.7100} \times 100 \qquad = 142.86$

Simsim $= \frac{\cancel{\text{shs}}.2500}{\cancel{\text{shs}}.2000} \times 100 \ = 125$

Millet $= \frac{\cancel{\text{shs}}.1500}{\cancel{\text{shs}}.1000} \times 100 \ = 150$

b) Simple price index $= \frac{\sum \text{PR}}{\text{N}} = \frac{120+125+125+142.86+125+150}{6}$

$$= \frac{834.29}{6}$$

$$= 139.05$$

c) Weighted price index = Price relatives $\times$ Weghts

Fish $= \ 120 \times 5 \ = 600$

Rice $= \ 125 \times 1 \ = 125$

Beans $= 125 \times 6 \ = 750$

Salt $= 142.86 \times 2 \ = 285.72$

Simsim $125 \times 3 \ = 375$

Millet $= 150 \times 4 \ = 600$

d) Average weighted price index for 2015 $= \frac{\text{Sum of weighetd indices}}{\text{sum of weights}}$

$$= \frac{(600+125+750+285.72+375+600)}{(5+1+6+2+3+\ +4)}$$

$$= \frac{2735.72}{21}$$

$$= 130.27\%$$

Conclusion:

- When the average weighted index is 130.27% (greater than 100%), i.e., (130.27 – 100)%, this implies there was an overall increase in the general price level by 30.27%. This further implies that that there was inflation in the economy
- When the average weighted index is 90% (less than 100%), i.e. (90 – 100 = -10), this implies that there was an overall decline in the general price level by (– 10) hence deflation in the economy

Q. Study the table below and answer the questions that follow.

Commodity	Base year price 2013 (shs.)	Current year price 2016 (shs.)	Price relative 2016	Weight	Weighted price relative
A	800	-	125	2	-
B	1000	-	120	1	-
C	600	-	80	4	-
D	1200	-	100	3	-

(a) Calculate the:
(i) Current year price for each commodity
(ii) Simple price index
(iii) Weighted price relative for each commodity
(iv) Weighted index
(b) Explain the problems encountered by developing countries in the computation of the cost of living indices

The importance/uses of price indices.

- They are used in adjusting nominal GDP to real GDP This is through using the GNP deflator
- They are used in wage/salary/pension determination. This is because wages need to be adjusted according to the changes in the value of money
- They are used to forecast & predict trends (changes) in the business activities over time based on time series data.
- They are used for comparing the cost of living between regions/countries at a time and for one country over time. This is because it is available for all regions/countries.
- It is used for deciding on whether to give any form of subsidies to producers or not. This is done to encourage or discourage production of certain commodities
- They are used to measure the changes in the value of money. This is through. determining the rate of inflation or deflation in an economy over time.
- They are used to determine the terms of trade for an economy. This is because it is available for all countries participating in foreign trade.
- They are used in tax rate determination. This is because taxes need to be adjusted according to the price changes in an economy.

The problems encountered when compiling price indices

- Difficulties of determining the base year. This is due to persistent fluctuations in the general/average prices levels of goods and services. This makes it difficult selecting the base year.
- Difficulties of selecting a representative of basket of goods and services for all groups of people in an economy. This is because the rich and poor have different tastes and preferences and the chosen basket of goods & services may not reflect the cost of living for the general population
- Difficulties of attaching valid weights on the various commodities and services. This is because weights keep on changing over time. This is attributed to new discoveries and changes in consumption patterns. This makes weights to lose relevance in the computation of the cost of living index
- Difficulties of data collection. This is due to great variations in the prices paid for the same commodity in different markets by the same or different groups of people in an economy.
- Inadequate skilled personnel and equipment necessary to carry out the exercise. This is because of the poor education system in most developing countries. This leads to poor data collection.
- Changes in the general price levels. This is due to inflation and deflation in an economy. This makes it difficult to attach valid weights on commodities consumed by people.
- Lack of standard measures and weights system. This makes items to be sold in heaps, bundles, etc. thus making it difficult to standardize the measurements of the representative goods and services.
- The existence of barter system of exchange. This is due to the low levels of monetization in most developing countries. This thus forces statisticians to impute figures which lead to biased results as there is no standard value of commodities that can be obtained.

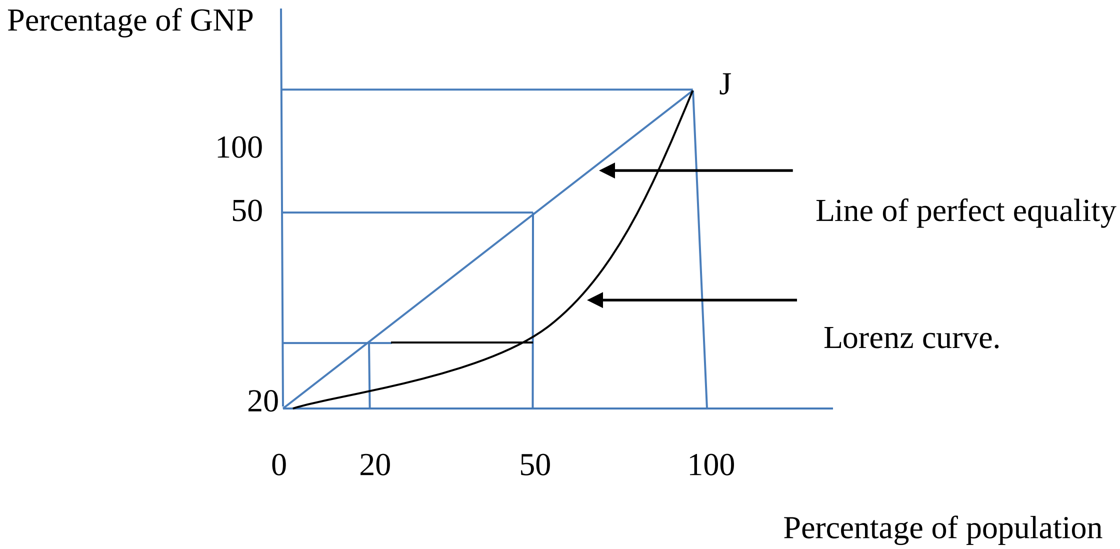
Note:

- ✓ Imputation of value. Means the value of an asset, service or company that is not physically recorded in any accounts but is implicit in the product.
- ✓ Implicit means that which is self-owned.

Income distribution in an economy

- Income distribution is the way in which the given members of a society share their income. It is the proportion of income that goes to a defined section of the population in an economy.
- In most developing countries, national income is not evenly/equally distributed among the population of their respective economies. There exists significant in egalitarian/unequal distribution of national income between regions, & nations.
- Income inequality/disparity refers to the economic gap between the rich and poor within the same economy and or different economies.
- The disparities in income distribution may be depicted using a Lorenz curve
- The Lorenz curve is one that depicts the actual quantitative relationship between the population of a given society and the relative share of their incomes in a given year

The Lorenz curve



- The line (OJ) shows perfect equality in the distribution of national income. That is, it represents 50% of the national income being distributed to exactly 50% of the population.
- However, in reality, perfect equality had never existed even in socialist economies.

E.g. the line of perfect equality shows perfect distribution of income where 50% of the *population receiving 50% of the national income. But the Lorenz curve shows that 50% of the population receives 20% of the national income.

- The Lorenz curve is drawn on the same graph for different regions/countries so as to make comparisons of income distribution among regions/countries possible
- It can also be drawn to show variations of income distribution in one country over time.
- The more the Lorenz curve lies away from the line of perfect equality, the greater the degree of disparity/inequality.

The causes of income disparities/inequalities in an economy.

- Differences in stock of wealth. Individuals with a large stock of wealth have high chances of investing & acquiring more wealth than individuals with little wealth. This is because wealth creates more wealth
- Difference in political climate. People living in politically stable areas have the ability to invest & accumulate more wealth. This is associated with the confidence for their life & safety of property as compared to their counter parts in politically unstable areas. This because of the fear of their life & destruction of property.
- Differences in the levels of education & training. Individuals with high levels of education & training earn higher incomes/wages as compared to individuals with low educational levels & training. This is attributed to the differences in their respective levels of education & training.
- Differences in the levels of growth & development. Government may deliberately plan to develop certain regions & sectors faster as compared to other areas/sectors. This creates income/wage differences among individuals in the different regions/sectors of a given country.
- Differences in natural talents & abilities. People with special talents/skills generate more incomes/wealth. This is because they are creative & innovative. However, people without special talents/skills earn less income/wealth. This is because they are less creative & less innovative.

- Differences in natural resource distribution. People in regions which are endowed with natural resources accumulate more wealth/incomes. This is associated with the existence of many resource deposits in such areas. However, people living in areas which are less endowed with natural resources accumulate less wealth & resources. This is because of the absence of natural resource deposits in such areas.
  than those in areas without such natural resources.
- Difference in age. People who are old/aged tend to have more wealth & income. This is because they have accumulated wealth over time. However, people who are young tend to accumulate less wealth/incomes. This is because they are still young & inexperienced.
- Differences in distribution of industries between urban & rural areas. This is due to the concentration of industries & other social & economic infrastructure in urban areas which leads to imbalances in income generating activities in favor of urban areas. Thus income inequalities/disparities.
- Differences in family background. Individuals from rich families have higher chances of inheriting wealth & family influence to get well-paid jobs as compared to their counter parts from poor families. This is because a rich family background has positive influence in the acquisition of wealth & incomes than a poor family background.
- Differences in luck. Individuals who are lucky have chances of becoming rich more easily than the unlucky ones especially through lotteries/betting etc. This is because nature has blessed some people more than others.

The benefits of income inequalities.

- Provides revenue to the government. This is through the administration of progressive taxation on peoples incomes & or the resources & services of different regions. This leads to infrastructural development.
- Encourages mobility of labor. This is attributed to the need to search for better opportunities. This leads to better standards of living.
- Promotes investments. This is associated with the rich having high marginal propensity to save which is invested. This results into increased employment creation, incomes and thus improved welfare
- Encourages hard work. This is because the poor are forced to work hard so as to earn a living. This leads to improved standard of living
- Guarantees labor supply to unattractive jobs. This is due to risky jobs commanding high level of payments. This provides incomes for the poor and thus improved standard of living.
- Encourages better working relationships between the poor and rich. This is through the poor employees having respect for their rich employers. This leads to peace and harmony in the society.
- Provision of incentives for investment. This is because the resources/incomes that flow to the rich are used for investment purposes. This leads to increased production/economic growth.
- Reminds the government of her subsidization role. This is through the use of progressive taxation. This leads to improved welfare among the low income groups.
- Provision of market. This is due to the existence of high marginal propensity to consume among the poor. This results into improved standard of living among the poor
- Increases inventions and innovations by the poor. This is attributed to the need to cope with the cost of living. This leads to increased output/economic growth.

The demerits of income disparity/inequality

- Reduces government revenue. This is because the majority of the people are poor and cannot be highly taxed. This leads to poor infrastructural development
- Leads to low levels of consumption and effective aggregate demand. This is due to the existence of low incomes among the majority of the people who are poor. This leads to low level of investments and economic growth rates.
- Leads to profit repatriation. This is because most of the rich people are foreigners in most developing countries who tend to reinvest their profits in their mother countries. This leads to low capital accumulation/formation in developing countries.
- Leads to the exploitation of the poor by the rich. This is due to the low payments of wages to the poor employees by the rich employers. (In addition, this is the through the rich monopolists restricting output-operating at excess capacity/underutilization of resources) and charging high prices for goods and services. This results into poor standards of living.
- Poor quality output. This is due to the low the limited research, inventions & innovations. This leads to reduction in efficiency at work/poor standards of living
- Leads to unequal regional growth. This is attributed to the concentration of resources/incomes in some few regions. This leads to regional imbalance
- Leads to resource underutilization. This is due to the existence of low incomes/low investment levels among the poor. This results into low output/low economic growth rates.
- Increases dependence burden. This is associated with the existence of many poor people. This results into poor standards of living.
- Leads to rural urban drift with its associated evils. This is due to the existence of high incomes/resources/better facilities etc. in urban areas. This leads to low standards of living/low output in the rural country sides.
- Increases social tensions in societies. This is attributed to increased crime rates among the poor with the intension of surviving/becoming rich/. This leads to disharmony in the society.
- Leads to the production and importation of luxury goods demanded by the rich. This undermines the production of the basic goods and services required by the majority poor. This leads to poor welfare for the majority poor
- Leads to balance of payments deficits. This is attributed to increased importation of goods and services from abroad (which leads to increased import expenditure) by developing countries (poor nations) while export earnings decline. This leads to low foreign exchange earnings.

The measures for income disparity/inequality

- Price control measures. This is through the use of minimum and maximum price legislations. This helps to stabilize incomes and wealth among the rich and the majority people.
- The use of fiscal policies. This is through the manipulation of government expenditures and taxation. This helps to improve the standard of living among the poor.
- Development of infrastructure. This is through the construction, rehabilitation, and maintenance of the existing communication networks (e.g. roads, railways, banks, factories etc.,) as engine of growth. This helps to facilitate the transportation, distribution and marketing of resources, goods and services.
- Market expansion. This is through research, and regional integration. This promotes trade and hence increasing the incomes and welfare of the people.

- Proper resource allocation and management. This is by ensuring proper record keeping, and transparency in the allocation/distribution of public funds. This helps to minimize corruption and embezzlement of public funds.
- Education reform. This is through transforming/changing the education system from theoretical to vocational so to provide relevant training & practical skill needed in the job market.eg. carpentry, tailoring, home economics, catering, entrepreneurship etc.
- Land reform. This is by changing the structure of land use and ownership (land tenure system) (e.g. land consolidation, reclamation, registration, as well as resettlement schemes, etc.). This helps to increase agricultural productivity and hence reducing income/wealth inequality between land lords and tenants.
- Political stability. This is through ensuring democratic governance, granting amnesty to rebellious groups, & conducting peace talks with rebellious groups. This helps to promote confidence for life, safety of property & investments in all regions as a way of ensuring equitable distribution of incomes and resources.
- Provision of credit facilities to the poor. This is by lowering the interest rates and softening other terms of loans. This helps to encourage income generating activities among the poor; & thus leading to the breakdown of poverty among the poor groups of people.
- Liberalization of the economy. This is through removing the unnecessary barriers to economic activities/trade. This helps to boost economic activities/investments and hence reducing income inequalities
- Control of population growth rates. This is through the use of family planning methods. This helps to increase peoples marginal propensity to save, percapita incomes, and hence increasing investments.
- Rural development. This is through decentralizing firms/industries/factories. This helps to provide jobs and incomes to the rural people

The theory of national income equilibrium (Macroeconomic equilibrium)

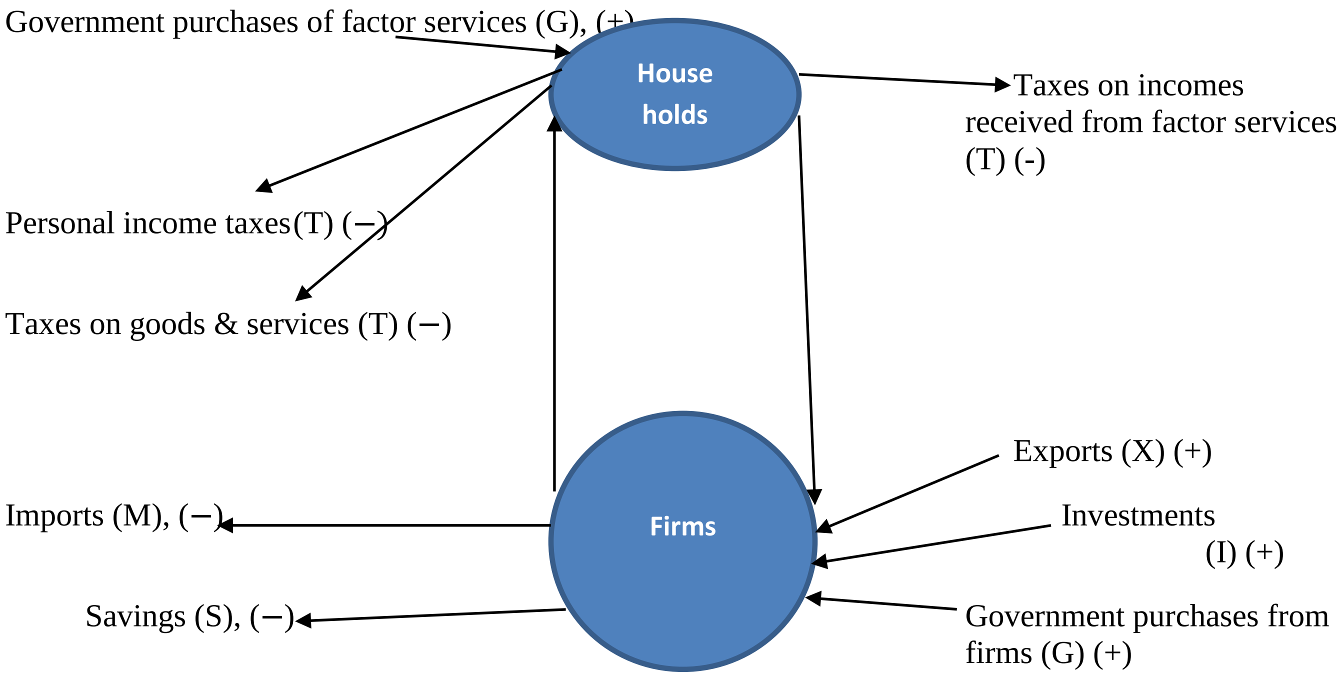
National income equilibrium refers to a state when there is no tendency for the national income to change (i.e. either rise or fall). It is the level of national income at which aggregate demand (AD) is equal to aggregate supply (AS) or production

(a) National income equilibrium in the short run (classical approach)

- In the short run, in an open economy, national income equilibrium is determined by both leakages and injections. Therefore, national income is in a state of eguilibrium when injections are equal to leakages.
- Leakages are withdrawals from the circular flow of incomes and expenditures
- Leakages are any incomes received by households and not passed on through spending to firms, and any incomes received by firms & not passed on as income payments (rent, interest, profits, and wages/salaries).
- The components of leakages are: savings (S), imports purchases (M), & net taxes (T), i.e. the differences between total taxes paid to the government and transfer payments made by the government.
- If the government or house hold does not spend its incomes but accumulates them as a reserve against some future expected expenditures, it will leak out of the circular flow of incomes and expenditures.

- Imports are regarded as one of the elements of leakages from the circular flow of incomes and expenditures because of the expense incurred on buying goods and services which accrue as incomes to other outside economies other than the importing country
- If the government taxes firms, some of their incomes will not be available to be passed onto the households as incomes. This is thus said to have leaked out of the circular flow of incomes and expenditures.
- However, some tax revenues received by the government as a result of taxing the firms may find its way back into the circular flow of incomes and expenditures if the government spends it on goods and services.
- In a nut shell, therefore, withdraws make the level of the national income to fall

Illustration of leakages and injections in an economy



(b) Injections are additions to the circular flow of incomes and expenditures (which do not originate from the expenses of domestic households but creates incomes for firms)

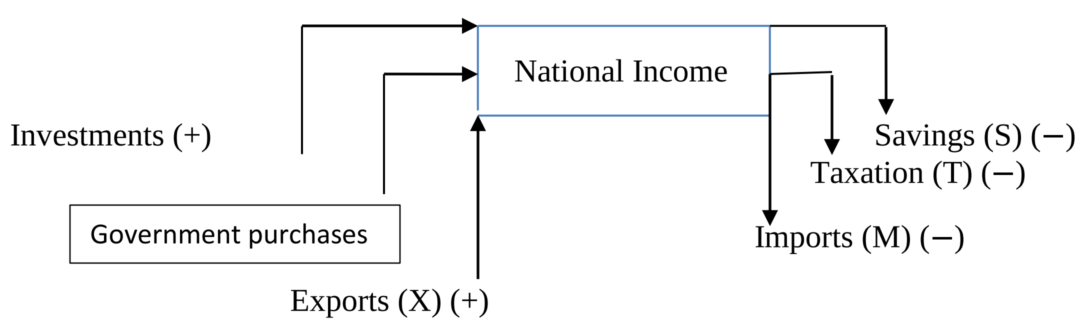
- The components of injections are: investments (I), exports (X), and government expenditure or purchases (G).
- Injections may also be referred to as a purchase made by firms, government, or foreign buyers that increases the flow of incomes in an economy.
- The government expenditure on domestic products is an addition to the circular flow that does not arise from the spending of the households but simply creates incomes for the firms.
  E.g. In the event of the government buying a jet fighter from a private firm within the economy, this expenditure of the government shall accrue to the firm as income. Hence the incomes the firm gets shall rise as well as the incomes of the households that supplied the factor services/resources to the firm concerned
- Exports add to the circular flow of incomes and expenditures as foreigners contribute incomes to the domestic economy by buying domestic goods and services
- Injections make the level of the national income to rise

- Conclusively, the equilibrium of national income is attained when leakages are equal to injections in an economy in a given period of time , usually one year
- This further implies that the component elements of both leakages and injections must also balance
- Thus leakages= $Injections$
  (Savings + Taxes + Imports) = (Investments, + Governments purchases + exports)

i.e. $(S + T + M) = (I + G + X)$

This may diagrammatically be shown as below:

<u>National Income equilibrium in the short run</u>

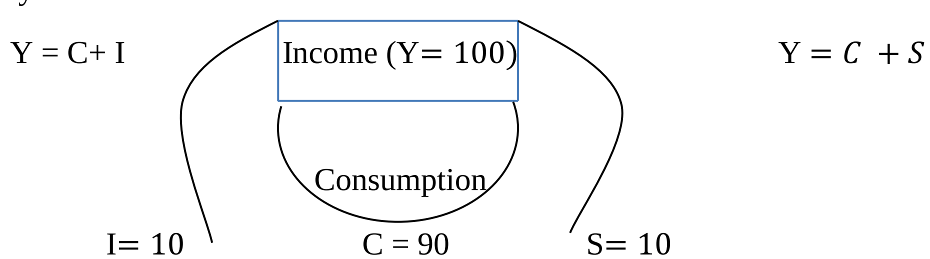


Income comprises both spendings on consumer goods, services and investment goods.
Thus Y = C+ I. But the income obtained from any venture is normally partly consumed and saved. Thus Y= $C + S$

As both C + S and C + I are assumed to be equal to Y, this implies that

C+ I = C +S. Thus (I) = (S)

This may be illustrated as below:



For national income to be in a state of equilibrium, it is necessary for the planned savings to be equivalent to the planned investment

If people wish to save 10 units out of a total income of 100, investment will have to equal to 10 units if that level of income is to be maintained

Income will be in equilibrium and show no tendency to change if savings and investments are exactly equal.

(b) National Income equilibrium in the long run (Macro-economic disequilibrium) (Classical theory)

National income equilibrium is attained when AD $= AS$ where all resources are fully employed in the production process.

Full employment is a situation where everybody who is capable and willing to work at an acceptable wage rate is engaged.

Aggregate demand is the total demand for an economic good within an economy or the total desired purchases of the buyers in an economy

It considers demand on a macro level rather than on micro level or on individual levels.

Aggregate demand comprises consumption (C), investment (I), government expenditure (G), and net earnings from abroad (X−M).

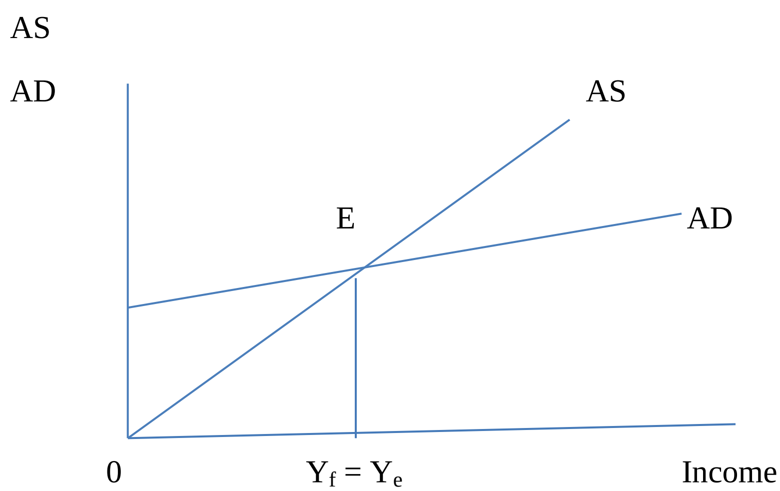
Thus AD$= C + I + G + (X - M)$

The AS is the total volume of goods and services currently available in a given market, or total desired output of all the producers in a country. It considers a variety of goods & services as well as many suppliers

The concept of AD and AS in determining a state of full employment of resources may be illustrated as below:

(Equilibrium of national income)

Full employment of income/resources



Foot note:

(E) Denotes equilibrium

(AS) denotes aggregate supply

(AD) denotes aggregate demand

(Y_e) denote equilibrium level of income

(Y_f) denotes full employment level of income/resources

(E) Denotes a state of equilibrium where AS=AD at full employment level of resources

Y_f denotes full employment level of income/resources

Y_e denotes equilibrium income

According to Lord John Maynard Keynes, National Income equilibrium is not only attained at a point where AS = AD but that full employment level of income (Y_f) may be greater or less than equilibrium income

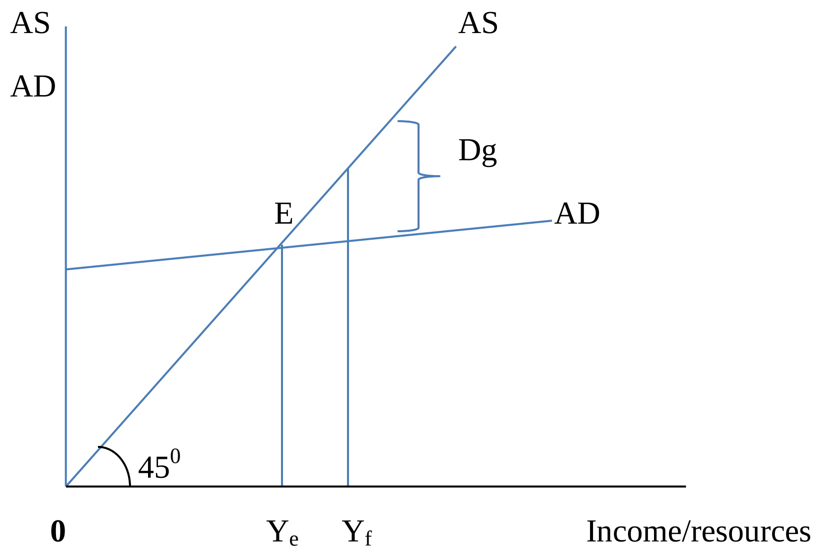
This implies that there is a possibility of having full employment of income (Y_f) being greater than equilibrium income (Y_e); and also having full employment of income (Y_f) being less than equilibrium income (Y_e)

It is, therefore, possible to have the following situations:

(i). $Y_f = Y_e$ (ii) $Y_f > Y_e$ (iii).$Y_f < Y_e$

This implies that full employment of income can occur either be above or below the equilibrium of income. Hence the above situations may lead to the creation of deflationary (positive output) gap and inflationary (negative output) gaps respectively

(a). The deflationary gap. (As >AD)



Foot note:

(Dg) denotes Deflationary gap

(E) denotes equilibrium.

(Y_f) denotes full employment level of income/resources

($Y_{e)}$ denotes equilibrium level of income

The deflationary gap is a situation where the AS exceeds the AD at full employment level of resources/income

At this level all that is produced is not demanded and the realized investment is greater than the actual demand

The deflationary gap is caused due to deficiency of aggregate demand in an economy for what is produced

Solutions to closing the deflationary/positive output gap

(1) The deflationary gap can be closed by increasing the aggregate demand

The major policy for increasing the aggregate demand is fiscal policy i.e. government's decision about spending and taxation. This may be in the following ways:

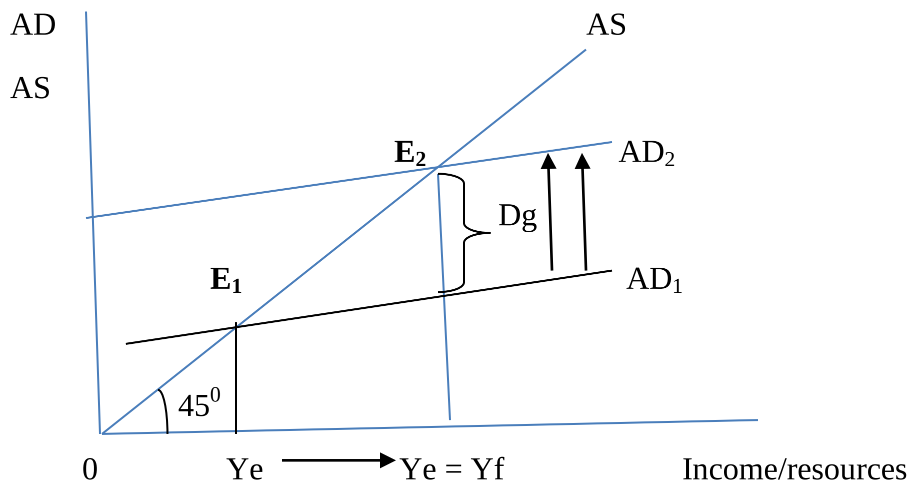
(i) Reduction of taxes imposed on peoples incomes. This helps to raise up the disposable incomes, the level of AD and thus closing the gap.
(ii) Increasing government expenditure on production, and investment on public works. This is through the provision of subsidies/grants to producers. This helps to inject more money in circulation and hence raising the AD which in turn closes the gap
(iii)Increasing workers' wages. This helps to raise their purchasing power and the level of effective demand of the labor force employed.

(2). Expansionary/monetary policies. This helps to raise the level of aggregate money supply and AD in an economy.

(i).Increasing the amount of money in circulation. This is through printing more money or using monetary tools such as OMO (buying bonds from the public), lowering the bank rates, reducing the margin requirements, reducing cash ratio, reducing the legal reserve requirement etc. This helps to increase the aggregate demand of the people in an economy.

(3). other measures include trade policies such as encouraging exports and discouraging imports in the economy. This is through lowering taxes on exports & increasing taxes on imports. This helps to generate an outlet for surplus production in the domestic economy and at the same time generate some incomes. This thus helps to increase the aggregate demand & close the deflationary gap.

Basing on the above measures, consequently, the AD curve shifts upwards thus closing the deflationary gap.



Foot note.

(Dg) denotes Deflationary gap

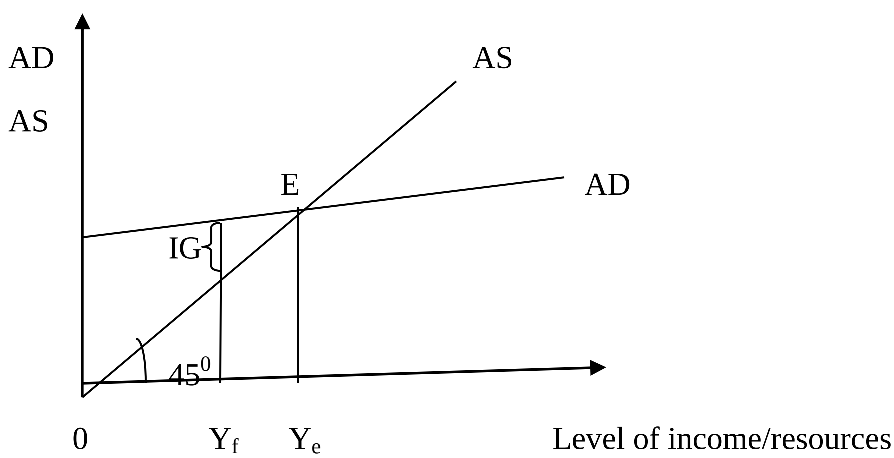
(E) Denotes equilibrium.

($Y_{f)}$ denotes full employment level of income / resources

($Y_{e)}$ denote equilibrium level of income

Equilibrium is attained at (E_2) at full employment of resources by increasing the AD from AD_1 to AD_2 & thus closing the gap

(b).The inflationary/negative output gap. ($AD > AS$)



Foot note:

(IG) denotes inflationary gap

($Y_{e)}$ denote equilibrium level of income

($Y_{f)}$ denotes full employment level of income/resources

(E) Denotes equilibrium level of income

The inflationary gap is a situation where the AD exceeds the As at full employment level of resources.

Realized investment is less than the actual demand. What is supplied is not enough. All that would happen is that prices would be pulled up and income would rise in monetary terms but not real terms

The inflationary gap is caused by supply deficiency.

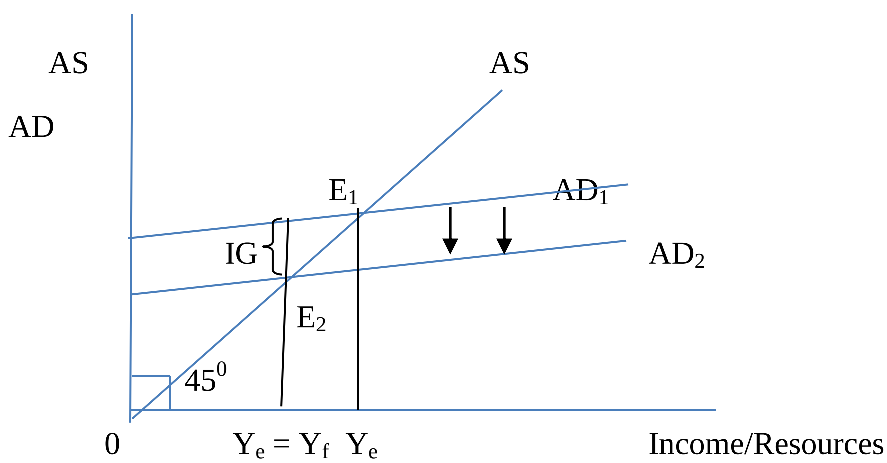
<u>Closing the inflationary/negative output gap.</u>

1. The inflationary gap can be closed by reducing the AD.

   The major policy for reducing the AD is by using fiscal policies

   (i) Increasing taxes with the view of reducing disposable income, purchasing power of labor force and AD. Thus closing the inflationary gap
   (ii) Reducing government expenditure on wages/salaries, allowances etc. This helps to lower the purchasing power of the civil servants/labor force and their effective aggregate demand.
   (iii) Reducing government expenditure in the economy. This is by retrenching the civil servants, and lowering the level of government subsidies to government owned producing units. (Industries, firms, parastatals etc.)
2. Restrictive/constrictive monetary policy. This is through reducing the amount of money in circulation by increasing interest rates, increasing bank rates, selective credit control, increasing the margin requirement, increasing cash ratio, increasing the legal reserve requirement etc.
3. Restrictive commercial trade policies. This is through levying high taxes on export & low taxes on imports trade. This helps to discourage exports and encourage imports. This increases the amount of output in an economy and thus matching up the level of AD with AS

Basing on the above policies, consequently, the AD curve shifts downwards and thus closing the inflationary gap



Foot note:

(Dg) denotes deflationary gap

(E) Denotes equilibrium level of income

($Y_{e)}$ denote equilibrium level of income

($Y_{f)}$ denotes full employment level of income/resources

At (e_2), equilibrium is attained by lowering the Ad from AD_1 to AD_2 and thus closing the gap

Consumption, savings, and investment theories.

(a). The consumption theory.

Consumption is that part of the total income devoted to expenditure on final goods and services by individual consumers/nations during a given period of time.

It is given by $C = Y_d - S$

Where (C) denotes consumption

($Y_{d)}$ denotes disposable income

& (S) denotes savings

Thus consumption expenditure refers to the amount of money spent on final goods and services to provide utility/satisfy (human) wants (eiher individually or collectively).

The relationship between consumption and the level of income is termed as the consumption function. Therefore, consumption (C) = c(Y)

Where ($_C$) denotes the marginal propensity to consume &

(Y) Denotes the total income obtained

The marginal propensity to consume is defined as the proportion/fraction/percentage of the additional income spent on consumption.

Or the ratio of change in consumption to the change in additional income that brought it about. Thus $MPC = \frac{\Delta C}{\Delta Y}$

The concepts used under consumption

- ✓ Autonomous consumption. Is one which is independent of the level of income. (That is, income inelastic)
- ✓ Induced consumption. Is one which depends on the level of income

The determinants of the level of consumption in an economy

- ✓ The level of disposable income. The high level of income encourages increased demand for goods and services (consumption). This is associated with high purchasing power of the consumers. However, low level of income discourages consumption of goods and services. This is associated with the low purchasing power of the consumers
- ✓ The level of taxation. An increase in taxes reduces demand for goods & services. This is due to the low disposable incomes of people hence a reduction in consumption. However, a reduction in taxes increases the consumption levels of goods & services. This is due to the increased purchasing power of the consumers
- ✓ The level of savings. Given high level of savings, reduced consumption is encouraged. This is as a result of reduced incomes/purchasing power of consumers/high marginal propensity to save. However, given a low level of savings, this leads to increased consumption levels. This is as a result of increased purchasing power of the consumers/low marginal propensity to save.
- ✓ The level of liquidity preference. High liquidity preference leads to increased consumption of goods & services. This is due to the high purchasing power of the consumers. However, low level of liquidity preference leads to reduced consumption of goods & services. This is due to the low purchasing power of consumers
- ✓ The level of government expenditure. Increased government spending leads to increased consumption of goods & services. This is attributed to the increased wages/salaries/purchasing power. However, a reduction in government expenditure leads to reduction in the level of consumption of goods & services. This is because of reduced incomes/wages/purchasing power.
- ✓ Consumers' expectation. Where consumers expect inflation (rising average/general price levels) in future, current consumption increases. This as a result of an anticipated fall in money value. However, where consumers expect a fall in the average/general price levels in future, the current demand/consumption for goods & services reduces. This as a result of an anticipated rise in the money value.
- ✓ The nature of income distribution. A high level of income disparities leads to low levels of consumption of goods & services. This is attributed to existence of low incomes in the hands of the majority poor However equitable income distribution encourages increased in consumption of goods and services. This is attributed to the existence of high level of incomes in the hands of people
- ✓ The size of the population. An increase in population levels encourages increase in consumption levels of goods & services. This is due to the high population growth rate. However, a fall in the population size leads to a fall in consumption levels of goods & services. This is due to the low population growth rate
- ✓ The economic climate. An increase in the average/general price levels (inflation) leads to reduced levels of consumption of goods & services. This is attributed to the fall in the real value of money/fall in the purchasing power. However, a fall in the average/general price levels leads to increased consumption of goods & services. This is attributed to the increase in the real value of money/increase in the purchasing power.

(b) . The savings theory

Saving refers to the part of the disposable income that is not spent on the current consumption of goods and services.

- The concept of marginal propensity to save.
- ✓ The marginal propensity to save is defined as the proportion/fraction/percentage of the additional income saved/not spent.
  It may also be define as the change in savings resulting from a given change in income
  Or the ratio of change in savings to the change in income.
- ✓ Thus MPS = $\frac{\Delta S}{\Delta Y}$
- ✓ By definition, therefore, MPC + MPS = 1. This is because to a consumer, the income earned is either consumed, saved, or both but in varying proportions.
  From this, then it follows that MPC + MPS = Y

Q. Given that a consumer has a total income of Ushs. (1) & Consumes $(\frac{3}{4})$ of it.

Show that MPC + MPS = 1

Alternatively, the ratio $\frac{\Delta C}{\Delta Y}$, i.e. MPC indicates the rate at which consumption increases as income increases.

However, in both cases, since an increment in income is either spent on consumption, or saved, it follows that; $\Delta Y = \Delta C + \Delta S$.

Dividing both sides by ΔY, ie. $\frac{\Delta Y}{\Delta Y =} = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y}$, it follows that

$1 = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y}$

Q. Given that a consumer has a total income of Ushs. 100, & that he consumes $(\frac{3}{4})$ of it and saves the remaining. Show that 1= MPC + MPS

Note that:

(i). The consumption function shows that current consumption is related to current income.

- ✓ To describe the relationship between current consumption & income, the concepts of the average propensities & consumption are used
- ✓ The average propensity to consume (APC) is the proportion/fraction/percentage of the total income that is spent on consumption.
  Or it is the proportion/fraction/percentage of the total income consumed.
- ✓ It is expressed as the ratio of total consumption to total income

Thus APC = $\frac{C}{Y}$.

Q. Given that an economy has a total national income of worth Ushs. 60,000 billion and total national consumption of worth Ushs. 48,000 billion. Compute her national APC.

(ii) The savings function shows that current savings is related to the current income

- ✓ To describe the relationship between the current savings and total income, the concepts of average propensities and savings are used.

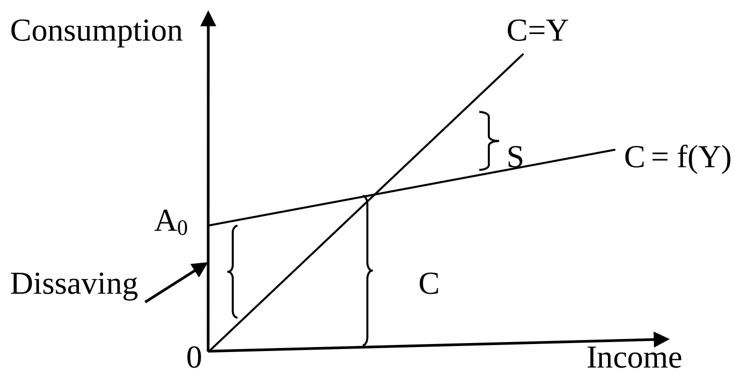
- ✓ The average propensity to save (APS) is the proportion/fraction/percentage of the total income which is saved. It is expressed as the ratio savings to total income.

Thus APS $=\frac{Savings\ (S)}{Income\ (Y)}$.

Some of the concepts used in savings

(i) Dissaving refers to negative savings. It occurs where consumption is greater than the disposable income e.g. when households borrow from the financial institutions or use past savings if Y = 0
(ii) Contractual savings. This is where an individual is supposed to save a fixed amount of money in a given time. E.g. saving with an insurance company, pension schemes, SACCO etc.
(iii)Discretionary savings. This is where people are not obliged to save a specific amount in a given time e.g. Bank deposits, building societies etc.

The savings function



Foot note.

(S) Denotes savings

(C) Denotes Consumption

(Y) Denotes Income

C = $_f$(Y) denotes Consumption function.

The determinants of savings

(i). The level of income. Given a high level of income earned, more is saved. This is due to their high marginal propensity to save/low marginal propensity to consume. However, where the level of income is low, low or less income is saved. This is due to their low marginal propensity to save/high marginal propensity to consume

(ii). The rate of interest. (on bank deposits). Where there is high interest paid on deposits, this encourages high level of savings with commercial banks. This is because of the high level of returns from savings. However, where there is low interest paid on deposits, this discourages savings with commercial banks. This is because of the low returns from savings.

(iii). The rate of inflation. High rate of inflation discourages savings. This is because of fall in real money value. However, low rate of inflation encourages savings. This is associated with the rise in the real value of money

(iv). Degree of occurrence of unforeseen circumstances (e.g. unexpected delivery, sickness, accidents, earth quakes, thunder storms, landslides, visitors etc.) encourages people to save. This is due to the need to be disaster prepared under all circumstances. However, low degree of occurrence of unforeseen circumstances discourages people from savings. This is because of the low level of self-drive to counteract disasters.

(v). The age level of people. Young individuals tend to save less. This is associated with the need to establish themselves in life. However; old people tend to save more of their incomes. This associated with the need to cater for their survival after retirement from active life.

(vi). The health status of people. Ill health discourages savings. This is because the sick expecting to die in the near future consumes/spends all they have on treatment instead of saving. However, good health encourages savings. This is because there is not much expenditure on health/treatment.

(c) The investment theory

Investment is the process of deploying, utilizing, and devoting part of a person's/firm's/country's income so as to increase the stock of capital or capital goods/assets.

Thus investment expenditure refers to the amount of money/is one devoted to the creation of/increasing the existing capital stock

The types of investments.

- Induced investment. Is one which depends on the level of income and profits. Where the level of incomes/profits is high, induced investments are encouraged. This is due to the existence of high marginal propensity to save. However, where the level of incomes and profits are low, induced investments are discouraged. This is because of the existence of the low marginal propensity to save.
- Autonomous investment. Is one which is independent of the level of incomes/profits. It is influenced by other factors like war, climate, population growth, labor force, marginal efficiency of capital, government policies toward investment etc.

The determinants of investments in an economy

(i) The level of income. The presence of high level of incomes leads to high level of investments. This is attributed to the high level of marginal propensity to save. However, low level of incomes leads to low level of investments. This is because of the low level of the marginal propensity to save/high level of marginal propensity to consume which encourage low level of investments in an economy.

(ii) Government policy on investment. Where the government policy on investment is favorable in form of providing subsidies/grants, credit facilities, low interest rates on loans etc. to investors, etc., this leads to increased (induced) investments. This is as a result of low average cost production incurred in investment. However, where the government policy is unfavorable/unconducive, inform of high taxes, inadequate credit facilities, inadequate subsidies, high interest rate on loans and other bureaucracies, investment is discouraged. This is because of high average cost of production incurred in investment.

(iii) Market size. A growing market encourages autonomous investment. This is due to the increase in the population size, or increase in foreign demand. However, a small market size discourages investments in the economy. This is because of a decrease in population size/decrease in foreign demand for goods & services.

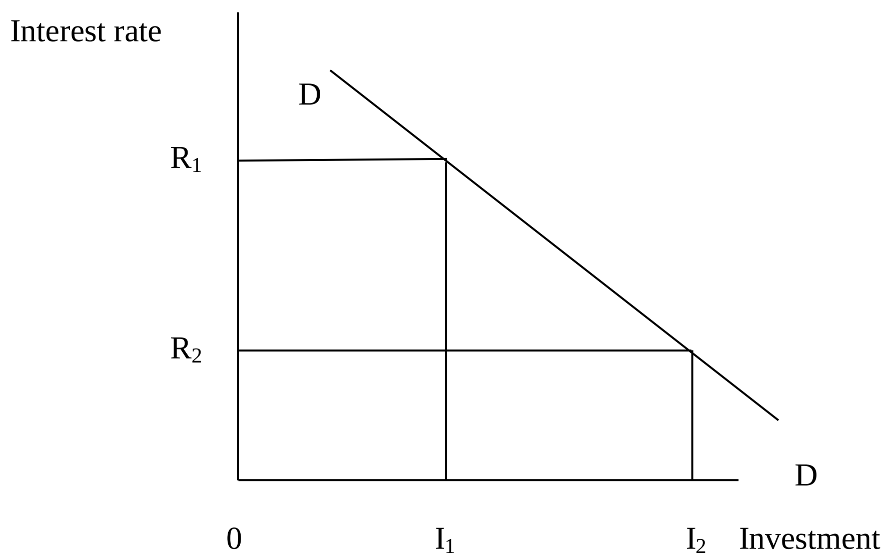
(iv) The level of marginal efficiency of capital. Given a high MEC, entrepreneurs are encouraged to invest in capital goods/assets. This is because of the increased monetary returns in investment. However, where the MEC is low, entrepreneurs are discouraged to invest. This is because of the low monetary returns in investment.

Note:

(i). The marginal efficiency of capital (MEC) refers to the ratio of the expected monetary returns from an additional unit of capital asset invested to its supply price. Or it is the percentage of profits expected from an investment of a capital asset.

Thus MEC = $\frac{Annual\ yield\ of\ capital\ asset}{Supply\ price\ of\ the\ capital\ asset} \times 100$

(ii). The demand for investment

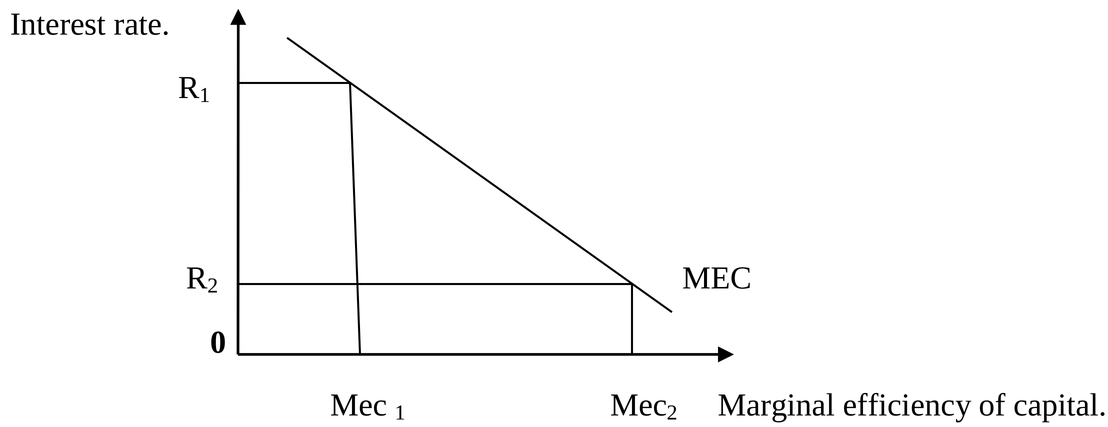


Footnote:

(R) Denotes interest rate

(I) denotes investment

(iii). The mechanical efficiency of capital



Foot note:

MEC denotes marginal efficiency of capital

MEI denotes

Note:

With low rate of interest on loans, MEC increases. This is because capital assets are purchased at low prices & their rate of return increases; this encourages investments. Therefore, an investor would invest as long as the MEC is higher than the rate of interest; they would not invest if the MEC is less than the rate of interest

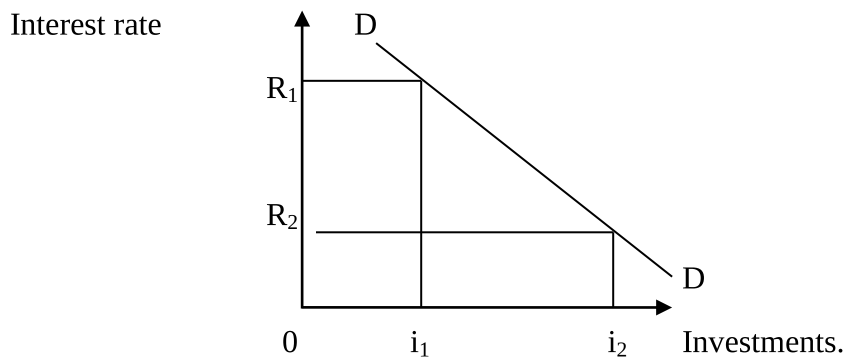
The following are the factors influencing the marginal efficiency of capital:

(v) The level of the existing capital stock. Where there is excess capacity in the existing plants, investments in new capital is discouraged. This is due to low capital returns in investment/capital. However, where plants/firms/industries are operating at full capacity, an increase in demand leads to increase in the level of investment. This is due to high returns in investment/capital.

(vi). The level of technology. Improvement in the level of technology leads to increased investments. This is as a result of increased MEC. However, the use of poor technology leads to low investments. This is as a result of reduced MEC thus discouraging investments in an economy.

(vi) The level of inventions & innovations. High level of inventions/innovations leads to more efficient methods of production. This is associated with reduced average costs of production/increased MEC of new capital/efficiency in production. However, where the level of inventions and innovations are low, this leads to a low level of investment in new capital goods. This is due to increased average costs of/low MEC of new capital/low efficiency in production.

(vii) The level of interest rates (Cost/price of borrowing loans). Given the interest rate on loans are high, this discourages investment in new capital goods. This is due to the high cost of borrowing loans for investment. However, where the interest rates on loans are low, investments are encouraged. This is due to the low cost/price of borrowing loans for investment.



<u>Footnote</u>

(R) Denotes the interest rate

(i) Denotes investment.

(v) The level of political climate. The existence of political stability encourages investment in new capital goods. This is because political stability creates confidence for the life & property of investors. However, the existence of political instability results discourages investments in new capital goods. This because political instability creates fear for the lifes & property of investors

(vi). The level of infrastructural development. The existence of better communication networks such as, banking facilities, schools, hospitals etc. encourage investments in capital goods. This is because the existence good infrastructure eases the transportation, distribution & marketing of goods & services/trade. However, the existence of poor communication networks & facilities such as banking facilities, schools hospitals etc. discourage investments in new capital goods. This is attributed to the difficulties of transportation, distribution, & marketing of goods & services

(Vii)The nature of entrepreneurial skills/abilities. High level of entrepreneurial skills/abilities in an economy encourages investments. This is associated with the high managerial capacity & management. However, low level of entrepreneurial skills/abilities discourages investments in an economy. This is associated with low managerial capacity & management.

(viii) Business expectations. When investors anticipate an increase in business activities, they purchase more capital goods/investments in capital goods. This is due to increased business returns/high profits margins involved. However, when investors anticipate decline in business activities (depression), they purchase less capital goods. This is due to the low business returns/low profit margin involved.

<u>The multiplier concept</u>

- ✓ Given that a house hold receives a monthly income of worth Ushs. 1000/-, it will either consume, save part of it or both. In this case, he may spend Ushs. 800/- on consumption, and save worth Ushs.200/-
- ✓ In the above instance, its MPC is $(\frac{C}{Y}) = \frac{800}{1000}$ or 0.8

  And its MPS = $(\frac{200}{1000})\ or\ 0.2$
- ✓ The sums of its MPC & MPS is always assumed to be one (1) i.e. MPC + MPS = 1

i.e. (0.8 + 0.2 = 1). But if the house hold spends all its income (Y) on consumption, then it follows that the MPS = 0 & thus the MPC = 1

- ✓ Given that in an economy there has been an increase in investment expenditure, the whole of this increment shall become incomes to the owners of the factors of production whose factor inputs have been employed in the investment project undertaken.
- ✓ However, some of these incomes received from the employment of the factor inputs shall be spent on consumer goods, capital goods, and others saved
- ✓ Consumer goods shall, therefore, be produced & the expenditure on them shall become incomes to the firms. The firms shall also spend part of these incomes on the production of further goods, services & save part of it. And so in this case, the process shall continue indefinitely. Therefore, this process is what is termed as the "<u>Multiplier</u>".
- ✓ The multiplier is defined as the number of times an initial change in expenditure multiplies itself to give a final change in income.
- ✓ Thus multiplier (K) = $\frac{\Delta Y}{\Delta E}$........... (1)

  Where ΔY denotes change in income

  ΔE Denotes change in initial expenditure

  From equation (1), $\Delta Y = K\Delta E$........(2)
- ✓ The size of the multiplier (K) depends on the size of both the MPC & MPS. Therefore, the multiplier (K) can be expressed in terms of MPC & MPS as follows

Multiplier (K) = $\frac{1}{(1-MPC)}$ .... (3)

But MPS = 1 – MPC (from MPC + MPS = 1)

= K = $\frac{1}{MPS}$ .... (4)

Note:

(K) = $\frac{\Delta Y}{\Delta E=} = \frac{1}{MPS} = \frac{1}{1-MPC}$

<u>Illustration of the operation of the multiplier process</u>

- Assume that the initial government investment expenditure is worth Ushs. 1000/-
- Assume that the money is invested in an industrial project where the MPC is $\frac{4}{5}$ of 1000 i.e. 80% or 0.8 & MPS is $\frac{1}{5}$ of 1000 i.e. 20% or 0.2.
- Using the table below, the multiplier process can be illustrated to determine how much income is created in the economy as follows

Period	Increment in income (Change in income)	Increment in consumption (ΔC)	Increment in Savings (ΔS)
1	1000	800	200
2	800	640	160
3	640	512	128
4	512	409.6	102.0
-	-	-	
-	-	-	
-	-	-	
N^{th}	Etc.	Etc.	Etc.
Sum	Ushs.5000	Ushs.4000	.Ushs.1000

- The total income created = (1000 + 800 + 640 + 512 +409.6 + 102.0 + …) = Ushs.5000/=

From calculations,

The multiplier (K) = $\frac{\Delta Y}{\Delta E} = \frac{5000}{1000=} = 5time$

Or $\frac{1}{MPS} = \frac{1}{0.2} = 5\ times$

$or\ \frac{1}{1-MPC} = \frac{1}{1-0.8} = \frac{1}{0.2}$ = 5times

The money created, (ΔY) = KΔE

From the above illustration, it is observed that:

- The initial investment expenditure of Ushs.1000/= has multiplied itself five times so as to generate a final total change in income of about Ushs.5000/-
- The size of the multiplier depends on the MPC & MPS of the population where the investment project is located.

<u>Some worked examples</u>

1. Given that the MPC is 0.6, work out the multiplier magnitude.

(Use either K = $\frac{1}{1-MPC}$ or $\frac{1}{MPS}$ or MPC + MPS = 1

2 work out the change in the original income if the change in expenditure is Ushs. 30,000/- & the multiplier is 5 time. (K =$\frac{\Delta Y}{\Delta E}$)

3 Given that a country's national income is shs.100 billion & MPC is 0.6. If the government expenditure increases from shs.120 billion to shs.600 billion, work out the final level of income.

Solution.

K = $\frac{1}{1-MPC}$ = $\frac{1}{1-0.6}$ = $\frac{1}{0.4}$ = 2.5 times. $\Delta Expenditure = 600 - 120 = 480$

ΔY = KΔE (from K = $\frac{\Delta Y}{\Delta E}$)

= 25x480 = shs.1200billions.

4. Given that the current level of GDP is shs.300million, change in national investment expenditure is 50million and the MPS is 0.2. Calculate the final level of national income.

Solution

K = $\frac{1}{MPS}$ = $\frac{1}{0.2}$ = 5 time4

$\Delta Y = K$ (NIE)

= 5(520m) = SHS.250, 000,000/-

ΔY = CGDP + ΔY

= 300,000 000 + 250,000,000

<u>= shs.550, 000,000</u>/=

5 (a) Define the term investment.

(b) Given the current level of GDP is shs.750, 000'000, the rise in the national investment expenditure is 150,000,000, MPC is 60%

6. (a) Distinguish between investment multiplier and government multiplier

(b) Given that the MPC in an economy is 0.7, and that there is a change in Investment of shs.50millions, calculate the:

(i) Investment multiplier
(ii) Final change in income in the economy

8 what is meant by marginal propensity to save?

Given that initial national income of a country is shs. 22,000,000,000/=, and that the marginal propensity to save is 40%. Calculate the final income of that country

<u>The types of multipliers</u>

Multipliers can be categorized depending what the expenditure is levied for or the sectors that spend. These include the following:

1. Investment multiplier. This refers to the number of times the initial investment expenditure (by various investors) multiplies itself to result into a final change in income

Thus the I M = $\frac{\Delta Y}{\Delta IE}$ or $\frac{1}{1-MPC}$ or $\frac{1}{MPS}$

Where (IM) denotes *investment multipliers*

(ΔY) Denotes change in income

(ΔIE) denotes investment expenditure

2 Government multiplier. Refers to the number of times the initial government expenditure multiplies (on public undertakings) itself to result into a final change in income.

Thus government multiplier = = $\frac{\Delta Y}{\Delta GE} = \frac{Change\ in\ income}{Change\ in\ government\ spendings}$

3. Tax multiplier. This refers to the number of times the initial expenditure on tax multiplies itself to result into a final change in income.

Thus the tax multiplier = $\frac{\Delta Y}{\Delta GE} = \frac{Change\ in\ income}{Change\ in\ tax\ expenditure}$

4. Income multiplier. This refers to the number of times the initial change in total expenditure multiplies itself to give/result into a final change in income.

Thus income multiplier = $\frac{\Delta Y}{\Delta E} = \frac{Change\ in\ income}{change\ in\ total\ expenditure}$

5. Consumption multiplier. This refers to the number of times the initial consumption expenditure multiplies itself to result into a final change in income.

Thus consumption multiplier = $\frac{\Delta Y}{\Delta CE} = \frac{Change\ in\ income}{Change\ in\ total\ consumption\ expenditure}$

6. Foreign trade multiplier. This refers to the number of times the initial expenditure on foreign trade multiplies itself to result into a final change in income. The foreign trade multiplier is subdivided into both export and import multipliers.

(i) Export multiplier. This refers to the number of times the initial export expenditure multiplies itself to result into a final change in income

Thus export multiplier = $\frac{\Delta Y}{\Delta XE} = \frac{Change\ in\ income}{change\ in\ export\ expenditure}$.

(ii) Import expenditure. This refers to the number of times the initial import expenditure multiplies itself to result into a final change in income

Thus import expenditure = $\frac{\Delta Y}{\Delta IE} = \frac{change\ in\ income}{change\ in\ import\ expenditure}$

5. The import multiplier increases/reduces with increasing/reducing marginal propensity to import.

The foreign trade multiplier is influenced by both marginal propensities to import and export

The income and import increase with increase in foreign trade multipliers i.e. Marginal propensity to import and marginal propensity to export

(i) The marginal propensity to import refers to the fraction/proportion of the additional income spent on imports. It is expressed as the ratio of a change in import expenditure to a change in income.

Q. (a) Define the term marginal propensity to import

(b) Given that a country's GDP increased from 100millions to shs.300millions & the value of imports increased from shs.25millions to shs.75millions, calculate her marginal propensity to import.

MPM = $\frac{Change\ in\ Imort\ values}{change\ in\ Income} = \frac{Shs.75{,}000{,}000-25{,}000{,}000}{Shs.300{,}000{,}000-100{,}000{,}000} = \frac{Shs.50{,}000{,}000}{Shs.200{,}000{,}00} = \frac{1}{4}$ or 0.25

(ii) Marginal propensity to export refers to the fraction/proportion of the additional income spent on exports.

Thus marginal propensity to export = $\frac{\Delta Y}{\Delta XE} = \frac{Change\ in\ export\ earnings}{change\ in\ Export\ expenditure}$

<u>The factors limiting the multiplier process in developing countries</u>

- Poor infrastructure. The existence of poor communication networks makes it difficult to transport, distribute and market goods and services. This discourages investments & the multiplier process in most developing countries.

- Limited accountability/high level of corruption & embezzlement of funds. This is due to poor supervision, record keeping, & management. This discourages investments & multiplier process.
- High level of political instabilities. This creates fear for life & destruction of properties of investors. This is discourages potential investors from investment & thus limiting the multiplier process.
- Limited resources. This is due to the existence of low incomes/inadequate capital & other resources. This discourage investments & hence the multiplier process.
- Limited credit facilities. This is attributed to the existence of few financial institutions & inadequate collateral securities/high interest rates. This makes it difficult for the potential investors to access loans for investments thus discouraging investments & the multiplier process in developing countries.
- Limited markets. This is attributed to the production of poor quality products and the existence of poverty. Thus discouraging investments in developing countries.
- Poor land tenure system. This is due to the existence of communal land ownership which makes it difficult for the government to allocate land to potential investors. This limits investments & the multiplier process in general.
- The existence of large subsistence sector. This leads to limited economic activities/low Incomes which cannot support any meaningful investments. This discourages investments& the multiplier process
- Unfavorable government policies on investment. This is associated with the existence of high level of taxation, limited subsidies, & long bureaucratic processes on investments. All these discourage investment & hence limiting the multiplier process.
- Over dependence on imported technology. This is attributed to the use of inappropriate technology. This leads to technological unemployment & thus low levels of investments

- High levels of liquidity preference. This is because most people keep their wealth in cash or near cash form instead of investing them in income generating activities (IGAs). This thus limits the multiplier process in developing countries.

- High population growth rates. This is attributed to the low levels of education/training. This leads to the inability to mobilize & combine the factors of production in the investment/production process/ low managerial capacity/dependence burden

- Limited entrepreneurial abilities/skills. This is attributed to the existence of poor education system in developing countries. This leads to low levels of managerial capacity development & misuse of resources meant for setting up & maintaining investment projects. This discourages investment & multiplier process in developing countries.
- High marginal propensity to import. This is because most developing countries import more than they export. So every increase in income is used to import instead of investing it. This reduces the investment & multiplier process in most developing countries.

The accelerator principle

- The accelerator principle is one which refers to the number of times the initial change in consumption expenditure multiplies itself to give/result into/lead to a final change in investment.

- Thus the accelerator principle = $\frac{\Delta I}{\Delta CE} = \frac{change\ in\ investment\ expenditure}{change\ in\ consumption\ expenditure}$
- There is a positive relationship between the level of income & the level of consumption (i.e. income effect). This implies that arise in a firm's income leads to an increase in the level of consumption expenditure which thus induces investment.
- The relationship in which investment influences income is termed as the "multiplier".
- However, there is also an influence of income on investment. Therefore, it is this influence that is contained in the accelerator principle.
- The accelerator principle is sometimes termed as the consumption multiplier. This is because the change in consumption expenditure is assumed to lead to a greater change in investment expenditure through the accelerator principle. Both the multiplier & accelerator work together to bring about changes in income & employment in an economy.

Given that in an economy, the increase in consumption of carrots from 10,000Kgs to 20,000Kgs led to an increase in investment from shs. 50 million to shs. 100million and that the price per Kilogram of carrots is worth shs. 1000, compute the accelerator

Solution

ΔC = (20,000 – 10,000) x1000 = 1,000,000

ΔI = (100 – 50) million = 50,000,000

Thus the Accelerator = $\frac{\Delta I}{\Delta C} = \frac{50{,}000{,}000}{10{,}000{,}000}$ = 5 times.

2. Given that in country (Z), there was some consumption expenditure worth shs. 5000, the original investment made was worth shs. 14,000, the new level of consumption (new demand) is worth shs.7000 & the new level of investment is worth shs. 20,000. What is the Accelerator?

Solution

$\Delta I = (20,000 - 14000) = 6000$

$\Delta C = (7000 - 5000) = 2000$

Thus the accelerator = $\frac{\Delta IE}{\Delta CE} = \frac{6\cancel{000}}{2\cancel{000}} =$ 3times.

At times the accelerator is regarded to be the rate of induced investment that results from the increased level of consumption.

It is also argued from the above point of view that in order to realize economic growth in developing countries, peoples incomes should be increased so that their demand can induce production/investment

The assumptions of the accelerator

(i). Investments/consumption levels in an economy are permanent

(ii). Investors usually respond to the changes in consumption/demand

(iii). Increase in consumption in a commodity leads to economic growth/NY in an economy

(iv). The level of investment in an economy is determined by consumption/demand alone

(v). There is full employment of resources

(vi). It assumes a closed economy

(vii). Resources are mobile and plenty in supply.

Criticisms/limitations of the accelerator principle

- It assumes that the level of investment is determined by demand/consumption alone. But this is not true as there are many other determinants of investment in any given economy. e.g. political climate, economic climate, interest rates, the level of marginal efficiency of capital, the market size, the level of income, the degree of technology, etc.

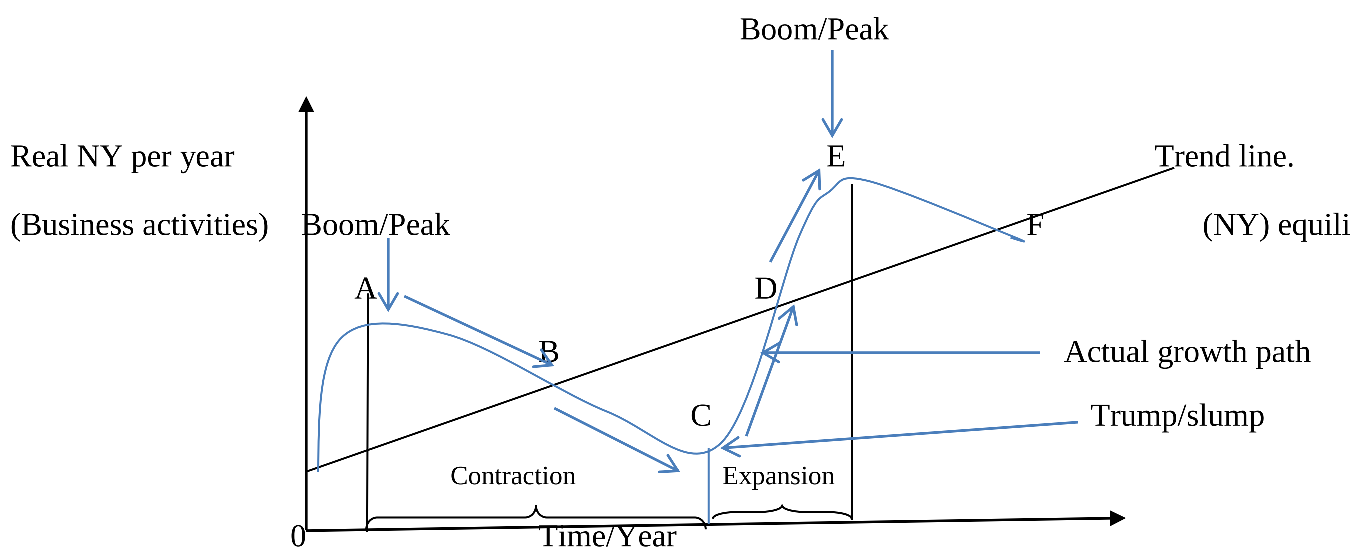
- It assumes that increased demand/consumption leads to an increase in production economic growth. But this may not be the case as increase in demand/consumption may be so destructive to human health e.g. the consumption of marijuana, liquor etc.
- (iii).It assumes that increase in consumption leads to an increase in investment. But this may not be always true as increase in demand/consumption may be temporary & the capital goods necessary to produce the goods whose demand/consumption has increased may need to be permanent. Therefore, investors in a commodity may not respond to the change in demand/consumption e.g. an increase in soda consumption during a school sports competition/league that last for a month. It may be very difficult for investors in soda to install expensive capital or machinery to produce soda.
- It assumes resources are mobile & plenty in supply. But this may not be always true as some resources may not be mobile & plenty in supply. Hence there cannot be instant response of investment to the increased level of demand/consumption.

- Investments in most cases are not always initiated by change in demand/consumption only but increase in autonomous government expenditures
- The principle ignores the restrictive policies used by the government which are aimed at controlling and regulating investments in the economy eg.restrictive fiscal & monetary policies.

The national income (business/trade cycle) fluctuations.

- Business trade cycle/national income fluctuations are the short term up and down path that economic/business activities take.
- The word cycle suggests regular oscillations of goods and bad times.
- The fluctuations can be readily identified. It is characterized by peaks, troughs, periods of contraction (recession & depression),& expansion (recovery & prosperity)

National income fluctuations



Foot note:

A & E denote a peaks/boom

C denotes trough/slump

A to B denote recession

B to C denotes depression

C to D denotes recovery

D & E denote prosperity

The characteristics of national income fluctuations

1. Peak. This may be referred to at times as the boom or the upper turning point. It is a period during which all economic activities are at their highest levels. It is the highest point of recovery.

- It is the highest level of real GNP in the cycle.

- Each peak depicts an economy operating at close to full capacity so that output/national income corresponds to a very high degree of utilization of labour, & other factors of production.
- During the peak cycle, there are likely to be shortages of resources in certain markets due to high level of economic activities
- Further rises in demand are now met by more increases in prices than by increases in production
- A situation of general excess demand for labour develops, cost & prices rise & business remains generally very profitable.

2. Recession. This is a down turn from the peak of economic activities during which real GNP declines from its previous value

- During a recession, RGNP & earnings also declines. Besides, as business profits also decline, so does demand for investment goods.
- Usually, there is unemployment of factor resources.
- During this period, as earnings fall, so does the standard of living.

3. Depression. Is a cyclical phase of the economy with unemployment of labour, capital, minimum production, investment, & savings are all rapidly falling, & falling prices in some sectors.

It is a period characterized by low level of demand, & a substantial amount of unused industrial capacity.

- Business profits are low or even negative. Confidence is lacking & as a result firms are unwilling to take risks in making new investments.
- Banks & other financial institutions have surplus funds that no one credit worthy wishes to borrow them.

4. Trough/slump. This may sometimes be referred to as the lower turning point. It is a period during which all economic activities are at their lowest levels. It is the lowest level of real GNP observed over the business cycle.

- It is reached when the economy begins pulling out of a period of contraction depression.
- During this period, there is an excessive amount of unemployment & idle productive capacity.
- Businesses are more likely to fail. This is because of low demand for their products.

THE INFLATION PROBLEM

Inflation is a situation where there is a persistent rise in the general/average price levels which is not backed up by a corresponding increase in output in an economy over time.

It is measured using price index i.e. $\frac{\text{Current year price}}{\text{Base year price}} \times 100\%$

Types of inflation.

Inflation can be categorized according to the degree of intensity and causes.

(a) According to the degree of intensity, inflation is described as mild and hyper.

1. Mild (Creeping/moderate/or gradual) inflation is a situation where the increase in the general price level or velocity of money is gradual.

It is not easy to notice mild inflation as the percentage rise in the general price level is small (1–6) % over a long period of time.

2. Hyper (galloping/runaway) inflation is a situation where the increase in the general price level (or velocity of money circulation) is so rapid.

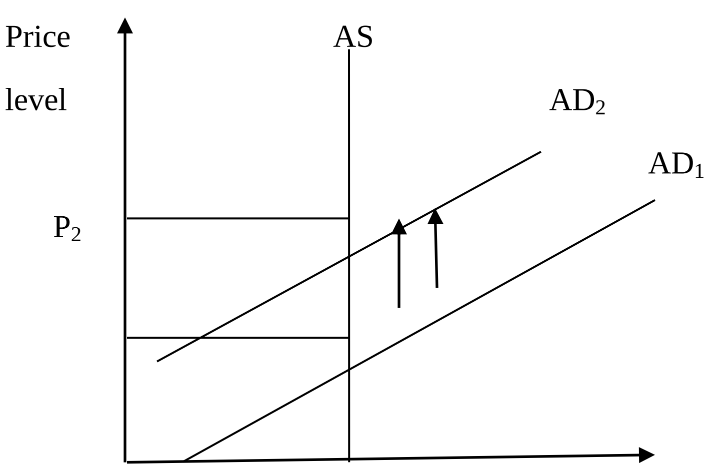
During hyperinflation, most people prefer holding tangible items other than money.

(b) According to causes, inflation is described as demand pull and cost push inflation.

1. Demand pull inflation is one that arises out of excessive aggregate demand over aggregate (at full employment of resources)

As wages of workers increase, they will want to spend their incomes on goods and services, but when extra goods and services are not produced, the excess demand will have the effect of pulling up prices thus causing demand pull inflation.

Demand pull inflation occurs when the aggregate demand exceeds the aggregate supply in the conditions of full employment of resources.



0 Q_1 Output (Kg)

Note:

(i) "AS" can't go beyond OQ_1 as all resources have been used up in the production proces.
(ii) Any increase in the aggregate demand leads to increase in the price level.
(iii) At OQ_1 level of output, the economy is said to be at full employment of resources.

Demand pull inflation is caused by the following factors:

- Printing of excess money by the central bank or excessive government expenditure on public undertakings.
- An increase in consumers autonomous spending/expenditure without an increase in income due to a favorable change in tastes and preferences.
- An increase in exports with a reduction in imports that leads to less supply of commodities in the local market.
- An increase in population growth rate. This increases the consumption of goods and services hence leading to demand pull inflation.

The policies for demand pull inflation

- The use of restrictive monetary policies. This is through increasing bank rates, sale of treasury bills, shares, bounds etc. to the public, credit squeeze etc. This helps to reduce money supply in the economy.
- The use of restrictive fiscal policies. This is through reducing government expenditure and increasing direct taxes so as to reduce on the disposable incomes of the people.
- The use of trade policies. This is by increasing the importation of scarce goods in the economy and discouraging the exportation of scarce goods from the economy.
- The use of production policies. This is by increasing the volume of goods through liberalization and privatization of economic activities.
- The use of wage freeze policy. This is by keeping down the salaries/wages of workers through applying maximum wage legislations. This leads to reduced purchasing power & aggregate demand

2. Cost push inflation is one caused by rising costs of production (rising costs of raw materials, & wage increases because of pressure of trade unions etc.).

The workers demand for higher wages causes manufacturers to increase the prices of their products so as to meet the demands of the workers and maintain their profit levels thus sparking off an inflationary spiral.

An inflationary spiral is situation in which a persistent increase in prices leads to a demand for higher wages which increases the cost of production leading to a rise in prices which again leads to a demand for higher wages.

Cost push inflation may occur in the following forms/causes of cost push inflation:

(i) Price-wage. This occurs when increase in commodity prices leads to workers to demand for higher wages.

- The demand for higher wages by the workers increases the cost of all commodities.
- In case of the initial increase in the price is being brought about by entrepreneurs/firms aiming at high profit margin, we have profit push inflation.
- Profit push inflation is one that occurs when entrepreneurs/firms raise the prices for their products to offset rising labor costs (wages/salaries) and to earn higher profits.

(ii) Wage-price spiral/dynamics. Is one which occurs when workers demand high wages or increased share of the output produced through their trade unions resulting into increase in the costs of the products produced.

(iii) Wage-wage spiral/inflation. Is one which occurs as a result of inter firm or inter sector comparison of wages among employees. Hence a rise in wages of workers in one firm, or sector causes an upward revision of wages in other similar occupations in the economy concerned. As entrepreneurs increase wages, costs of production and prices of goods and services also increase.

The policies for cost push inflation

- Provision of subsidies to producers. This lowers average cost of production, increases the domestic output and leading to reduced price levels.
- Discouragement of the exportation of scarce goods and services. This is through imposing heavy taxation on them. This helps to increase the level of domestic output & to lower the level of general price levels.
- The use of wage control measures. This is through the use of wage legislations, wage freeze etc. This helps to reduce on the high demands by workers.

(c) Other types of inflation.

These, among many, include the following:

3. Imported inflation. Is one which occurs when goods and inputs are imported from a country experiencing/prone to inflation.

General Price level may further is increased by increased costs of transportation, insurance premium, customs duties, ware housing/storage, freight etc.

The policies for imported inflation.

- Expansion of the market. This is by joining regional integration/market research/trade fair/trade bursar/trade promotion etc. so as to get cheaper goods through trade creation.
- The use of import substitution. This is by producing locally what was formerly imported. This helps to reduce government expenditure abroad.
- The use of subsidization of imports of essential commodities by the government. This is through reducing taxes on imports. This helps to reduce their costs of transactions and thus enabling them to charge low prices
- The use of import restrictions. This is through imposing heavy duties on imports. This helps to reduce the volume of imports from inflation prone countries.

4. Structural inflation. Is one caused due to the supply rigidities and structural bottlenecks in the sectors of the economy leading to decline in the supply of essential goods

Or it is one that arises due to supply inelasticity and structural rigidities (e.g. inefficient marketing, and distribution systems) in the industrial sectors of the economy.

The causes of structural inflation are the following:

- Breakdown of (key) industries due to depreciation of machines. This leads to low output and hence increases in prices.
- Infrastructural break down. This is due to the collapse of transport & communication networks that lowers production levels. This raises price levels of the goods and service that are produced.
- Political instabilities, which discourages investors due to the fear of life and destruction of property; and hence leading to low output and high prices
- The existence of natural hazards such as landslides, earth quakes, floods bad weather etc. that leads to low production and hence increases in the general price levels.
- Hoarding of goods by traders. This creates artificial shortages and thus leading to increase in the general price levels.
- Foreign exchange shortages. This is due to the decline in the production of export goods & services. This leads to increase in general price levels of the scarce goods & services produced.
- Scarcity of inputs/raw materials/natural resources etc. This is due to shortages of foreign exchange. This leads to low output & hence increase in the general price level

<u>The policies for structural inflation</u>

(i) Maintenance of political stability. This is through conducting peace talks, good governance, democracy, granting amnesty etc. This helps to create a conducive investment climate thus leading to increase in output & low price levels.
(ii) Improvement in technology. This is by encouraging inventions, innovations, & research. This helps to increase the productivity of factor inputs & thus leading to fall in general price level.

5. Expectation inflation. Is one which occurs when the general price levels of commodities rise up due to an anticipated future increases in prices (by producers/businessmen) and announcement/annual budget effects.

6. Monetary inflation. Is one which occurs due to excessive increases in the supply of money in an economy

7. Bottleneck/scarcity inflation. Is one which occurs when the general price level is pushed up due to structural changes (such as wars, bad weather conditions, earth quakes, etc.) and also structural rigidities (such as breakdown of transport system and production units).

8. Headline inflation. Is one which occurs mainly as a result of increases in the prices of food items.

Or is one which takes into account the component of food

9. Underlying inflation (Core inflation). Is one which does not take into account the component of food but mainly the prices of other goods.

Or is one which occurs mainly due to the increases in the general price levels of other goods without food prices.

10. Suppressed inflation. Is one where the excessive persistent increase in the general price level of commodities is controlled by the government through the use of price controls.

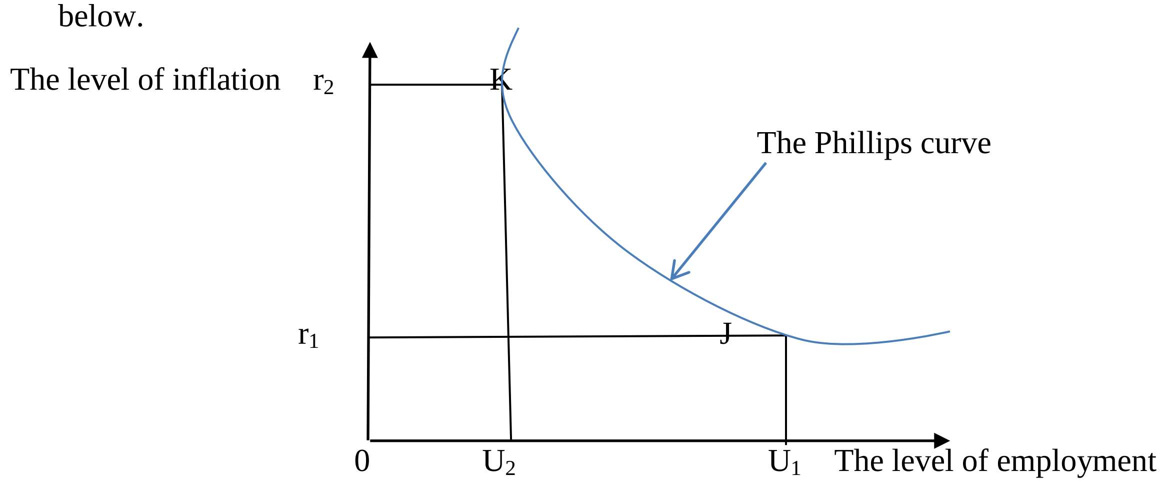
The theories of inflation

There are four theories of inflation and these include the following:

- Monetary inflation. According to this theory, inflation is caused by increase in money supply in an economy i.e. too much money in circulation.
- Structuralist theory of inflation. According to this theory, inflation is caused by structural breakdown of the economy either due to bad economic policies, wars, or poor harvest in agricultural sector caused by natural factors.
  Or Inflation results from supply inelasticity and structural rigidities in an economy's industrial sector
- Demand pull theory of inflation. According to lord .M. Keynes, inflation is caused by excessive demand that is not matched with or backed by increase in supply. Increases in aggregate demand forces price levels to shoot up leading to inflation
- Cost push theory of inflation. This theory suggests that inflation results primarily from the increase in the production costs, usually caused by rising costs of raw material, or excessive wage increases resulting from the pressure of trade unions

The inverse relationship between inflation and unemployment.

Where there is a high rate of inflation, unemployment is encouraged and where there is a high rate of unemployment, this leads to a high rate of inflation. This is shown by the Phillips curve as below.



Note:

- ✓ At point (K), inflation is high and unemployment is low.
- ✓ At point (J), inflation is low but unemployment is high.

How rapid inflation causes unemployment (The causes of stagflation)

This is through the following ways:

- Discouraging investments, & savings. This is due to increased average costs of production. This leads to reduced economic activities & thus leading to unemployment.
- Discouraging hard work. This is due to fall in the value of wages/salaries. This hence causes voluntary unemployment
- May lead to political unrest. This is due to the loss of confidence/popularity in the government in power. This leads to limited economic activities and hence causing unemployment
- Encouraging rural urban migration This is attributed to the existence of rural urban socio-economic infrastructural imbalance, hence leading to open urban unemployment
- Reducing the effectiveness of government planning in providing employment opportunities.
- Discouraging lending of financial capital for investments. This is due to the high bank rates on financial institutions. This discourages investments and thus leading to unemployment.
- Discouraging foreign investors. This is attributed to the existence of long bureaucracies, high margin requirements, & high taxes levied. This reduces the level of investments thus leading to unemployment.
- Low aggregate demand for finished products. This is due to the low level of incomes/low purchasing power of people, and hence decline in investments & unemployment of resource
- Discouraging exportation. This is through the imposition of high taxes on exports of goods & services. This lowers the level of economic activities in the export sector thus causing unemployment.
- Encouraging capital flight and repatriation of profits. This is through the existence of foreign direct investments. This encourages investments abroad thus leading to unemployment in the domestic economy.
- High average costs of production. This is through increasing interests rates on loans. This discourages borrowing and investments thus causing unemployment.
- Policies of controlling inflation. This is through using price controls, restricted importation, reduced money supply, etc. discourage investments and thus causing unemployment

Some of the terms used in inflation

- Stagflation. Is a situation where there is a high rate of inflation co-existing with high rates of unemployment.

This leads to low standards of living, low income inequalities, political unrest, low tax revenue, increase in dependence, rural urban migration, decline in savings, and investments, loss in confidence in an economy's currency, increased cost of borrowing, social distress and misery, etc.

- *Stagnation.
- Strato-inflation. Is one where the rate of inflation ranges from about 10% to several hundred percent or infinite
- Disinflation refers to the government endeavor to stop inflation so as to maintain relative money value.
- Deflation. Is a situation where there is a decrease in the general price levels marked by an increase in the value of money
- Reflation. Is a situation where there is relatively a smaller rise in the general price levels after a period of a depression.

The causes of inflation in Uganda

- ✓ Importation of goods and services from inflation prone economies. This is due to encouraging foreign trade with countries that suffer from inflationary problems. Price levels are further increased by transportation costs, insurance premium, freight, ware housing/storage costs etc.
- ✓ Break down of infrastructure. This is due to the collapse of industries, firms, and transport network that lowers production levels. This raises price levels of the goods and service that are produced.
- ✓ Excessive money supply/uncontrolled credit creation. This is due to printing of too much money or irrational expansion of monetary policy by the central bank increases peoples purchasing power, aggregate demand and hence price levels.
- ✓ Desire for excessive profits by businessmen. This is due to the excessive increases in price levels by business men in order to increase their profit margin
- ✓ Excessive government expenditure. This is through subsidization of government enterprises, salaries, or wages, etc. which increases peoples' purchasing power, aggregate demand, and hence general price levels.
- ✓ Increased demand for exports. This is where the demand for exports to the trading partner increases such that what is produced locally becomes inadequate and thus leading to increased general price levels.
- ✓ Depreciation of the local currency. This is through the loss in the value of the local currency in terms of the foreign currencies. This increases the general price levels of the goods and services and thus leading to inflation
- ✓ Political instabilities (in some parts.) This is because during this time, people do not settle down to produce goods and services due to the fear of loss of life and the destruction of property. Hence this increases the price levels of goods and services. Besides, potential investors fear and are scared away thus leading to low output and hence increase in the general price levels.
- ✓ Increased inflows of incomes from abroad. This is through encouraging foreign investments in the country. These inflows are in form of foreign currencies, grants, remittances, foreign aid etc. to the domestic economy. This increases the purchasing power, aggregate demand, and hence inflation
- ✓ Speculative behavior of business men. This is through businessmen increasing the prices of goods and services when they anticipate price increases in the near future. This increases the general/average price levels of goods and services and hence inflation.

The effects of inflation in an economy

Inflation has both positive (desirable) negative (undesirable) effects as follows:

Positive effects:

- Stimulation of production. Mild inflation encourages hard work. As production is carried out in anticipation of demand, the high prices encourage producers to increase their levels of production so as to benefit from the high prices prevailing in the market. This leads to increased output and hence economic growth
- Promotion of mobility of labor. This is because workers attempt to look for the best employment opportunities in an economy. This leads to efficiency and increased output /economic growth.
- Stimulates employment. This is because as producers step up their levels of production so as to benefit from the high prices, employment opportunities are created as labor intensive techniques are mostly used. This leads to the provision of incomes & hence better welfare.

- Encourages hard work. This is because as people's incomes become inadequate due to the high prices, they are encouraged to work harder so as to be able to meet their consumption habits/cost of living. This leads to improved welfare.
- Increases government revenue. This is through taxation on incomes, output, profits, goods & services, private firms, & investments. This leads to the construction of socio-economic infrastructure.
- Promotion of savings. This is as a result of the high profits realized by businessmen. This thus leads to increased investments/welfare standards
- Stimulates growth. This is due to the increased output produced as a result high price levels. This leads to improved standards of living.
- Leads to high profit levels. This is due to the high prices of goods and services prevailing in the market. This thus leads to investments/better welfare.
- Encourages entrepreneurial skills development. This is through the stimulation of inventions, innovations, research & creativity. Hence leading to increased investments
- Leads to increased investment levels. This is as a result of increased profit levels, obtained from the high price levels. This leads to the provision of employment& incomes.
- <u>The negative effects of inflation</u>
- Leads to industrial unrest. This is due to the constant demand for wages increases through trade unions. This disrupts the working of the economy.
- Discourages borrowing. This is because of the high interest rates charged on borrowed funds. This thus leads to low credit creation & economic activities
- Emergency of trade malpractices. This is because of people struggling to survive. This leads to low levels of government revenue & hence poor infrastructural development.
- Savings and investments are discouraged. This is because during inflation money losses value & peoples incomes become inadequate to sustain them. This leads to poor standards of living.
- Reduction in production. This is through increased costs of inputs/raw materials. This leads reduced standards of living.
- Fall in real incomes. This is because of the depreciation of the domestic currencies. This makes fixed income groups to suffer due to the rising costs of living.
- Makes governments unpopular. This is due to the failure to control inflation. This leads to political instabilities/unrests due to people losing confidence in the government.
- Worsens B.O.P problems. This is because incomes at home encourage high demand for imports. While high prices at home discourages exports thus leading to inadequate foreign exchange earnings.
- Low production. This is because agricultural products tend to lag behind inflation. This makes their earnings, savings, investments, productivity, and welfare to fall.
- Leads to capital outflow. This is because during inflation investors prefer investing in foreign countries which are not suffering from inflation. This leads to profit repatriation
- Worsens income inequality. This is because inflation distributes incomes/wealth inequitably. This makes profit earners richer while fixed salary/wage earners remaining poor. This leads to poor welfare standards for the minority people.
- Loss of confidence in the currency. This is due to the loss of value in the value of money coupled with low standards of living & high cost of living. This leads to low savings & investments

- Makes planning difficult. This is because inflation affects long term plans due to uncertainties regarding future profit levels, future interest rates, future foreign markets, etc. This thus leads to slow economic growth rates
- Leads to unemployment. This is because of some firms closing down due to the increased costs of raw materials, labor, etc. This leads to low incomes and thus low standards of living.
- Decline in investment. This is due to reduced savings as the value of money falls. This leads to low output & hence low standards of living

The policies for inflation in Uganda

- Taxing the incomes of people. This is through using high direct taxes levied on the incomes of the citizens. This reduces the disposable incomes of the citizens and checks on the aggregate demand.
- Reduction of government expenditure. This is through reducing expense made on subsidies for firms, retrenchment of civil servants etc. This reduces the amount of money in circulation
- Sale of government securities. This is through selling bonds, shares, treasury bills, etc. This regulates the amount of money in circulation
- Privatization of public enterprises. This is by transferring the ownership and management of the non-performing government enterprises/assets etc. to private individual/companies. This controls structural inflation through increasing output.
- Provision of investment incentives. This is through offering subsidies/grants, and tax holidays to investors. This increases output and thus reducing structural and scarcity inflation.
- Improvement of infrastructure. This is through the construction of roads, rehabilitation and maintaining of the existing communication networks. This eases the transportation, distribution, & marketing of goods from areas of plenty to areas of scarcity thus minimizing inflation.
- Reduced government borrowing from the central government. This is by increasing the bank rates on borrowed funds so as to discourage commercial banks from borrowing funds for credit creation. This reduces the amount of money in circulation & hence reducing the amount of money in circulation.
- Deficit financing. This is through increased internal borrowing i.e. from the public through the sale of securities, & bonds. This reduces the amount of money in circulation. Hence minimizing inflation
- Importation of essential commodities. This is undertaken through special import programmes. Hence imports from countries prone to inflation are reduced by imposing high taxes on them & encouraging domestic production of goods and services. This increases domestic output & hence reducing the general price levels of goods
- Elimination of trade malpractices. This is through the impositions of high taxes on hoarding, smuggling, etc. which aggravate shortages. This increases the domestic output and hence minimizing scarcity inflation.
- Reorganization of distribution channels of goods and services. This is through rationing of scarce goods and nationalization of major distribution channels. (E.g. foods and income policies). This reduces scarcity inflation
- Price controls (price & income polices). This is by fixing of the prices of certain goods like fuel, sugar, and wages etc. which are so sensitive that an increase in their prices sparks off inflationary spiral. This reduces the general/average price levels of goods and services.

- Controlled issuing of currency. This is through the use of restrictive monetary policies (E.g. increase in bank rates, sale of securities to the public, high margin requirements, selective credit control, etc.) to reduce money supply and demand. This reduces the amount of money in circulation.
- Import and export policies. This is by limiting the exports of scarce essential goods & services through increased export duties and encouragement of imports of scarce essential goods through reduced import duties. This increases the supply of the scarce goods & services in the domestic markets thus leading to fall in general price levels
- Reduction of political instabilities. This is through conducting peace talks with rebellious groups, granting amnesty to those who surrender democratic governance, etc. This helps to encourage investments and hence increased output and reduction of scarcity inflation

THE ROLE OF FOREIGN/INTERNATIONAL TRADE IN DEVELOPMENT

International trade refers to the transactions between two or more countries, involving the physical transfer of goods and service from one country to another.

It is the process of buying and selling of goods and services between the nationals of different countries.

It also involves the transactions between governments, manufacturers, wholesalers, retailers etc. of any two or more countries that fall within the scope of more foreign trade

It takes the forms of: (i) Bilateral trade (ii) Multilateral trade

Where the trade involves only two countries exchanging goods and services, it is called a bilateral trade.

Where the trade involves more than two countries involved in trade, it is called a multilateral trade

It would obvious not be of so much advantage for a country to only trade with one country since they would soon discover that a number of things are not produced in either of the countries.

Besides, a country does not necessarily need to buy goods and services from the one that purchases her goods and services. This thus entails the need for multilateral trade between countries.

International trade is divided into two, i.e.

(i) Import trade and
(ii) Export trade
(a) Import trade refers to the purchase of goods and services from another country into the home country. It concerns itself with the imports of goods and, services.

Import trade is thus divided into visible and invisible imports

Visible imports are tangible .goods that is brought into a country from another country.

Invisible imports are the services that are brought into a country from another country

(b) Export trade is the sale of/ transfer of goods and services from one country to another.

Foreign trade may be both visible and invisible trade

(i) Visible trade is the exchange of goods between countries.
(ii) Invisible trade is the exchange of services between countries. E.g. tourism, electricity, insurance etc.

The theory of foreign trade has the following basis:

(i) The principle of comparative advantage.
(ii) The principle of absolute advantage

(iii).The vent for surplus theory

Why foreign trade developed

Foreign trade developed because of the following reasons:

- Differences between natural resource deposits between countries. This is because nature has blessed different countries differently. Therefore, there is need to specialize & exchange the outcome so as to get what they do not have through foreign trade.
- The need to dispose off surplus output. This is because of the existence of specialization between countries. This would help avoid resource wastage.
- The need to import modern technology & capital. This is because some countries have natural resource deposits but lack adequate capital & technology to exploit them. Hence the need for foreign trade for such countries to acquire capital & technology to fully use their resources
- Difference in tastes & preferences among the citizens of different countries. This is because some countries/citizens prefer imported better quality products to the poor domestically produced ones. Hence the need for foreign trade.
- The need for specialization between countries. This is due to the existence of different resource deposits and differences in production costs between countries.
- The need to promote good international relations among countries. This can be enhanced through foreign trade as a means.
- The existence of inadequate self-sufficiency between countries. This is because no one country can satisfy all her needs without the support from other countries. Hence the need for international trade.

- The need for foreign exchange. Foreign trade enables countries to secure foreign exchange which can be used for import purposes.
- The vent for surplus theory of foreign trade. This is through opening up of world markets so as to enable the utilization of idle resources in countries. This thus led to emergence of trade between countries

<u>The basic principles/theories of foreign trade</u>

This is explained by the law of comparative advantage, the principle of absolute advantage & vent for surplus theory.

a) The principle of comparative advantage.

- This states that given two countries, two commodities, & given amount of resources, a country should specialize in producing a commodity where she has the least opportunity cost compared to the other country.
- The principle of comparative advantage is the extension of division labor (specialization)
- The basis of specialization is where individuals have different endowments/natural resource deposits so it pays them to concentrate in the field in which they have an advantage
- A country is said to have a comparative advantage if she can produce a commodity at a lower opportunity cost than the other country (irrespective of the absolute advantage)

<u>For instance</u>;

Country	Cotton (Kgs)	Coffee (Kgs)
Kenya	4000	16,000
Uganda	10,000	20,000

Opportunity cost = $\frac{Alternative\ foregone}{Actual\ output}$ or $\frac{Foregone\ quantity}{Actual\ quantity}$

The opportunity cost of producing cotton for:

Uganda.

= $\frac{20{,}000Kgs}{10{,}000\ kgs}$ = 4 units of coffee (foregone)

This means that to produce one unit of cotton Uganda foregoes 2 Units of coffee

Kenya.

$= \frac{16{,}000\ Kgs}{4{,}000\ Kgs}$ = 4 units of coffee (foregone)

This means that to produce one unit of cotton, Kenya foregoes 4units of coffee

Therefore, Uganda should specialize in the production of cotton since she has a lower opportunity cost (2 units of coffee) than Kenya (4units of coffee). This means that Uganda has a comparative advantage in the production cotton.

The opportunity cost of producing coffee;

For Uganda: $\frac{10{,}000\ \cancel{Kgs}}{20{,}000\ \cancel{Kgs}} = \frac{1}{2}$ of Cotton (foregone)

This means that Uganda foregoes ½ Kgs to produce one unit of Coffee.

For Kenya: $\frac{4{,}000\ Kgs}{16000\ Kgs}$ = ¼ units of cotton foregone to produce one unit of coffee.

Kenya should specialize in the production of coffee because it incurs lower opportunity cost ie ($\frac{1}{4}$ tons of cotton) than Uganda ($\frac{1}{2}$ tons of cotton).This implies that Kenya has a comparative advantage in the production of coffee.

<u>The assumptions of the theory of comparative advantage</u>

- It assumes of the existence of only two countries taking part in world trade. This means that there exists only bi-lateral trade
- It assumes the production of only two commodities using the same level of resources.
- That labor is the only factor involved in production & is identical in nature. This means that labor has the same efficiency & skills in the two countries
- It assumes a constant technology in production between the two countries involved
- It assumes perfect mobility & division of factors of production
- That there exists perfect competition in both the goods and factor markets (free entry, exit for firms with or without capital)
- That barter trade system exists between the two countries involved in trade
- It assumes the same exchange rate for the two countries engaged in trade.
- It assumes the absence of the law of diminishing returns. This implies that there are no economies & diseconomies of scale between the two countries involved.

- Assumes full employment of factors of production in the two countries involved in trade. This means that there exists no excess capacity/underutilization of resources
- That technical skills & knowledge (efficiency) are given/constant. This means that they cannot be improved upon.
- There are no transport costs involved in business transactions between the two countries
- The prices of the two commodities produced are determined by the costs of labor used in the production process
- There exists free trade between countries involved in foreign trade. This implies that there are no trade restrictions between countries
- There exists constant tastes & preference in the two countries engaged in trade.

<u>The criticisms/weaknesses/limitations of the theory of comparative advantage</u>

- The assumption of the existence of only two countries engaged in foreign trade is unrealistic. This is because in the real world there exist many countries engaged in trade.
- It assumes free trade between countries. But in the real world foreign trade is characterized by a lot of restrictions & other barriers.
- The factors of production being equally efficient are not realistic in nature. This is because different factors have different efficiencies and productivities between countries.
- It assumes a constant technology. But technologies are constantly changing due to rise in research, inventions, & innovations. This leads to changes in efficiencies, productivities, & benefits to trade.
- It assumes the absence of diminishing returns but production in the real world is characterized by diminishing returns. This is due to the existence of poor farming practices in the agricultural sector.
- The assumption of no transport costs between countries is unrealistic in nature. This is because there are always costs involved in the transportation, allocation, distribution, & marketing of goods & services, and they determine the nature of the pattern of international trade.
- The theory assumes perfect competition in both the goods & factor markets. This is not true as there exists a lot of imperfections in the goods & factor markets in the real world.
- The existence of full employment of factor resources is unrealistic assumption. This is because there exists high rates of unemployment, underemployment, & underutilization of resources in all countries.

- That costs of labor as a factor is more important & it ignores all the other costs of production in determination of commodity prices. This is not true as there are other determinants of prices of goods & services.
- It further regards labour as being a homogeneous factor in production. But this is not true as labour is heterogeneous in nature. This is because it differs in skills, attitudes toward work, experience, & productivity
- That developing country should specialize in primary products as they have a comparative advantage in them. This is very disadvantages for developing countries as the prices of agricultural products do fluctuate greatly.
- It does not consider the need for diversification & self-reliance. This makes it difficult for developing countries to have favorable terms of trade.
- Developing countries produce the same commodities. In this case the theory does not explain how specialization & exchange can take place between countries.

<u>The relevance/application of the theory of comparative advantage</u>

- It encourages expansion of markets. This is because of the existence of specialization between countries. This leads to increased output.and hence economic growth
- It enables a country to acquire more goods and services more cheaply. This is due the existence of specialization between countries. This leads to better welfare standards.
- Encourages production. This is due to the existence of differences in resource deposits between countries. This leads to increased output & hence economic growth.
- It is applicable under regional integration. This is due to the existence of specialization in trade between countries. This results into increased output & thus high economic growth rates.
- It emphasis specialization. This is due to the existence of differences in natural resource endowments/deposits between countries.

(c) <u>The principle of absolute advantage.</u>

It states that given two countries producing commodities using similar resources, a country should specialize in the production of the commodity where it can produce more units at less costs than the other country.

The principle of absolute advantage may be illustrated as below:

Country	Cotton (Kgs)	Coffee (Kgs)
Kenya	2,000	8,000
Uganda	10,000	20,000

Given that the above data, Uganda has absolute advantage in the production both cotton & coffee. This is because given the same amount of resources; Uganda is able to produce more units of both cotton & coffee than Kenya.

(d) The vent for surplus theory.

This theory states that opening up of world markets (to developing countries) through international trade encourages the use of formerly idle/underutilized resources in countries to produce .larger primary products, the surplus of which can be exported to foreign markets.

It explains:

- ✓ The view that the exploitation of idle natural domestic resources for export can lead to an increase in national income/output.
- ✓ How international trade creates an outlet for the use of some resources possessed by some countries for export purposes.

This theory advocates for the opening up of external markets to initiate opportunities for countries to produce for export.

The role of foreign trade in development

(a) Positive role

- Creation of employment opportunities. This is associated with the existence of many economic activities/investments/expansion of markets/free movement of factors of production. This leads to the provision of incomes & hence better standards of living.
- Improving quality of output. This is due to the existence of competition between countries trading partners. This leads to improved standard of living
- Encouragement of consumer sovereignty. This is through the production of a variety of goods and services between countries. This leads to improvement in standards of living
- Promotion of mutual understanding between countries. This is attributed to trade liberation between countries. This leads to , harmony & economic stability among trading partners.

- Provision of foreign exchange. This is because of the increased exploitation of idle resources for the production of exports. This leads to improved balance of payments position.
- Promotion of technological progress/technological transfer. This is attributed to research, inventions, & foreign direct investments/movement of capital/methods of production, skills, knowledge etc. This leads to increased output & hence economic growth.
- Source of government revenue. This is due to the duties imposed on imports and exports by the trading partners/countries. This leads to infrastructural development.
- Increased exploitation of idle natural resources. This is through vent for surplus theory/This is because the opening up of external markets creates an opportunity for countries to produce for exports. This leads to increased production of output & hence economic growth
- Provision of efficiency in production. This is due to competition that exists between trading partners/countries. This leads to improved quality output & hence better standards of living.
- Expansion of/widening the markets. This is through undertaking market research, & regional integration. This leads to increased production of goods and services/enjoyment of economies of scale/increased output.
- Promoting industrialization. This is due to the free movement of raw materials, factors of production, & technology between countries. This leads to increased output & thus economic growth.
- Increased output. This is associated with the existence of specialization in the production process. This leads to economic growth
- Promotion of competition. This is because of the existence of trade liberalization/multi-lateral trade. This leads to efficiency in production/increased quality output.
- Acquisition of a variety of goods & services. This is due to the existence of multilateral trade/existence of competition between trading partners. This results into increased choices for the citizens & hence improved standards of living.
- Promotion of capital inflow. This is because of the existence of foreign direct investments. This leads to capital accumulation & hence increased output

(a) <u>Negative role</u>

- Importation/consumption of undesirable/harmful products. This is due to the free interaction/movements of resources/products/trade liberalization etc. between countries. This leads to poor standards of living.

- Over exploitation of resources. This is due to the operation of vent for surplus theory. This in the long run leads to exhaustion/depletion of resources.
- Leads to imported inflation. This is due to the importation of goods & services from an inflation prone economy. This leads to low standards of living/high cost of living.
- Reduced revenue. This is because of the free movement of goods, services and factors of production between countries. This leads to poor infrastructural development
- Emergency of unemployment problems. This due to out competition of some inefficient firms leading to their closure. This results into low levels of incomes & hence poor standards of living
- Leads to cultural erosion. This is through technological transfer, foreign direct investments, imports & exports of goods & services between countries. This results into foreign domination & hence under development
- Leads to dumping problems. This is due to the existence of markets in developing countries for the more developed countries markets. This results into the retardation of infant domestic industries.
- Leads to international inequalities. This is because developed countries produce & export high quality, & expensive manufactured goods & services to developing countries. However, the developing countries produce & export low quality primary products to developed countries. This leads to underdevelopment of developing countries.
- Leads to brain drain. This is because of the existence of better prospects in developed/trading partners/countries. This leads to inadequate skilled manpower in developing countries/underdevelopment
- Acts as a disincentive to work. This is because people in developing countries are assured of the supply of high quality goods & services from foreign countries. This discourages economic activities/production in developing countries & hence low output/low economic growth rates.
- Encourages political instabilities in developing countries. This is due to the importation of fire arms/military hard wares/equipment etc. from more developed countries. This leads to underdevelopment in developing countries.
- Leads to collapse of domestic industries. This is because of the exposition of domestic firms/industries to foreign competition. This leads to low output & hence low economic growth rates
- Leads to demonstration effect. This is through the indigenous people consuming other countries/foreign luxurious & expensive goods & services

This undermines the growth of local/domestic industries in developing countries/low level of industrialization

Commercial policy

This refers to government policy meant to influence & direct the volume, value & direction of trade in an economy. Or

It is a set of rules, regulations and measures adopted by countries for conduct of international & domestic trade so as to achieve the desired economic objectives.

The objectives of commercial policy.

The following are the objectives of commercial policy

- Encouraging & promoting cooperation with other countries. This is through liberating trade between countries. This helps to improve balance of payments position
- Encouraging foreign investment & capital inflows. This is through ensuring a conducive investment climate in trading partners for the purpose of increasing economic growth rates.
- To encourage industrialization. This is through protecting domestic industries so as to increase output & hence economic growth rates.
- So as to increase employment opportunities. This is by encouraging foreign direct investments/increased economic activities between countries.
- For the purpose of increased government revenue. This is through the imposition of duties/taxes on trade between countries. This helps to improve infrastructural development.
- To increase foreign exchange earnings. This is by increasing the production for exports & discouraging imports. This helps to improve the balance of payments position.
- In order to encourage favorable balance of payments position. This is through encouraging production for export. & discouraging imports. This helps to increase foreign exchange earnings.

The tools of commercial policy.

- Tariffs
- Quotas
- Exchange rates
- Trade agreements
- Economic integration

- Dumping
- Export credit etc.

<u>The tools/instructions protectionism/barriers to trade.</u>

These among many include tariffs quota, exchange rate controls, trade agreements, trade sanctions/embargo, total ban, administrative controls/restrictions, subsidies etc.

Trade restriction/protectionism refers to anything which interferes with the free flow of goods and services between and among nations.

It is the interference with free trade through using commercial policy tools.

The following are the reasons for trade restrictions/protectionism/trade barriers:

- To protect domestic/local industries from foreign competition. This is through imposition of high taxes on foreign goods and services & or low taxes on locally produced goods and services/provision of subsidies to local industries.
- To encourage the use of local resources. This is by using capital intensive techniques of production/providing subsidies to domestic industries/firms.
- To reduce dependence on foreign aid/goods so as to attain self-sufficiency/reliance. This is through encouraging the establishment of local firms/industries or the increased use of local resources.
- To guard against the consumption of undesirable goods & services. This is by the imposition of high import duties on foreign goods & services.
- To earn revenue. This is through levying tariffs on both domestic & foreign goods & services.
- To encourage the formation of regional integration. This is through harmonizing policies, & ideologies
- To promote creativity, inventions & innovations at home. This is through subsidizing the infant domestic industries.
- To control dumping by trading partners. This is enhanced through levying taxes on cheap imported foreign goods & services.
- To promote employment at home. This is through increased resource utilization/encouraging the establishment of firms/local industries/the use of labor intensive techniques of production.
- To minimize political interferences from abroad.

- To improve a country's balance of payments position. This is through increased production for export/discouraging imports & encouraging exports.

The following are the tools/instruments of protectionism/trade barriers in an economy:

(1). Tariffs. Is a tax levied on imports & or exports as they enter or leave a country respectively.

Where it is levied on imports, it is called import tariffs/duties. And where it is levied on exports, it is called export tariff/duties

A tariff takes two forms i.e. advalorem & specific tax.

(a). An advalorem/purchase tax is one levied as a fixed percentage (e.g. 30%) on the value of an imported commodity at the point of entry into the importing country. Or

It is one levied on goods (imports) according to their value. Or

It is one where the rate charged is directly related to the value of the commodity in question e.g. Value added tax, import taxes on vehicle & machines.

(Value added tax is one levied on the value of each of the processes carried out by a producer or at each stage of production. This means that high taxes are levied on high valued goods. E.g. luxury goods.

(b)A specific tax is one which is imposed as an absolute charge on the physical volume of the commodity (expressed as so much per kilogram, litre, etc.)

(2). A non-tariff barrier. Is anything other than tariff that may restrict or limit the free flow of goods & services between countries e.g. quota, exchange control & trade embargo.

(3). Quota. Is a quantitative restriction on the amount of goods & services imported into/exported outside a country during a given period of time. Or

It is a predetermined quantity of a given commodity that can be imported/imported/exported by a country in a particular period of time. Or

It is a physical limitation on the quantity of any item that can be imported into/exported outside a country respectively.

In this regard the government issues import/export license in accordance to or proportional to the predetermined quota

(4). A total ban is an order/mandate that prohibits trade & the movement of goods & services between trading partners

It is usually levied as a result of bad relations between trading partners or harmful products, security risk commodities e.g. Poor international records, poor human rights records, human rights violations etc.

(5). Trade embargo/sanctions. This refers to the government prohibition of importation/exportation of goods from or to countries whose polices are not acceptable (e.g. economic sanctions).

The aim of trade embargo is to promote peace, harmony, & human rights observations etc.

(6). Administrative regulations/control. This refers to the use of certain minimum international specification or standards set by a government for importers or exporters to follow. The procedures tend to be lengthy & costly that it becomes uneconomical to import or export certain products hence controlling foreign trade.

(7). Foreign exchange control. This is where the government restricts the supply of foreign exchange for import purposes e.g. allocating foreign exchange at lower rates to importers essential commodities & at high rates to importers of nonessential & luxurious commodities etc. so as to reduce on their importation.

The government through the central bank, in addition, regulates the demand & supply of foreign exchange so as to help maintain the official exchange rate

(8). Special import deposits. This is where the government requires the importers of certain goods to first deposit a given amount of money with the central bank before being licensed to import. This reduces on the number of importers thus discouraging imports in the country.

(9). Devaluation. This is the deliberate government policy of lowering the value of the domestic currency in terms of other international currencies.

This discourages imports & encourages exports by making imports expensive & exports cheaper to foreigners

(10). Government subsidization. This is a financial support given to infant domestic/local industries to lower their average costs of production so as to make their products competitive.

The arguments for trade restrictions/protectionism.

- Provision of government revenue. This is realized from the taxes imposed on goods, services & trading licenses. This facilitates infrastructural developments (financing of recurrent & development expenditures)
- National security reasons. This is through the restriction of certain security risk items. This leads to peace & stability in the economy.
- Facilitates the development of entrepreneurial skills. This is through the transfer of technology/ideas/knowledge/on job training/foreign direct investment. This leads to the promotion of managerial capacity building.
- Promotion of self-sufficiency/reliance. This is through the encouragement of import substituting industries. This leads to increased output & hence economic growth rates.
- Infrastructural development. This is through the construction, rehabilitation & maintenance of communication facilities/networks. This eases the transportation, allocation, distribution, & marketing of goods & services.
- Saves the scarce foreign exchange earnings. This is because it encourages the establishment of import substitution industrialization. This leads to reduced foreign exchange outflow/increased capital accumulation & hence accumulation of foreign exchange reserve.
- Improvement of balance of payments position. This is through the establishment of import substitution industrialization. This leads to increased foreign exchange earnings.
- Control of inflation. This is by restricting trade with countries prone to inflation. This leads to better welfare of citizens.
- Encouragement of the exploitation & utilization of idle natural resources. This is because the protection against imports increases the aggregate demand for the locally produced goods & services. This results into increased output & hence economic growth.
- Facilitates the development of local/domestic industries. This is through being sheltered from foreign efficient competing industries. This results into increased output & hence increased economic growth rates.
- Creation of employment opportunities. This is attributed to the protection of domestic industries/existence of industrial activities. This leads to the provision of incomes & thus improvement of standards of living.

The arguments against trade restriction/protectionism

- Provision of inefficiency in production. This is because local firms are not exposed to foreign completion. This leads to the production of poor quality goods & service

- Encouragement of trade retaliation. This is because of protectionism as a weapon of improving on its economic conditions at the expense of its trading partner. This leads to high cost of living.
- Leads to the emergence of local monopolies. This is through the protection of domestic infant firms/industries. This leads to the exploitation of citizens through being charged high prices.
- Leads to technological unemployment. This is due to the use of automation in the production process. This leads to the provision of low incomes & hence poor standards of living among the citizens.
- Leads to increased government expenditure. This is because it is costly for the government to implement & enforce protectionism policy. This makes it difficult for her to meet her recurrent & development expenditures.
- Leads to poor standards of living. This is because protectionism reduces the choice of the citizens/due to the production of poor quality & expensive goods & services.
- Promotion of profit repatriation. This is because most of the protected domestic infant firm/industries are foreign owned/due to the existence of foreign direct investments. This leads to capital out flow/capital flight/limited capital accumulation.
- Leads to economic dependence. This is because most of the raw materials, technology, skills, ideas, knowledge etc., are all imported from other trading partners. This leads to high costs of production & hence high cost of living/lack of self-reliance.
- Leads to balance of payments deficits. This is due to increased importation of expensive inputs, technology, skills, ideas, knowledge, expatriates etc. from abroad. This leads to low foreign exchange earnings

Trade liberalization

Trade liberalization is the removal of unnecessary controls on trade hence giving people the liberty to trade without undue government controls (like total ban, quota systems, tariffs, administrative controls, etc.) to increase value, volume, & benefits of trade. Or

It is the removal of unnecessary restrictions on trade (by relaxing the use of instruments such as quota, total ban, tariffs, & administrative controls) in order to give people opportunities for increased participation in trade/increased value, volume, & benefits of trade/increased trade

<u>The implications of trade liberalizations in an economy</u>

(a) The positive implications of trade liberalization in an economy

- Increased level of output. This is attributed to increased exploitation & utilization of resources. This leads to increased economic growth rates
- Encourages increased resource utilization. This is due to the existence of competition/use of capital intensive techniques of production. This results into efficiency in production/better quality output.
- Encourages inventions, & innovations/technological transfer. This is through undertaking research into better techniques of production/the existence of foreign direct investments in an economy. This leads to increased output & hence economic growth.
- Improves quality of goods/output. This is due to the use of advanced techniques of production/the existence of completion among trading partners. This results into improved standards of living among the trading partners.
- Encourages efficiency in production. This is through the existence of competition in production/the use of capital intensive techniques of production. This leads to improved quality output.
- Increases revenue to the government. This is through imposing (tariffs) taxes on imports & exports. This leads to improved infrastructural development.
- Tends to control (structural) inflation. This is through increased resource exploitation & utilization. This leads to better standards of living.
- Up holds consumer sovereignty. This is through the production of variety of goods & services in an economy. This widens the choices of the citizens/consumers
- Encourages foreign investments/inflow of capital/resource inflows. This is through the existence of foreign direct investment in an economy. This leads to capital formation/accumulation in an economy.
- Wide variety of goods & services produced/widens consumer choices. This is due to the existence of many economic activities/investments. This leads to improved standards of living among the citizens.
- Increased infrastructural development. This is through the construction, rehabilitation, & maintenance of communication networks/facilities. This eases the transportation, allocation, distribution, & marketing of goods & services between & among trading partners.
- Promotes entrepreneurial skills. This is through the existence of on job training/technological transfer/the existence of foreign direct investments. This results into managerial capacity development.

- Helps to develop labour skills. This is associated with the existence of on job training/technological transfer/the existence of foreign direct investments. This results into managerial capacity development.
- Fights monopoly power. This is due to the existence of competition between & among trading partners. This leads to efficiency in the production process/increased quality output.
- Promotes economic diversification. This is associated with the existence of many economic activities/investments between and among countries. This leads to increased output & thus increased economic growth rates.
- Leads to increased employment opportunities. This is due to the existence of many economic activities/investments in an economic. This results into the provision of incomes & hence improved welfare of the citizens.

(b) <u>The negative implications of trade liberalization in an economy</u>

- Leads to the collapse of firms. This is associated with the out competition of local/domestic firms/industries. This leads to unemployment, low incomes & thus poor welfare of the citizens
- Leads to unemployment. This is as a result of the use of automation/use of advanced techniques in the production process. This leads to low incomes & thus poor standards of living among the citizens
- Depletion of some resources. This is attributed to over exploitation & use of some resources. This leads to low output & hence low economic growth rates.
- Flooding of markets. This is due to the production and exportation of similar products between & among trading partners. This results into B.O.P deficits/problems.
- Distortion of consumer choices. This is due to the existence of persuasive advertisement/intensive sales promotional activities. This results into poor welfare among the citizens
- Leads to consumer exploitation. This is attributed to the existence of ignorance among the citizens about the products on the market. This leads to poor standards of living.
- Encourages capital flight/outflow. This is associated with the existence of foreign direct investment/technological transfer. This rests into low capital accumulation.
- Environmental degradation is accelerated. This is associated with increased resource exploitation & utilization. This results into poor standards of living
- Leads to foreign economic dominance. This is due to the existence of foreign direct investments/technological transfer/importation of raw materials, etc. in an economy. This leads to insufficient of self-reliance.

- Makes an economy susceptible to economic instabilities (e.g. price fluctuation, exchange rate fluctuations, fluctuations in the supply of raw materials, & power supply etc.). This leads to low revenue & thus poor infrastructural development.
- Leads to increased exposure of consumers/citizens to harmful products. This is due to the absence of certain restrictions. This leads to poor standards of living.

Terms of trade

Terms of trade refers to the rate at which one country's products are exchanged for those of another. Or

It refers to the import purchasing power of a country's exports.

It represents the units of domestically produced goods foregone to secure one unit of imported ones. It is, therefore, the amount of imports that are obtained in return for exports.

It measures the import purchasing power of a unit of exports expressed as a relation between export prices & import prices of its products.

Suppose cotton is the only export of a country, & its import prices double, it would take two units of cotton to purchase the same quantity of imports as before. Therefore, the terms of trade are the opportunity costs of obtaining other (products) goods & services through international trade.

The terms of trade depends on the prices of goods & services entering international trade.

The terms of trade are said to be favorable to a given country when the prices of its exports are high relative to the prices of its imports. This is because the country can have a larger amount of imports in exchange for her exports.

The terms of trade are said to be unfavorable when the import prices of a given country are higher than her export prices. This is because the gains from international trade have reduced due to the small amount of exports exchanged for a larger amount of imports.

The types of terms of trade.

These include the following:

(i) Barter/Commodity terms of trade
(ii) Income/Monetary terms of trade

(ii).Gross barter/Commodity terms of trade

(a). Barter/Commodity terms of trade. This refers to the ratio of export prices to the import prices. Or

It refers to the ratio of price index of export to the price index of imports.

Thus Barter/Commodity terms of trade $= \frac{price\ index\ of\ exports}{Price\ index\ of\ imports} = \frac{Px}{Pm}$

When the terms of trade is greater than one, i.e. $\frac{Px}{Pm} > 1$, the country is said to be experiencing favorable terms of trade.

When the terms of trade is less than one, i.e. $\frac{Px}{Pm} < 1$, the country is said to be experiencing unfavorable terms

Barter/Commodity terms of trade can also be expressed as percentage using the formula below:

Barter/Commodity terms of trade $= \frac{price\ index\ of\ export}{Price\ index\ of\ import} \times 100 = \frac{Px}{Pm} \times 100$

Barter/Commodity terms of trade are favorable when $\frac{Px}{Pm} \times 100$ if greater than 100% i.e.

$\frac{Px}{Pm} \times 100 > 100\%$.

The Barter/Commodity terms of trade are unfavorable when $\frac{Px}{Pm} \times 100$ is less than 100% i.e.

$\frac{Px}{Pm} \times 100 < 100\%$.

Given that the price index of exports is 120 and the price index of imports is 1000, & quantity of exports is 200Kgs; compute

(i) The Barter/Commodity terms of trade.
(ii) State the country's Barter/Commodity terms of trade. (Justify your answer)

Terms of trade may be expressed in either physical or monetary terms, & thus the concepts of Gross Barter/Commodity terms of trade and Income/Monetary terms of trade.

Income/Monetary terms of trade. This refers to the ratio of the value of exports (revenue obtained from exports) to the price index of imports. It shows how much a country can import using the incomes obtained from exports.

Therefore, Income/Monetary terms of trade

$= \frac{Price\ index\ of\ exports}{Price\ index\ \ of\ imports} \times$ Export quantity Or (Barter T.O.T) × (Qx)

$= \frac{Px}{Pm} \times Qx$ Or (Barter T.O.T) × (Qx)

Where Qx denotes the quantity of exports

Px denotes the price of exports

P_m denotes the price index of imports

Give the price index of export is 120, the price index of import is 100, & quantity of exports is 200kgs, compute;

(i) The Barter terms of trade
(ii) The income terms of trade

(iii). State the nature of the country's terms of trade. (Give reasons for your answer)

Income/Monetary terms of trade takes into account both the volume and value of exports.

Given that the price index of exports is 140, the price index of imports is120, & the quantity of exports is 220Kgs, work out the:

(i) Barter terms of trade
(ii) Income terms of trade

(iii). What is the nature of the country's terms of trade? (Justify your answer)

(c) Gross Barter/Commodity terms of trade. This refers to the ratio of the quantity of exports to the quantity of imports.

Thus Gross Barter/Commodity terms of trade $= \frac{Quantity\ of\ exports}{Quantity\ of\ imports} = \frac{Qx}{Qm}$

Given that the price index of export of a given country is 140, the price index of imports is 120, the quantity of exports is 220kgs, and the quantity of imports is 200kgs, compute the:

(i) Gross Barter/Commodity terms of trade.

Terms of trade may, therefore, be expressed in either physical (GBTOT) or Monetary (YTOT) terms.

<u>The causes of unfavorable terms of trade in developing countries.</u>

- Possession of high marginal propensity to import. This is attributed to the high preference for manufactured products from abroad. This results into unfavorable terms of trade.
- Protectionism by more developed countries against the export of developing countries. This is through the imposition of tariffs & non-tariff barriers on trade. This makes it difficult for the developing countries to access the international markets. This so much reduces the demand for exports from developing countries thus leading to unfavorable terms of trade.
- The existence of weak bargaining power among the developing countries. This is due to limited economic integration which leads to low prices for their products.
- The production & exportation of cheap/poor quality primary products/raw material by developing countries. These products fetch low prices from the world market thus resulting into unfavorable terms of trade.
- Development of raw material saving technology by the more developed countries/advancement of techniques of production. This is attributed to automation in the production process. This reduces the demand for raw materials by the more developed countries thus leading poor terms of trade.
- Market flooding/limited markets abroad. This is due to the production & exportation of similar products by the developing nations. This thus leads to excess supply on the world market & low export prices.
- International agreements favor the more developed countries. This is due to fixing low export prices for developing nations & high export prices for the more developed countries. This leads to poor terms of trade for the developing nations.
- The existence of poor trade policies, e.g. devaluation. This makes the exports for the developing countries cheaper & imports expensive & yet they have inelastic demand.
- Dependence on a few export crops/limited variety of exports. This is due to inadequate economic diversification in most developing countries. This results into inelastic demand for imports & thus poor terms of trade for developing nations.

- Production of low quality export products. This is as a result of the use of inappropriate techniques of production in most developing nations. This leads to low prices for the developing countries exports & thus poor terms of trade.
- Land lockedness. This leads to high transport costs for the exports & imports of developing nations. The high transport costs reduce the gains from exports & increase the prices for imports thus leading to poor terms of trade.

Measures to improve the terms of trade in developing countries

- Expansion of the market. This is through undertaking market research, joining regional integration, advertising/publishing export products, organizing trade shows/fairs/bursars etc. This helps to improve on the marketability of & export prices.
- Adoption of favorable government policies on trade. This is by subsidizing the local firms/industries/privatization of inefficient parastatals. This helps to improve on the quality & quantity of the exports & thus increasing the export prices.
- Formation of strong commodity associations. This helps to jointly negotiate for fair export prices on the world market.
- Encouragement of manufacturing & processing plants/firms/industries. This is through the establishment of import industrialization & export promotion. This helps to add value to exports & thus improving terms of trade.
- Adoption of technological development. This is by technological transfer, research, encouraging foreign direct investments, inventions & innovations in developing countries. This leads to increase in the prices of exports & thus improvement of the terms of trade.
- Promotion of export diversification. This is through the introduction of a variety of export products/economic activities in an economy. This helps to overcome market flooding & hence increasing the export prices/improving the terms of trade.
- Improving the bargaining power on the world market. This is through joining regional markets/economic integration/cooperation. This helps to increase export prices.

Balance of payments

Countries engaged in international trade must pay one another for the goods & services being exchanged. Payments are either in cash or exchange of different goods & services (barter trade).

Each nation keeps an account of its economic transactions with the rest of the world. This is presented in the form of a balance sheet known as the balance of payments

The format of B.O.P account

Debit side (Payments)	Credit side (Receipts)
Imports	Exports

A country pays its imports using the revenue from exporting to other countries. Exports earn currencies of other countries which a country uses to pay its imports.

The term Balance of payments refers to the difference between a country's receipts from abroad & expenditures/payments abroad during a given time. Or

It is a systematic record of a country's receipts/incomes and expenditures/payments in foreign transactions in a given year. Or

It is the difference between earnings (incomes/receipts) from abroad & payments/expenditures abroad (visible & invisible trade & net capital transfers) of a country during a given time. Or

It is the payments & receipts for both visible & invisible items including capital movements. Therefore, all transactions are recorded whether they arise from trade, services or transfer of capital.

All the receipts are credited & payments debited in the double entry system used in recording.

When a country's receipts from abroad exceed her payments abroad, she is said to have favorable B.O.P i.e. B.O.P surplus

When a country's payments abroad exceed her receipts from abroad, she

is said to have a B.O.P deficits

The causes of balance of payments deficits in developing countries.

- Low of exports. This is because of the existence of natural hazards & the use of inappropriate techniques of production. This leads to failure of agriculture and decline in exports.
- Exportation of low quality products. This results from the use of poor technology in the production process, & the effects of natural hazards, pests

& diseases that a affect the quality of export products negatively. This leads to low demand for export products abroad & thus balance payments deficits

- Exportation of mainly primary products. This comprises mainly poor quality agricultural raw materials. This fetches low incomes/revenues/prices from abroad & thus leading to balance of payments deficits.
- The existence of high marginal propensity to import. This is due to the high preference for manufactured products/goods from abroad. This results into balance of payments deficits.
- The existence of political instabilities. This leads to heavy expenditure on the importation of military hard wares, & defense related equipment to stabilize the economy. This leads to capital outflow & thus balance of payments problems.
- Importation of highly priced (manufactured consumer & capital) goods. This is at the expense of low priced exports of developing nations to the more developed nations thus leading to balance of payments problems.
- High expenditures on payments/servicing external debts. This results into high capital outflow & thus balance of payments deficits.
- Trade restrictions (in export markets.) This is through the imposition of tariffs & non-tariff barriers on trade. This lowers the incomes/earnings from exports & thus leading to balance of payments problems.
- Heavy government expenditures abroad. This is through payments on diplomatic missions, contributions to international organizations, etc. thus leading to B.O.P problems.
- High levels of profits & wages repatriation. This is because most of the productive units, are foreign owned/much of the earnings by foreign companies & individuals, investors, etc. flow out of the country inform of profits, wages etc. thus reducing the country's incomes/receipts from abroad leading to B.O.P deficits.
- Market flooding/limited markets abroad. This is enhanced due to the production & exportation of similar products by Uganda (DCs) to other trading partners.
- External determination of export prices.
- Limited variety of exports/limited export diversification. This is due to the reliance on few export crops which experience price fluctuations on the world market. This leads to low incomes/receipts from abroad & hence resulting into B.O.P deficits.

Measures for balance of payments deficits in developing countries.

The persistent B.O.P deficits can be reversed by using a deliberate trade policy. Such a policy should lead to increase in exports, reduction in imports, increased capital inflows, & a reduction in capital outflows.

Therefore, the ways of solving B.O.P deficits, among many, include the following:

- Import restrictions. This is by increasing import duties, minimizing imports & import expenditures. This helps to increase exports & export earnings hence B.O.P surplus.
- Export promotion. This is through increasing the exports base & reducing the bottlenecks in the export process &through subsidization of local producers/trade liberalization. This helps to increase exports & export earnings.
- Foreign exchange control. This is through restricting the issuing of foreign exchange for import purposes. This is also achieved by giving foreign exchange at lower rates to importers of essential commodities which are scarce in the economy. & at high rates to importers of non-essential commodities. This helps to regulate foreign exchange expenditures.
- Diversification of export products. This is through encouraging the production of a variety of goods & services for exports. E.g. the non-traditional crops to be grown & exported other than relying only on the traditional cash crops.
- Direct government control. This is done through the imposition of tariffs, non-tariff barriers, on imported goods & services, making them expensive & thus reducing their demand.
- Expansion/diversification of markets. This is by developing countries joining regional integration, (e.g. COMESA, EAC, ECOWAS, KBO, IGAD, PTA etc.) undertaking research & publishing/advertising their products. This helps to expand their markets & widen the source of foreign exchange earnings for the countries in the region.
- Maintenance of good political climate/stability & security. This is through promotion of peace talks, granting amnesty to rebellious groups, encouragement of good/democratic governance, etc. This helps to create a conducive investment environment & reduction in expenditure on defense.
- Promotion of tourism. This is through promoting peace, political stability/security, advertising tourism, etc. so as to attract tourists & thus leading to increased foreign exchange earnings.

- Promotion of import industrialization strategy. This is by establishing local industries to produce commodities which were formerly imported as a way of minimizing imports & import expenditures. This helps to increase exports & export earnings in the long run.
- Encouragement of foreign investment. This is through the encouragement of foreign direct investments, and giving tax concessions. This helps to reduce their average costs of investment thus increasing exports.
- Development of infrastructure. This is through the construction, rehabilitation, & maintenance of the communication facilities, banking & insurance services. This helps to facilitate export production, distribution, transportation, exchange & marketing of goods & servicers.
- Promotion of divestiture. This is achieved through the complete privatization of non-performing/inefficient parastatals. This helps to reduce government expenditures & promotion of efficiency in export production & hence better quality exports.
- Man power development. This is by reforming the education systems in developing countries. This helps to reduce the expenditures on expatriates.
- Negotiate for the removal of trade restrictions on exports. This is through liberalizing economic activities. This helps to increase the volume of trade & earning from it.

The theories of foreign exchange

Foreign exchange is the system where one currency is exchanged for another.

Foreign exchange reserves/international reserves are amounts of foreign currency held by a country in the central bank Or

It refers to the monetary assets that are used to settle B.O.Ps deficits between countries

The forms of foreign exchange reserves in an economy include United States dollars, pound sterling, the Duetche mark, Gold reserves, International monetary fund drawing rights, (IMFDR), Special drawing rights, (SDRs), etc.

The SDRs is a paper substitute for Gold that is created by the international monetary fund & distributed to member countries as international reserves.

Sources of foreign exchange

- It is obtained from the exports of goods & services; e.g. cotton, & tourism respectively.

- Remittances & transfers from nationals working abroad.
- Divestiture, i.e. the sale of assets of a country abroad & those within the country.
- Capital inflows from foreigners wishing to buy shares, bonds, and securities or investing within (foreign direct investment) the country.
- Foreign aid in terms of grants, loans, etc. from bilateral and multilateral donors.
- Foreign diplomat missions & non-governmental organizations in the country.
- Foreigners travelling or visiting a country, attending conferences, etc.

The importance of foreign reserves.

- It is used for paying imports & capital goods and intermediate inputs used in industries.
- It is used for repaying foreign debts/debt servicing.
- It is used for financing diplomatic missions abroad.
- It is used for international travelling of individuals & government delegations
- It is used for financing balance of payments deficits
- They back up the local currency of a given country
- They determine money supply and value.
- The amount of foreign reserve indicates the performance of a country in foreign trade.
- It is used for foreign investments i.e. buying of shares, bonds, securities, etc. in foreign companies.

Reasons for the scarcity of foreign exchange in developing countries

The following factors explain the causes of foreign exchange shortages in developing countries;

- The existence of narrow export base. This is attributed to the reliance on a few traditional cash crops. This leads to low earnings from abroad
- Declining terms of trade. This is due to the existence of competition from synthetics substitutes & low quality export products. This results into low foreign exchange earnings.
- Heavy debt servicing. This is due to the repayment of external debts together with high interest rates. This leads to persistent B.O.P deficits.

- Break down of infrastructure. This is due to poor management & scarcity of inputs/the use of poor techniques in the construction, rehabilitation, & maintenance of communication facilities. This leads to low/poor quality export products & thus low foreign exchange earnings.
- Profit repatriation. This is through the existence of foreign direct investments, technological transfer, etc., which remit their profits home other than re-investing them within the country. This leads to low capital accumulation/low foreign exchange earnings.
- Excessive government expenditure on military hardware, wars, travelling/diplomatic missions abroad by government delegations, etc. This leads to B.O.P deficits/foreign exchange shortages
- Market flooding/limited markets abroad. This is due to the production & exportation of similar products abroad by developing countries. This leads to poor foreign exchange earnings/B.O.P shortages

Foreign exchange theory.

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Economic/regional integration/cooperation/markets/trading blocs.

Economic integration refers to the coming together of different countries in a given region for the purposes of carrying out economic activities so as to benefit from economies of scale. Or

It is the coming together of a group of countries in a given region for the mutual benefit of all. Or

It is where a group of countries in a given region join together in carrying out economic activities with the aim of increasing socio-economic benefits from trade, and fostering economic development through a coordinated decision making in some specific fields of economic activity e.g., trade.

The examples of economic integration/trading blocs among many include the following:

- The East African Community (EAC-2001). This was formed in 2001 with six member states e.g. Uganda, Kenya, Tanzania, Rwanda, Burundi, & South Sudan.

- The Economic Community of West African States, (ECOWAS - 1975). This was established in 1975 with 15 member states e.g. Nigeria, Benin, Burkina faso, Cote voire, Gambia, Ghana, Guinea etc.
- The European Economic Community, (EEC),
- The Kagera Basin Organization (KBO),
- The African Caribbean Pacific (ACP). This comprises 79 member states; with 48 countries from Sub-Saharan Africa, 16 from the Caribbean,
- & 15 from Pacific.
- The common market for Southern Africa (COMESA). This comprises 21 member states.
- The South African Development committee. (SADIC). This comprises 15 member states e.g. South Africa, Zimbabwe, Mozambique, Angola, Zambia, Botswana etc.

<u>The origins of regional integration/trading blocs.</u>

- ✓ Common historical factors e.g. Background, (ancestry, language, tribal groupings etc.)
- ✓ Common political background (e.g. Britain as a colonial master controlling East Africa led to the formation of former (EAC)
- ✓ Economic factors e.g. interdependence of the EEC countries, the economies of EAC etc.

<u>Aims of economic integration.</u>

- ✓ To enlarge & diversify markets within the integrated region. This is through coming together, joint research, advertising/publicizing, organizing trade fairs/bursars etc. This helps to increase output within the region.
- To boost industrialization. This is through the establishment of common processing & manufacturing firms/plants within the integrated region. This helps to increase output & hence economic growth within the integrated region.
- ✓ To increase political understanding & promote political harmony in a region. This is through interacting & sharing facilities within the integrated region. This helps to create good relationships between & among member states.
- ✓ Eliminating barriers to trade such as tariffs, quotas, & other forms of restrictions
- ✓ To minimize expenditure of scarce foreign exchange. This is through the establishment of a common monetary system/establishment of import substituting industries within the integrated region. This helps to improve the balance of payments position for the member countries.

- ✓ To avoid duplication of goods & services. This is because in a given region, different countries specialize in the production of different commodities according to resource endowments. This helps to ensure proper resource allocation & use within the integrated region.

<u>The conditions necessary for the success of economic grouping/integration to succeed</u>

- ✓ Geographical proximity/nearness. Countries should be geographically close to one another for the purposes of reducing transport costs, to enhance the constructions of joint infrastructure, to link the member states/so as to effect preferential treatment & the necessary joint infrastructure to link the member states.
- ✓ Common ideology. Members should have a common ideology & historical background so as to foster the harmonization of socio-economic policies. E.g. socialism, capitalism etc.
- ✓ The existence of peace & harmony. There should be the prevalence of good relationships between & among member states.
- ✓ The existence of good political will. There should exist a good political will & commitment by all member states to all trade agreements, resolutions & be ready to implement them.
- ✓ The existence of cooperation. Member states should be willing to meet the required costs, resources, etc.& to foster economic cooperation
- ✓ Similar or the same size. Where possible, member states should be of the same geographical size for effective sharing of the costs of infrastructural developments and markets.
- ✓ Relatively the same level of development. This helps to ensure fair distribution of economic benefits among the member states.
- ✓ The use of the same currency. This would ease trade & the conversion of currencies.

<u>The forms/stages of economic integration.</u>

There are five stages involved in the development of an economic integration and these are: Preferential trade area, free trade area, customs union, common market, and economic union.

- Preferential trade area. Is the first stage of economic integration/cooperation where member countries reveal the need for integration, & agree to give preferential treatment to each other when setting import tariffs and & quotas on selected commodities.

Each member country retains its tariff structure but gives a preferential treatment in terms of lower tariffs on selected goods & services from or to member countries.

- Free trade area. Is the second stage of economic integration where member states strengthen their economic cooperation. At this stage, they agree to transact on tariff free trade between & or among themselves but maintain different external tariff structures on goods & services from non-member states.
- Customs union. Is a stage where member countries agree to free internal trade while levying a common external tariff on goods from non-member countries. In addition, there is also free movement of goods & factors of production like labor among member states.

(Customs union is a form of economic integration in which member states have free trade among themselves and common external trade barriers/tariffs).

- Common market. Is a stage where tariffs & quotas on trade between member countries are removed but members agree to apply a common level of tariffs on goods entering the union from outside. In addition, there is free movement of goods & factors of production such as labor, capital, among the member states. etc.

(Common market is a form of economic integration in which member states have free trade among themselves, common external trade barriers, and free mobility of factors of production among themselves.)

- Economic union. This is the last stage & highest form of economic cooperation which has all the elements of a common market. (E.g. they eliminate all trade barriers, among themselves, charge a common tariff structure on commodities from non-member states, allow free mobility of factors of production within the region.) This stage involves the harmonization of monetary & fiscal policies, exchange rates, transport, industrial, etc. policies. There is also a joint ownership of some enterprises like railways, roads, dams, banks, etc. by member states. They also adopt a common economic policy, strategies & use common currency, e.g. the EEC. It is at this stage that member countries lose their political independence & join into a political federation

The benefits of economic cooperation/integration/groupings.

- Leads to trade creation. This is through the movement of production activities & trade from high cost non-member countries to low cost member countries within the economic integration. This leads to the promotion of trade within the region.

(Trade creation refers to the movement of production activities & trade from high cost non-member countries to low cost member countries within the economic integration.)

- Enlarges market among member states. This is through coming together/joint research, trade fairs/bursars, advertising/publicity of products within & outside the region. This results into increased output & hence economic growth rates within the integrated region.
- Encourages joint research. This is through member states fusing resources together. This leads to high quality goods & services produced within the integrated region.
- Leads to international peace & harmony. This is attributed to the sharing of common facilities, enterprises, institution etc. within the integrated region. This creates confidence for life & safety of property hence increased trade/production/investments within the integrated region.
- Creates job opportunities. This is due to the existence of many economic activities/investments within the integrated region. This leads to the provision of incomes & thus improved standard of living.
- Facilitates technological transfer. This is associated with the existence of foreign direct investments within the region. This leads to increased output in the region.
- Leads to increase in output. This is through increased resource utilization within the region. This results into high economic growth rates within the integrated region.
- Promotes cooperation & understanding. This is attributed to common sharing of facilities/enterprises/currency/interacting within the region. This results into peace & harmony within the integrated region.
- Stimulates competition. This is attributed to the countries of a given region coming together to trade. This results into high quality goods & services within the integrated region.
- Better utilization of resources within the integrated region. This is due to the use of automation within the integrated region. This leads to increased output & hence increased economic growth rates within the integrated region.
- Reduces balance of payments deficits. This is because of the production of better quality products for exports by member countries. This results into increased foreign exchange earnings.
- Avoids duplication of resources/goods & services. This is because of specialization within the region. This leads to increased volume & quantity of output produced.

- Improves the bargaining position/power of member countries. This is attributed to collective negotiations for higher prices for the region's exports to non-member countries. This leads to improved terms of trade/balance of payments position for member states.
- Strengthens political cooperation & understanding among the member states. This is through the member states interacting.in trade & jointly owning some enterprises. This leads to the establishment of good trade relations between & among member states.
- Production of variety of goods & services. This is due to the existence of many economic activities/investments within the region. This leads to wider consumer choices & hence better standards of living.
- Production of quality output. This is through the existence of competition among the member states/the use of efficient techniques of production. This results into improved standards of living.
- Provision of infrastructure at a relatively low average costs to each member state. This is due to proximity/nearness between & among member states. This results into the ease of transportation, distribution, & marketing of goods & services within the integrated region.
- Facilitates trade. This is through the adoption of & use of a common currency at certain stages of integration. This results into economic stability within the integrated region.
- Stimulates industrial development. This is due to the establishment of common processing & manufacturing firms/plants within the integrated region. This results into increased output & hence economic growth within the region.
- Promotion of economic interdependence. This is attributed to sharing of resources & facilities within the region. This results into increased self-sufficiency & reliance

<u>The demerits of economic integration/cooperation/group stages of the integration.</u>

- Leads to trade diversion. This is due to the movement of production activities & trade from low cost non-member countries to high cost member countries within the integrated region. This discourages production & consumption within the region.

(Trade diversion refers to the movement of production activities & trade from low cost non-member countries to high cost member countries within the integrated region) Or

(It refers to the shift of trade from low cost & efficient non-member countries of the region to high cost & inefficient member countries.)

- Leads to loss of revenue. This is as a result of the elimination of tariffs at certain stages of the integration. This results into low infrastructural development within the region.
- Encourages dependence syndrome. This is because member countries greatly rely on one another for resources. This results into lack of self-reliance & independence
- Leads to uneven distribution of economic benefits/unfair distribution of gains from trade. This is due to the differences in resource endowment within the member states. This results into regional imbalance within the integrated areas.
- Leads to quick resources exhaustion. This is because resources are utilized to serve the wider market created as a result of the integration. This leads to decline in production within the integrated region.
- Leads to uneven development. This is due to unfair distribution of infrastructure, (industries, firms, banks, enterprises, hospitals, schools, colleges, universities,) & other gains from trade. This results into poor standards of living within the integrated region.
- Loss of self-reliance. This is due to the sharing of some resources, enterprises, political & economic decisions & ideologies etc. among the member states. This leads to economic dependence within the integrated region.
- The problems of implementation & harmonization of socio-economic policies. This is attributed to the existence of different ideologies within the member states. This leads to low economic growth rates within the integrated region.
- Low benefits from trade/market flooding. This is because some of the member states produce similar products. This leads to balance of payments deficits.
- Undermines national sovereignty of the member states. This is because economic integration interferes with the socio-economic & political policies of the member states where individual member countries may not be in position to pursue independent policies. This leads to lack of socio-economic independence
- Uneven distribution of economic benefits. This is because some member countries which are well endowed with resources benefit more than the others as a result of the wider market created. This leads to regional imbalance.
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POPULATION, LABOUR, AND WAGES

(a)Population.

This refers to the number of human beings in given area at a particular time.

Population is important because of the following reasons:

- It provides the consuming unit and market for the goods and services produced
- It is a source of labour force as it is used in the production process
- ✓ The population size of any given country is ascertained through population census. In most countries population census is carried out after every ten years.
- ✓ Population census refers to the process of counting/enumerating the people in a particular area after every certain given period of time.

The reasons for carrying out population census in developing nations are as follows:

- To establish the correct size of the population. This is achieved through actual head counting of each & every house hold in an economy by population enumerators.
- To establish birth and death rates which help in the formation of population
- To discover the distribution of population and densities which help in planning for the distribution of social services
- To establish the rate of population migrations both internally and externally.
- To establish the rate of unemployment in a given country
- To establish the extent of population variables like migrations, divorce, separations etc. in a country for various purposes
- To know the various economic activities in a given country
- To know the standard of living of people in given societies and the country at large. This is by using the information on incomes and the total population in a given area
- To establish the quality of population This is through establishing the level of education attained by the house holds & their respective members in an economy

The problems of population census

Political manipulations. This is through population figures being deliberately distorted by opinion leaders for political reasons. This leads to inefficiency in the provision of social services.

Inadequate facilities. This makes it difficult to collect, analyze, and interpret data. This leads to inadequate provision of social services.

Inaccessibility of some areas. This is due to poor communication networks/facilities, and underdeveloped infrastructure. This makes it difficult to transport, distribute, allocate & market goods & services in a given country.

Inadequate data. This is due to the existence of inaccurate information given by some people during the time of national census. This makes it difficult obtaining reliable population figures, population growth rate, standard of living/percapita income, provision of social services. etc.

Political instabilities in some parts. This scares away enumerators due to the fear of their life and the destruction of property (machines/computers, vehicles, cameras etc). Besides, political instabilities make people to get displaced and hence making it difficult to count people.

The existence of conservatism/rigidity/negative attitudes. This is due to some bad cultural practices that do exist. Some people do not entertain being enumerated and as a result deliberately give wrong information on their respective family sizes to enumerator.

Language problems. This is attributed to the diversity of languages spoken in some places. This makes it difficult to communicate/gather data during the time of population census.

Limited skilled enumerators/ man power. This is because of the defective education system in most developing economies. This hinders the collection, analysis, and interpretation of data on population.

Inadequate funds/resources. This is attributed to the low levels of accountabilityvenue/low revenue base in most developing countries. This makes it difficult to collect, analyze and interpret and store data/information.

Population structure

This is the way the population of a given country is distributed in regard to sex, age, occupation, education, citizenship, & marriage.

Or it is how a country's population is described by age, as follows:

(00 - 14) i.e. young dependents

(15 – 64) i.e. the working class and

(65^+) i.e. old dependents

- ✓ Population structure is important in the determination of economic activities, dependence ratio, birth and death rates of a given country.

<u>Some of the terms used under population</u>

- ✓ Birth rates. These refer to the number of children born alive each year per thousand population of a given country.
- ✓ Death rate. This refers to the yearly number of deaths per thousand population of a given country.
- ✓ Mortality rate. This refers to the number of deaths per thousand live births
- ✓ Fertility rate. This refers to the average number of children born per a woman within a given country
- ✓ Or it refers to the (general) yearly number of children born alive per 1000 women within the childbearing bracket (normally between the ages of 15 & 49 years).
- ✓ Dependency refers to the reliance of one unit on another.
- ✓ Dependency ratio refers to the proportion/ fraction of the dependent population (young people below 16 Years & the elderly above 64^+ years) to the total population.
- ✓ Dependency burden refers to the proportion of the total population of a country falling in the ages of 0 to 15 & 64^+, which is considered economically unproductive and therefore not countered in the labor force. Or

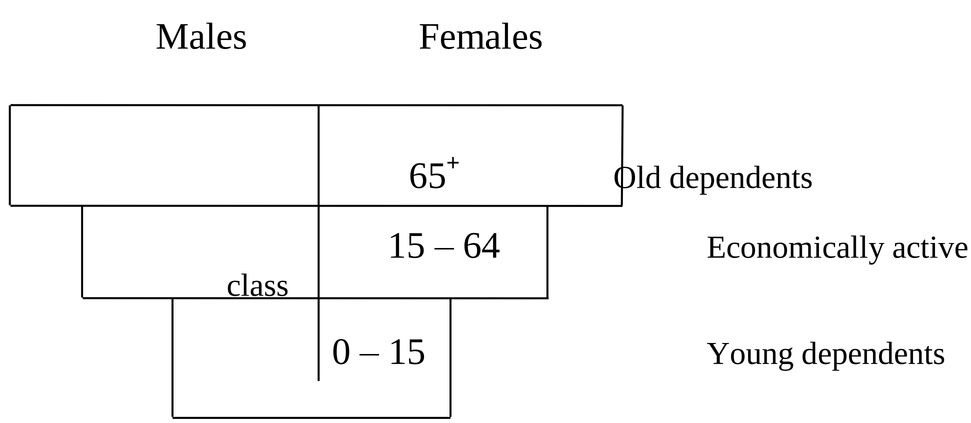
  It refers to the proportion of the total population of a country falling in the ages of 00-14 & 65^+ which is considered economically unproductive in relation to the labour force. Or

  It is the ratio of the country's unproductive population to the productive labour force.

- ✓ Dependency ratio refers to the ratio of dependent population to the total population

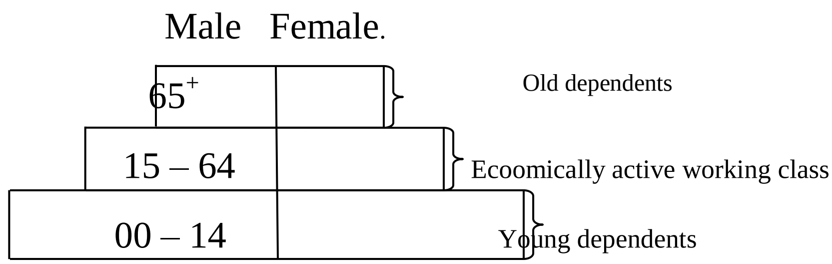
The different population structures which indicate the distribution by sex, and age are illustrated as shown below:

(a) Population pyramid in more developed countries (MDCs)



In the more developed countries the population structure is dominated by few young dependents and many old dependents. This is attributed to the following factors:

(i) Controlled birth rates. This is due to the existence of high levels of sex education, use of family planning measures/controls etc.
(ii) Improved medical facilities which have increased life expectancy
(a) Population pyramid in developing countries (DCs)



In developing countries, the population structure is dominated by few old dependents and many young dependents. This is attributed to the high birthrates, low death rates, and life expectancy.

The above population structure implies that the dependency burden (the ratio of the non-working class to the working class) is high. This indicates the relative dominance of persons in the dependent ages (00 – 14 & 65^{+}) in relation to those in the economically active ages as broadly defined in most social and economic system.

The dependency burden is determined by the old dependents and the number of young dependent, the retired class, and the physically and mentally handicapped in relation to the working-class.

- Q. Given that the working class in a country is 12,000,000, the young population is 14,000,000, and the elderly population is 4,000,000. Calculate the country's:

Solution:

(i) Dependency ratio $= \frac{Unproductive\ population}{Economically\ active\ population}$

$$= \frac{(14{,}000{,}000+4{,}000{,}000)}{(12{,}000{,}000)}$$

$$= \frac{18\cancel{,000,000}}{12\cancel{,000,000}}$$

$= \frac{3}{2}$

$= 3:2$

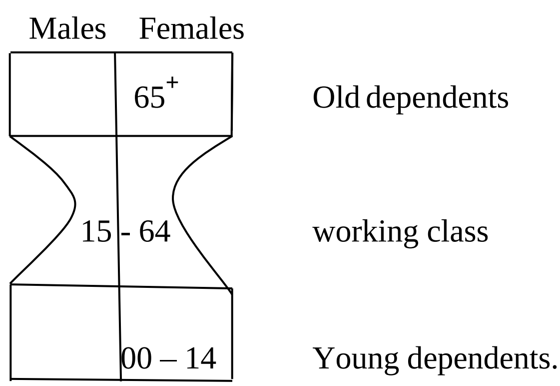
(ii) Dependency burden $= \frac{14{,}000{,}000+4{,}000{,}000}{12{,}000{,}000}$

$= \frac{18\cancel{,000,000}}{12\cancel{,000,000}} \times 100\%$

$= \frac{3}{2} \times 100\%$

$= 150\%$

In areas where there are migrations, the population structure is dominated by many young & old dependents. This could be attributed to the drift of the working class to other areas in search for greener pastures or refugee. This structure is illustrated as below:



<u>Population growth.</u> This refers to the rate at which human population increases. It is estimated by a yearly percentage increase in the population.eg 3.2%, 3.5%, 5%, etc.

Growth in population of a given country is categorized into both artificial and natural.

(i) Artificial population growth is one brought about by the effect of migrations and emigrations into and away from a given area respectively over time.

Note:

- Migration refers to refers to the general movement into & out of a country. Therefore, migration is combination of both emigration, & immigration.
- Emigration refers to the movement of people out of a country.
- Immigration refers to the movement of people into a country

(ii) The natural population growth is the difference between birth and death rates.

Or it is one brought about by the increase in birth rates and fall in death rates.

Q. Given that the birth rate is $\frac{30}{1000}$, and that death rate is $\frac{20}{1000}$, calculate the natural population growth rate.

Natural growth rate = (Birthrate – Death rate)$\times$ 100%

$= (\frac{30}{1000} - \frac{20}{1000}) \times 100\%$

$= \frac{30-20}{1000} \times 100\%$

$= \frac{10}{10\cancel{00}}\ x\ 1\cancel{00}\%$

= 10%

In developing countries, the population under the age of 15 accounts for almost as much as half of the total population. This poses economic burden to the generally small productive labour force and to the government in regard to the provision of. Social services such as health, education, recreation, housing, water, etc.

The description of Uganda's population structure

- It is dominated by the young (who constitute over 40% of the population). This is mainly due to the high birth rates or uncontrolled birth rates.
- Females are more than the males as by the 2002 and 2012 population census This is attributed to the high rate of mortality among males.(men are subject to a lot stress in their daily socio-economic life)
- The population is mainly rural based, with approximately 80% of the population living in rural areas. This is attributed to the existence (availability) of land and subsistence production in rural country sides.
- Majority of the population are semi-skilled and/or unskilled. This is due to the poor /defective education system in Uganda.
- It is characterized by high illiteracy rates (i.e. about 32%). This is attributed to the poor/defective education system/high fertility rates.
- The productive labour force is mainly engaged in primary production. This is attributed to agriculture being the back bone of the economy.
- Big population leaves below international poverty line. This is because production is mainly undertaken for subsistence needs.

International poverty line refers to an arbitrary international real income measure, usually expressed in constant dollars (e.g. $200), used as a basis for estimating the proportion of the world's population that exists at bare levels of subsistence – i.e. those whose incomes fall below this poverty line.

- There is uneven spatial distribution of the population. This is attributed to climatic, socio-economic and political differences existing in the country.
- It is characterized by high annual growth rate (of about 2.8 – 3.5) %. This is because of the high fertility/birth rates prevailing in the country.

The implications of Uganda's population structure

(a) Positive implications of Uganda's population structure

- High market potentials. This is due to the high population which increases the market size/aggregate demand for the domestically produced goods. This promotes the establishment of import substitution industrialization and thus creating more employment opportunities

- High potential for labour force. This is because of the high population growth rate. This leads to increased output/high economic growth rates

- Stimulation of increased output. This is attributed to the high population growth rates which increase labour supply. This leads to increased economic growth rates.

- Provision of high tax potential. This is attributed to the existence of high productive labour supply which is taxed. This leads to increased government revenue.
- It serves as an initiative for massive future investment. This is because the small section of foreigners with adequate capital encourages capital inflow in the economy for setting up investments. This leads to increased output/capital accumulation.
- Encourages labour mobility. The young are usually innovative/creative/& or have room for potential invention. This is through training/education/research etc. into better methods of production. This leads to increased output and hence increased economic growth.
- High potential for increased utilization. This is attributed to the big population size. This leads to increased output and hence economic growth.
- Encourages labour mobility. This is because the young people available for work & are willing to work anywhere in an economy and to accept new assignments at any time. This leads to increased output and hence economic growth rates.

- It serves to awaken the government to her responsibility. This is through the big population exerting/putting pressure on the government to provide the necessary socio-economic infrastructure. This leads to increased output/increased infrastructural development.(easy distribution, allocation, transportation, & marketing of goods & services)

(b) Negative implications of Uganda's population structure.

- Low labour productivity: This is due to the dominance of females who are limited in participating economically toward development. This is due to social–cultural limitations and the high degree of female absenteeism at places of work (due to maternity leaves and their need for domestic work). This leads to low levels of economic growth.
- High dependence burden. This is associated with the existence of many dependents/due to the existences of small working population compared to young and old dependents. This leads to low level of saving/investments, and hence low capital accumulation.
- The existence of high levels of unemployment and underemployment. This is attributed to the high population growth rate. This leads to low incomes and hence low standard of living.
- Low effective demand/limited domestic market. This is associated with the existence of high levels of unemployment and underemployment/low levels of incomes in the economy. This results into low consumption levels & hence low standards of living.
- External resource dependence (reliance on imported raw materials, capital foreign aid, technology, foreign direct investments etc.). This is because majority of the population are semi-skilled and/or unskilled. This results into balance of payments problems/deficits.
- Increases/worsens debt burden. This is because of the big population size/high population grow rate. This leads to balance of payments deficits.
- Over utilization of natural resources. This is due to the high population size/pressure on the land/aquatic/forests etc. This leads to environmental degradation/depletion of resources.
- Quick depletion of resources. This is due to over exploitation of the available resources to sustain the big population. This leads to environmental degradation.
- High rate of rural urban migration & its negative effects. This is associated with the existence of attractive facilities in the urban areas disregarding the rural areas/rural-urban imbalance in development. This leads to low levels of production in the rural areas.

- Balance of payments deficits/problems. This is attributed to high import requirements to supplement domestic supply. This leads to low levels of capital accumulation/formation.
- High government expenditure on the provision of social services. This is due to the existence of high population growth rates. This results into budgetary deficits.
- It results into brain drain. This is due to the high levels of unemployment & underemployment. This leads to low levels of output & hence low economic growth rates.

The concepts of increasing, declining/decreasing and ageing population.

(a) An increasing population.

Is one which is characterized by high (population) growth rates due to high birth rates, and low death rates.

- It is common in developing countries where the birth rates are high and death rates are low.
- The increasing population may result into population explosion.
- Population explosion refers to the rapid increase in the population of a given area relative to the resources available.
- The implications of an increasing population are the same as the implications of Uganda's population structure.

(b) A decreasing population. Is one characterized by a continuous fall (declining) (population) growth rates.

- It is common in more developed countries where the birth rates are very low. (e.g. in Great Britain, France, Japan, United States of America etc.)

The implications of a decreasing population.

(a) Positive implications:

- Encouragement of savings. This is due to reduced dependence burdens. This leads to increased investments and hence output.
- Reduction of dependence burden. This is attributed to the low birth rates. This leads to (improved welfare) & capital accumulation in an economy

- Helps to check on inflationary tendencies/ shortages of goods & services in an economy. This is due to reduced aggregate demand brought about by declining population. This leads to improved standards of living.

- Reduction of pressure on the land and other natural resources. This is because of the fall in population growth rates. This minimizes diminishing returns associated with land and environmental degradation
- It reduces congestion/rural-urban migration & its evils. This is because of the fall in birth rates. This leads to reduction in open-urban unemployment in an economy.
- Reduction in unemployment problems. This is due to due to reduced labour force as the population declines (& hence the remaining labour force is in position to get employment). This leads to the acquisition of incomes & hence better standard of living.

  (b) <u>Negative implications</u>.
- Reduced investments. This is due to the fall in aggregate demands for goods & services arising from low population growth rates. This results into unemployment in the long run, low incomes & hence poor standards of living.
- Fall in aggregate demand for goods and services in the economy. This is attributed to the low population size. This leads to unemployment in the long run, low incomes, & thus poor standards of living.
- Discouragement of labour mobility. This is because workers are not on pressure to search for employment as they are few. This leads to poor quality output and thus poor standards of living.
- Reduction of labour supply. This is due to fall in birth rates. This leads to low level of economic growth.
- Reduction of competition among workers. This is due to the declining birth rates. This leads to inefficiency in production/poor quality output.
- It reduces government revenue. This is attributed to the reduced labour force whose incomes are taxed. This leads to poor infrastructural development

(c) An ageing population. Is one characterized by a big proportion of the people/population in the old age group i.e. above 65^{+} years.

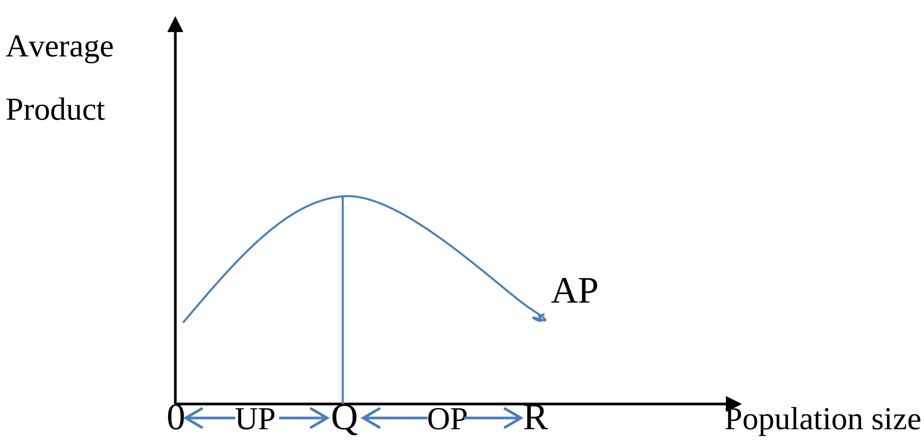
It is caused due to the following factors:

- A fall in birth rates. This is due to improved education, medical facilities & services
- Improved nutrition
- Improvement in methods of production
- Low death rates. This is due to improved medical facilities and services

  <u>The negative implications of an ageing population.</u>

- It leads to structural unemployment. This is due to the change in the demand in favor of the production of goods and services for old people. This leads to low incomes & thus poor welfare.
- High level of rigidity/conservatism. This is because old people find it difficult to learn/adopt new skills/methods of production. This leads to low/poor standards of living in an economy.
- It leads to labour immobility. This is due to failure to adapt to new changes/ reluctance to move to new occupations/jobs/places. This leads to low quality output.
- It leads to loss of efficiency & retardation in technological development. This is because old people are less inventive/innovative/creative, & less competitive in nature. This results into poor quality output.
- Increased dependence burden. This is due to the need to provide health care, clothing, shelter etc. services to the old people. This leads to low savings & hence low capital accumulation.
- It reduces the labour force. This is attributed to the limited number of the young dependents/people. This leads to a threat on the future manpower needs necessary to run an economy
- It leads to budget deficits. This is through the provision of pensions, gratuity, & other retirement benefits to the old people. This results into low savings & hence low capital accumulation.
- Reduction in percapita income. This is due to the limited contribution of the old dependents/people to gross national product (GNP). This leads to poor standards of living in an economy.

The concepts of under, optimum, and over population



Foot note

(AP) Denotes average product

(Q) Denotes optimum population

(UP) Denotes under population

(OP) Denotes over population

(a) Optimum population.

The term “optimum” refers to the best that can be achieved in a given economic situation.

Therefore, an optimum population is one that provides labor force that is sufficient to combine with the existing complementary/cooperant factors leading to maximum output per worker/highest per capita income.

Or an optimum population is one at which the existing technology, machinery, exchange with other nations, output per head etc. is at its best/maximum.

Or it is one which provides the labour force that yields the highest possible output given the available natural resources and stock of capital stock.

Or it is one that provides labour force that is sufficient to combine with the existing cooperant factors leading to maximum output per worker/highest percapita income.

Or it is the most desired population level (ideal population size) by all countries. This is because it can be sustained by the existing resources. It is difficult to achieve optimum population due to the inadequate technology, & resources etc. that do not match the existing population growth rates.

Optimum population is not constant/fixed. This is due to the changes in technology, technical knowledge, machinery, exchange with other nations, output per head etc.

(b) Under population.

The term under population is one where the (labour force) number of people is less than the existing natural resources & stock of capital. Leading to a rise in the average product percapita.

It implies that resources are not fully utilized/underutilized due to inadequate labour force resulting from the small population size leading to a rise in average product percapita

Under population is undesirable due to the high costs of establishing socioeconomic infrastructure in a given area/country

The negative implications of under population

- Underutilization of resources. This is due to the existence of inadequate labour force/small population size. This leads to low out put
- It discourages specialization & division of labour. This is attributed to the existence of subsistence production. This leads to low output & thus low economic growth rates.
- It discourages both local & foreign investments. This is due to the limited market size.arising from the low population size. This leads to unemployment/low incomes & hence poor standards of living.
- Limited market size. This is associated with the small population size/low aggregate demand arising from the low population size. This results into poor welfare of the people.
- High cost of establishing socioeconomic infrastructure. This is due to the increased unit costs of providing infrastructure by the government. This leads to wastage of resources.
- It leads to low output. This is because of the inadequate competition & initiative in the production process. This results into low economic growth rates.
- Shortages of labour force. This is due to the small population size. This leads to low output & hence low economic growth rates/leads to reliance on foreign manpower/expatriates.

c) Over population.

The term under population is one where the (labour force) number of people is greater than the available resources & stock of capital leading to a fall in average product percapita

Or it is one where the (labour force) number of people is in excess of the available resources & stock of capital.

Or it refers to the population size that supplies excess labour force relative to the other factors of production resulting into a fall in average product percapita

Over population in any given area can be identified by the following signals (indicators of overpopulation)

(i). Diminishing returns & environmental degradation/decay.

(ii). Inadequate factor inputs e.g. land, capital, & other resources.

(iii). Low standards of living

(iv). High levels of unemployment.

(v). Congestion, inadequate accommodation

The advantages of over population

(Refer to the positive implications of Uganda's population structure)

The disadvantages of over population

(Refer to the negative implications of Uganda's population structure)

Population theories

These include;

(i) The demographic transition population theory, and
(ii) The Malthusian population theory

(i) The demographic transition population theory

Demography is the study of population and is various characteristics (such as age, sex, groups, geographical & occupational distribution, etc.

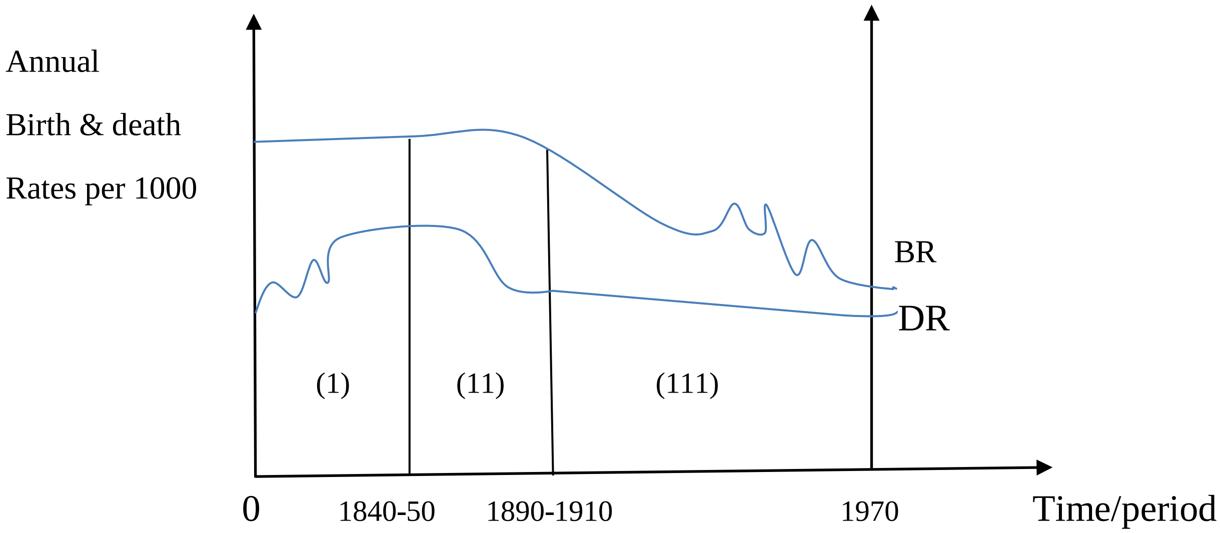
Demographic transition, therefore, refers to the phasing out process of high population growth rates from virtually stagnant growth stage characterized by high birth & death rates, through a rapid growth stage, to a stable, low growth stage in which both birth and death rates are low

This theory explains population growth from a historical perspective for more developed countries. According to this theory, population growth in the MDCs has passed through three main stages. These stages are the following:

- ✓ Stagnant phase,
- ✓ Rapid population growth rate phase, and
- ✓ Stable population growth rate phase.

This has been considered over a long period of time/years.

The demographic transition population theory in the more developed countries (MDCs)



Foot note:

- ✓ BR denotes birth rates
- ✓ DR denotes

Stage one (i)

This indicates a stagnant population growth. These were:

- The initial periods with almost no development at all.
- The societies were still backward
- The birth rates were very high due to fertility rates, high low education, polygamy etc.
- The death rates were also high due to poor standards of living, low levels of technology & inadequate medical care

Stage two (ii).

- This is a stage when birth rates remained high for the same reasons as in stage one. But due to improved standard of living, death rates declined
- This stage begins to occur when modernization associated with improved public health care, better diets & high incomes led to a marked reduction in mortality rates (Drs) which gradually raised life expectancy. This had led to high population growth rates.
- This is a stage which is being experienced by many developing countries to day

- In developing countries the birth rates are relatively high while death rates are falling.

Stage three (iii);

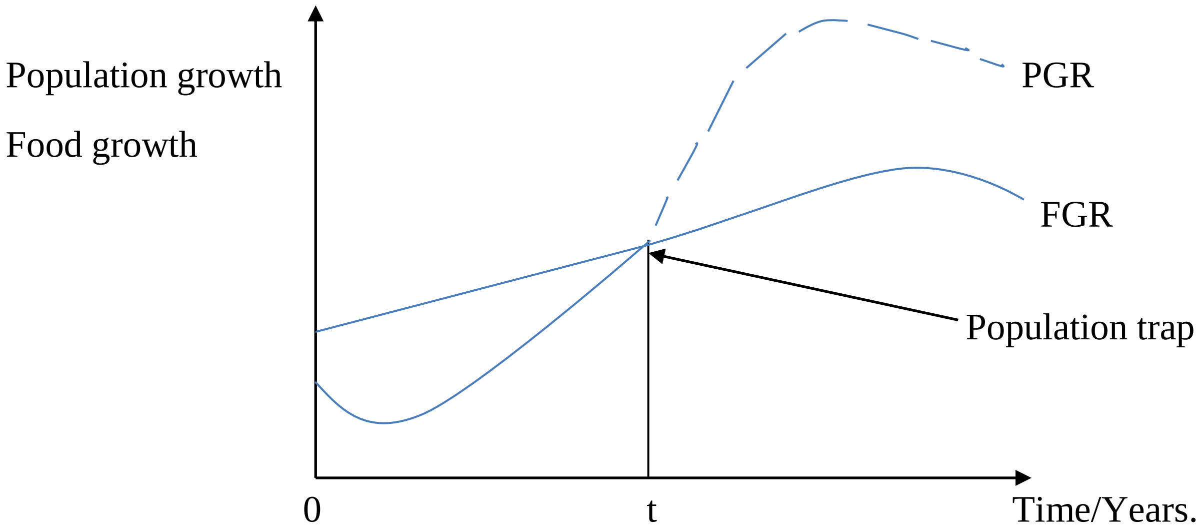
- This stage occurs when the forces of modernization & development cause fertility to begin to decline so that eventually falling birth rates converge with lower death rates leaving little or no population growth.
- This is the final stage of the population transition theory.
- At this stage birth rates decline rapidly due to improved education, the use of family planning, methods, & high level of women involvement in various economic activities.
- The death rates are falling due to the improvement in medical facilities & high standards of living.
- Thus the population growth rate is low but this time with low birth rates & low death rates.
- This is the stage to which many more developed countries belong.

(ii) The Malthusian population theory

This was a theory put forward by Rev. Thomas Malthus, a British Economist, to explain the relationship between population growth and economic development (food supply & other resources) in great Britain in the C16th (1798)

The Malthusian theory states that: Whereas population grows at a geometric rate, food production grows at an arithmetic rate; and at a given point in time (t), the population would outstrip the means of subsistence leading to starvation and death (Population trap would occur). After such a time, there was need to control the population through negative checks (moral retrain, celibacy, etc.) and positive checks (pestilence, wars, diseases, famine, earth quarks, floods, malnutrition etc.) which could serve to reduce population growth, and then population growth would equal food supply.

The Malthusian population traps.



Writing in his essay on the principle of population and drawing on the concept of diminishing returns, Malthus got concerned with the dangers of the then increasing population of Great Britain. He, therefore, postulated (put forward) the following assumptions to explain his theory:

The assumptions of the Malthusian population theory

- Population growth depends entirely on food supply.
- That there is a universal tendency for the population of a given country, unless checked, to grow at a geometric rate, doubling after every 30 to 40 years. e.g. 2, 4, 8, 16, 32, 64, 128, etc.
- At the same time, due to the diminishing returns to the fixed factor, food supplies could only expand roughly at an arithmetic rate. e.g. 1, 2, 4, 6, 8, 10, 12 etc. That each member of the population having less land to work with, his marginal contribution to food production would actually start to decline.
- That man's biological capacity to reproduce exceeds his physical capacity to increase the supply of food stuff (NY). To Malthus, the rate at which population grows was much faster than the rate at which food grows. This was a threat to the future survival of mankind.

- He predicted that at this rate of growth in both food and population, at a given time (t), the population growth would outstrip the means of subsistence (food supply) hence leading to starvation and death hence population trap.

(Population trap is a situation where the population growth rate is equal to the food production rate at a given time (t), after such a time, population would be trapped and hence forced to follow food growth curve. Unless checked, population would be reduced by evils such as people eating their children, or killing them at birth.)

- According to Malthus there would be a time when the population would exactly equal food production. This is what he termed as population trap. That if population exceeded this point, then the country would suffer catastrophes. He thus recommended that people should observe moral restrain i.e. abstain from early marriages.
- According to Malthus, every effort to improve the conditions of people through state subsidies and private charity would fail because of the increased population growth it would generate. This is because the people would no longer be responsible for their off springs directly.

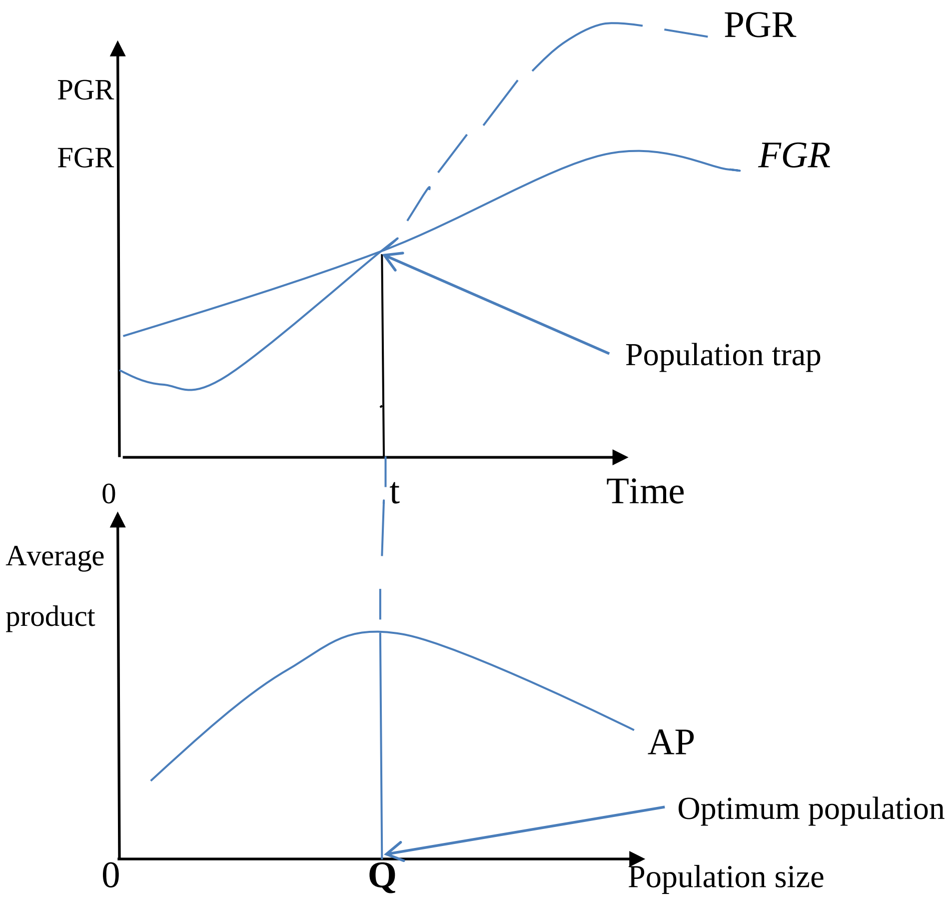
Individuals would produce so many children hoping that some charitable individuals/organizations would look after them. He, therefore, recommended that all countries should ensure that their population did not exceed the population trap.

- He advocated for/proposed positive/natural and negative/preventive checks as a means of controlling population growth rates.

The positive/natural checks are those which increase death rates e.g. famine, diseases, earthquakes, floods, malnutrition etc

The negative/preventive checks are those which reduce the population growth rate e.g. late marriages, family planning, discouraging polygamy etc

The relationship between the Malthusian population trap and optimum population



Foot note

"PGR" denotes population growth rate

"FGR" denotes food growth rate

"AP" denotes average product

The Malthusian population trap coincides with the optimum population

The relevance of the Malthusian population theory to developing countries

The theory to a lesser extent is applicable/relevant to developing countries in the following ways:

- Land is fixed in supply and subject to the law of diminishing returns. This situation is experienced in developing countries as Malthus postulated in his theory.
- As there is not so much scientific and technological advancement in developing countries, their traditional mode of production has not been fully

penetrated into. This implies that the Malthusian population theory is applicable to the developing countries as their productivity falls with the escalating/increasing population growth rates

- The positive/natural checks such as diseases, earth quakes, AIDs/HIV, etc. and artificial/negative/preventive checks such as wars, late marriages, celibacy, family planning etc. suggested by Malthus have all been very effective in reducing the population growth rates of most developing countries
- The NY(food supply) and population growth relationship of Great Britain described by Malthus is applicable to the conditions in developing countries as they experience high population growth rates that tend to interfere so much with their development efforts. This, therefore, calls for population control measures in most developing countries.
- It is the basis for analysis in population issues in most developing countries.

The limitations of the Malthusian population theory to developing countries

- The theory assumes constant technology. But technological changes do occur and this would help increase food supply and reduce the mortality rates in developing countries
- The theory assumes a closed economy; yet developing countries have open economies and therefore with the possibilities of international trade.
- Malthus did not take in to account the scientific advancement in agriculture e.g. Agricultural modernization, application of fertilizers, greenhouse effect, improved seed variety, land reclamation, etc. which would help increase food production and thus food production/national income.
- The theory never took into account the enormous/great improvement of technological progress in production; population policy measures such as the use of contraceptives etc. which would help ease population pressure.
- The theory ignored the possibilities of migrations to ease population pressure in the over populated areas. Yet today migrations are taking place in developing countries to more developed countries.
- Malthus, in his theory, did not state the exact time when population trap would be reached. If he did, developing countries would have taken precautions by storage of the available food from other countries so as to safe guard them from starvation, dying, eating their own children etc.
- Malthus put forward his theory before the age of exploration; meaning that he never considered the extension of the British empires outside Britain. But later on new lands & colonies were obtained e.g. Australia, Argentina, Canada, etc.

- He was narrow minded in his theory as he thought Great Britain was the entire world and thus never thought of migrations and the possibilities of improved means of transport that would make it possible to import food from the new world (areas of plenty) to Britain (areas of scarcity).
- He did not fore see the possibilities of getting foreign aid and resources from other countries. He thus underrated the role of foreign trade/aid in alleviating food shortages. He never thought about private/charitable organizations & or individuals feeding the hunger stricken population.
- He took into account agriculture as the backbone economy of Great Britain. But most countries of the new world and others are undergoing transformation, industrialization, commercialization, etc. systematically replacing the traditional agricultural sector
- According to Malthus, preventive checks only pertain to moral restrain and late marriages. He never thought of the introduction of modern techniques of family planning devices which are used in developing countries today.
- According to him, population growth depends on food (NY). But in developing countries, population growth does not only depend on food but also other factors such as the nature of families (e.g. polygamy), Cultural/traditional factors, & religious values attached to children This forces them to produce as many children as possible.
- He as assumes a subsistence economy. But developing countries are growing out of subsistence to commercial agriculture where food can be processed and stored for future use.
- The theory assumed fixed supply of land. Yet more virgin pieces of land have been opened up through land reclamation of swamps, forests, polders etc. so as to increase food supply.
- In some countries, positive checks such as wars diseases, famine, etc. have occurred not as a result of high population size as suggested by Malthus but due to political/power struggles.
- The theory ignored the role of technological development through which food supply can be increased to support the rapidly growing population using the relatively fixed land. This violates the diminishing returns assumed by Malthus.

<u>Population problems in developing countries</u>

- ✓ High level of brain. This is due to the highly skilled, professional, trained & educated individuals leaving their countries in search for greener' pastures in more developed countries. This Leads/results into low output & low economic growth rates

- ✓ High levels of unemployment. & underemployment. This is attributed to the low levels of economic activities as a result of low savings & capital. This leads to low levels of productivity & percapita income.
- ✓ Rural urban migration. This is due rural-urban imbalance in development (the existence of poor rural facilities & better urban facilities). This results into open urban unemployment, congestion, high crime rates, & other social evils in the urban areas.
- ✓ Food shortages. This is associated with high population growth rates. This makes developing countries to import foodstuff from the more developed countries. Thus leading to economic dependence
- ✓ Over exploitation of natural resources. This is due to increased resource utilization to support the high population growth rates in developing Countries. This results into environmental degradation/exhaustion of resources
- ✓ Low capital accumulation. This is attribute to high consumption expenditures leaving little or nothing for savings & investment .This leads to low output & low economic growth.
- ✓ High dependence burdens. This is due to high population growth rates making the developing countries to rely on the MDCs for aid/resources. This leads to lack of self-sufficiency.
- ✓ Political instabilities. This is due to the struggle for the existing limited resources & services. This results into disharmony/low output & hence low economic growth rates
- ✓ Diminishing marginal returns.in the agricultural sector. This is associated with the population pressure on land & other natural resources. This leads to low levels of output & low economic growth rates.
- ✓ High levels of illiteracy. This is attributed to the low levels of education/defective education system. This results into man power problems in developing countries.
- ✓ Balance of payments problems. This is as a result of increased government expenditure on the importation of foods & other social requirements for the population. This leads to foreign exchange shortages in developing countries
- ✓ Poor standards of living. This is due to shortages of food & social services.

<u>Why it is necessary to control the High population growth rates in developing countries</u>

- ✓ To reduce food shortages. This is by reducing dependence burden so as to improve the standards of living of the citizens.

- ✓ For the purposes of improving balance of payments position. This is through reducing expenditures on food imports and other social requirements for the population. This helps to increase foreign exchange earnings.
- ✓ Reducing high levels of unemployment and underemployment. This is by creating more economic activities/investments so as to avail incomes to people.
- ✓ To reduce diminishing returns to the agricultural sector & other natural resources. This is through reducing the high population pressure on the land so as to increase productivity and per capita incomes of the developing nations.
- ✓ Increasing capital accumulation. This is by reducing the high consumption expenditures thus increasing investments & outputs in the developing countries.
- ✓ To improve standards of living. This is by increasing the supply of goods and services so as to people's welfare.
- ✓ To reduce over dependence on natural resources. This is by improving the education systems, using family planning methods etc. Hence reducing environmental degradation & pollution.
- ✓ Minimizing rural urban migration & its evils. This is by improving on rural infrastructural facilities so as to reduce unemployment, underemployment, high crime rates, congestion, pollution & other social evils in urban areas/increase the level of production in the rural country sides in developing nations.
- ✓ To reduce high dependence burden. This is because the increasing population relies on foreign resources and other consumer goods. This helps to improve the standard of living in developing countries.
- ✓ To reduce brain drain. This is through improving domestic infrastructural facilities.
  This helps to reduce unemployment, and creating more investments. This helps to provide incomes, increase domestic output & improving the welfare of the citizens in the developing countries.
- ✓ Improving literacy rates. This is through reforming the education system so as to improve the standard of living
- ✓ To reduce political instabilities. This is by creating more social services, conducting round table talks with the rebellious groups, granting amnesty to those who surrender good/democratic governance etc. so as to create peace and harmony in developing nations.

<u>Population measures in developing countries</u>

- ✓ Use family planning methods. This should be by using contraceptives so as to regulate the population growth rate.
- ✓ Encourage higher education. This should be by emphasizing girl-child education so as to check on fertility rates, quality of children produced and postpone marriages for future.
- ✓ There should be rural development policies put in place. This is by making rural areas attractive so as to check on rural urban migration & its evils. Such policies include rural electrification, security, water supply, recreational facilities etc.
- ✓ Legalizing abortion as a way of controlling unwanted pregnancies and population growth rates.
- ✓ Using coercive policies. This should be by imposing force/taxes, economic disincentives, on people per the number of children born in a family by the governments of developing countries so as to reduce the population growth rates
- ✓ Creating a stable political climate. This should be through conducting peace talks, granting amnesty to those who surrender, and good/democratic governance. This helps to facilitate investments and hence creating employment opportunities and incomes.

(b) LABOUR.

The term labor is the human physical and mental effort used in the production process.

It is one of the most important agents of production that helps to coordinate and organize the other factors of production.

It consists of unskilled, semi-skilled, & professional labor.

It comprises the working age group (15–64 years). But excludes full time students, house wives, the handicapped/disabled etc. who are not involved in economic activities hence dependent on the working class.

Labour as an agent of production that earns either a wage or salary.

<u>The characteristics of the labour force in developing countries</u>

- ✓ It is rapidly growing in nature. This is attributed to the high population growth rates.
- ✓ It is dominated by the young group of people between 15 to 30 years. This is due to the existence of high birth rates.

- ✓ High levels of unemployment & underemployment. This is due to the existence of inadequate economic activities/investment opportunities.
- ✓ It is dominated by semi-skilled, unskilled & illiterate labour force. This is attributed to the low levels of education.
- ✓ It is dominated by job seekers rather than job creators. This is associated with the poor/defective education system.
- ✓ The existence of low levels of productivity. This is due to the low levels of education and training/the existence of inadequate complementary factors in the production process.
- ✓ There is high mobility of labour & brain drain. (This is mainly common with the small fraction of highly skilled labour that prefers to search for greener pastures abroad.) This is attributed to the existence of wide spread unemployment and underemployment.
- ✓ It is mainly employed in the public sectors/governments with very few in the private sectors & others self-employed. The number of those employed in the private sector is steadily increasing due to the privatization policy of inefficient parastatals
- ✓ There is high rate of rural urban migration of the young people. This is due to the existence of rural-urban socio – economic imbalances. This leads to massive open urban unemployment & other social evils
- ✓ The existence of weak trade unions. This is due to the poor organization of labour force & political influences.
- ✓ There exist high rates of absenteeism from work. This is mainly due to poor health conditions of the labor force
- ✓ It is full of target workers. This is because they aim at achieving their objectives in a given time & leaving the job thereafter.

Labour force/supply

- ✓ This is the proportion of the population that is made up of the working age group; excluding the full time students & house wives. Or
- ✓ It is the total number of people of the working age group that is available for employment at a given time. Or
- ✓ It is the number of people in the age group of (15–64) who can offer themselves for employment at the ongoing wage rate.

The determinants of labour supply/force

- ✓ The level of motivation at work. High levels of motivation, attractive wages, better working conditions, etc. increases labour supply. This is attributed to the presence of a driving force in work. However, poor motivation of workers reduces labour supply. This is due to the absence of a driving force in work.

- ✓ The level of political climate. The presence of political stability encourages high supply of labour. This is attributed to the confidence for life & safety of property The existence of political instability scares people away from work due to the fear of loss of life & destruction of property leading to low labour supply.
- ✓ The degree of labour mobility/fluidity of workers (labour). High degree of labour mobility encourages increased labour supply. This is due to the ease of movement to & fro work places & jobs. However, low degree of labour mobility leads to low supply of labour. This is due to the inability to move from place to place & from job to job.
- ✓ The level of experience and expertise needed for a particular job. Given high level of experience & expertise, the labour supply reduces. This is attributed to the many years of required to attain the needed experience & expertise. But where the level of experience & expertise required is low, then the supply of labour increases. This is attributed to the few years required to attain the needed experience & expertise.
- ✓ The level of education/skills/training. The high level of education/skills possessed by workers leads to low labour supply. This is due to their inelastic of supply. However, low level of education & skills leads to increased labour supply. This is due to their elastic supply.
- ✓ The rate of investment. Given the rate of investment is high, this encourages high labour supply. This is due to the existence of a lot of opportunities. However, given that the rate of investment is low, labour supply is reduced. This is attributed to the existence of limited opportunities.
- ✓ The health conditions of the workers. Good health conditions of workers encourage increased labour supply. This is due to the efficiency in work. However, poor health conditions leads to reduced labour supply. This is due to inefficiency in work.
- ✓ The nature of the job. Jobs that involve a lot of risks lead to reduced labour supply. This is due to the high risks involved. However, jobs with few risks encourage increased labour supply. This is due to the safety involved.
- ✓ The rate of population growth. Given a high population growth rate, this encourages high labour supply. This is attributed to high fertility rates, improved health care services, low death rates, etc. But where there exists low population growth rate, this leads to low labour supply. This is attributed to low fertility rates, poor health care services, high death rates etc.

- ✓ The government policy on labour. Favorable government policy inform of high retirement age of workers, open recruitment in civil service etc. leads to increased labour supply. This is due to the ease of entry into & acquisition of jobs. However, unfavorable government policies inform of early retirement age of workers, restrictions of child labour restricted recruitment in civil service etc. leads to reduced labour supply. This is attributed to the difficulties of entry into & acquisition of jobs.

Demand for labour supply

- ✓ This refers to the number of labourers employers are willing to employ at a given wage rate in a given period of time. Or
- ✓ It refers to the quantity of labour desired by an employer at a given wage rate in a given time. Or
- ✓ It refers to the number of people employers are willing to offer jobs to at a given wage rate in a given time.
- ✓ The demand for labour is derived demand for the products produced that it produces. That is, where the demand for the products produced by labour is low, this leads to reduced demand for labour; and where the demand for the products produced is high, this leads to a high demand for labour.

The determinants of the demand for labour

- ✓ The degree of substitutability of labour/the ease with which labour can be replaced/substituted. Where it is easy to replace labour with machines, an increase in the price/wage of labour prompts entrepreneurs to replace labour. This is due to the efficiency of machines in the production process. However, where it is difficult to replace labour with other factors of production, this encourages entrepreneurs to recruit more labour in the production process. This is due to the high average cost of employing other complementary factors in the production process.
- ✓ The cost/price/wage of labour. Given a high price/wage rate of labour, this leads to a low demand for labourers by entrepreneurs. This is due to the high average cost of hiring a labour. But where there is a low price/wage rate, this encourages entrepreneurs to demand for more laborers. This is due to the low average cost of employing labourers
- ✓ The price of substitute for labour. Given a high price of the substitute for labour, this leads to a high demand for labour. This is because it is cheap to pay for labour/low average cost of hiring labour. But where there is a low price for labour substitute, this leads to a low demand for labour. This is

because it is expensive to hire labour/due to the high average cost of hiring labour.

- ✓ The nature of the technology used. The use of capital intensive technique reduces the demand for labour. This is because of the efficiency derived from using machines/capital, than other factors, especially labour. However, the use of labour intensive technique increases the demand for labour. This is because of the low average cost of using labour than other factors especially, capital in the production process.
- ✓ The degree of competition for labour among the firms. Where there is high degree of competition for labour by firms, this leads to a high demand for labor. This is attributed to the scarcity of labour supply. And where there is a low degree of competition for labour by firms, this leads to a reduced demand for labour. This is due to labour being plenty in supply.
- ✓ The demand for the products of labour. The high demand for the products produced by labour leads to an increased demand for labour. This is because the demand for labour is a derived demand. Where there is a low demand for the products produced by labour, this leads to a low demand for labour. This is attributed to the demand for labour being derived from the products it produces.
- ✓ The size of the firm. Given a bigger size of the production unit, this leads to a high demand for labour. This is associated with the existence of large scale production. And where the size of the firm is small, this leads to a reduced demand for labour in the production process. This is due to the existence of small scale production.
- ✓ The government policy on wages. The establishment of minimum wage legislation leads to a reduced demand for labor by entrepreneurs/employers. This is because of the high average costs incurred in hiring labour. (i.e. it is expensive to hire labour.) However, setting up of maximum wage legislation leads to an increase in the demand for workers/labourers by firms. This is attributed to the low cost of hiring labour.

The efficiency and productivity of labour.

- Efficiency refers to the degree of competence by which desired results are achieved.
- Therefore, the efficiency of labour refers to the measure of the quality and quantity of output a unit of labour can produce in a given time.
- Productivity refers to the out per unit of a factor.
- Therefore, productivity of labour refers to the output produced per unit of labour employed in a given time.

The determination of efficiency and productivity of labour

- The quality of education and training/skills. The high level and quality of education and training/skills increase the efficiency and productivity of labour. This is because of the acquisition/possession of the relevant skills/education/knowledge/training/expertise in the production process. And the low level and quality of education and training/skills etc. leads to low efficiency and productivity of labour. This is associated with inadequate acquisition of skills/training/knowledge/expertise etc. in the production process.
- The health and physical conditions of workers. Workers who are healthy & in good physical conditions are more efficient in the production process. This is because they are able to do work. And those who are sickly and physically handicapped are less efficient in the production process. This is due to the lack of the skills and abilities needed to work normally.
- The strength and nature of the supervisory staff. Given the high level of efficient supervision by administration, this leads to high level of efficiency and productivity of labour. This is due to the proper guidance and counseling given to the workers. Where there is poor supervision of the labour force, this results into low level of efficiency & productivity of labour force in the production process. This is attributed to the poor guidance and counseling given to the workers in the production process.
- The level of technology used. The use of advanced techniques of production increases the efficiency and productivity of labour in the production process. This is attributed to the use of machines in the production process.
  However, the use of poor techniques of production results into low efficiency and productivity in the production process. This is attributed to the use of inadequate complementary factors of production.
- Prospects of promotion at the work place. The existence of high hopes of promotion for workers leads to increased efficiency and productivity of workers. This is due to the existence of a driving force in the production process.
  Whereas the absence of hopes of promotion for workers at work place results into reduced efficiency and productivity of workers in the production process. This is due to low driving force to work harder in the production process.
- Personal qualities/abilities. The presence of more inventive, innovative/creative and hardworking labour force results into increased efficiency and productivity in the production process. This is due to the existence of a driving force to work harder. While the absence of inventive,

innovative, creative and hardworking labour force leads to reduced efficiency and productivity in the production process. This is due to the absence of motivation/driving force to work harder.

- The nature of the working conditions. The presence of good working conditions and motivation of workers increase the efficiency and productivity of workers. This is due to the existence of a driving force/factor to work harder. However, poor working conditions and motivation reduce the efficiency and productivity of the labour force in the production process. This is because of the absence of a driving force/factor to work harder
- The level of experience and seniority of the workers. High level of experience and seniority of workers results into efficiency and increased productivity in the production process. This is because they already know what to do. However, low level of experience and seniority leads to low efficiency and productivity in the production process. This is because they are still learning what to do in the production process
- The degree of specialization and division of labour. High level of specialization increase efficiency and productivity of the labour in the production process. This is because the right worker is put in the right position. But low level of specialization and division of labour result into reduced efficiency and productivity of labour in the production process. This is because of inadequate experience in the production process.
- Availability and quality of complementary factors of production. The presences of high quality complementary factors increase the efficiency and productivity of labour. This is because labour is able to combine with the other factors efficiently & adequately. Whereas the absence of good quality complementary factors of production leads to low efficiency and productivity in the production process. This is as a result of inadequate combination of the other factors of production in the production process.

(C) <u>Wages</u>

- A wage is a <u>monetary reward</u> to labour for the <u>services it offers</u> in the production process in <u>a given time</u>.
- Wages are classified into nominal, real and reserved wage.

✓ A nominal wage is one paid to a worker in <u>monetary terms</u> in <u>a given period of time</u>. e.g. Shs. 100,000/= per month or
It is the <u>actual amount</u>, in <u>monetary units</u>, received as income.

✓ Real wage refers to the basket of goods and services that a nominal wage can buy in a given period of time. Or
It is the purchasing power of the nominal or money wage.

Real wage = $\frac{Nominal\ wage}{Price\ index}$

- ✓ Reserve wage refers to the <u>minimum wage/wage floor</u> below which the individual worker cannot accept a given job offer.

<u>Methods of wage determination in developing countries</u>

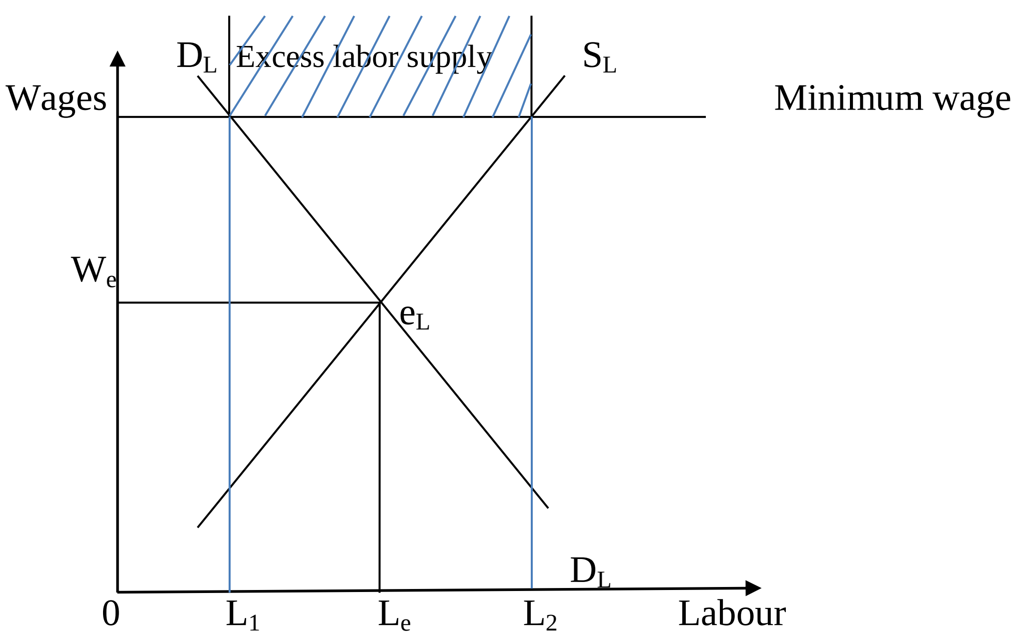
(1) Through collective bargaining. This refers to round table negotiations between the representatives of trade unions and the employers aimed at improving wages and other working conditions of workers.

The presence of strong trade union results into higher wages & better conditions of workers. This is because of their good lobbing skills/negotiation abilities. However, the presence of a weak trade union leads to low wages and poor conditions of work. This is due to their poor lobbing/negotiation skills

(2) Through government wage legislation. This is where the government sets the wages to be paid to the employees/workers by the employers/firms. This can either be a minimum or maximum wage.

Minimum wage legislation/wage floor. Is one which is set by the government above the equilibrium wage below which an employer/firm should not pay the employees.

<u>The minimum wage legislations</u>



<u>The reasons for the setting of minimum wages in an economy:</u>

- To protect the employees/workers from being exploited by the employers/firms. This is because employers/firms sometimes under pay their workers who have low bargaining powers.
- To provide a living wage to the employees/workers. This is because it is set in consideration with the cost of living.
- To reduce brain drain. This is through improving the working conditions of the workers. This helps to retain the trained and professional labour force within an economy
- To protect workers/employees where unions are particularly weak and where the wages are depressed by an excessive supply of labour.
- To increase the purchasing power of the workers/employees. This helps to increase the welfare of the workers harmony among the workers in developing nations.
- To minimize industrial unrests and disputes resulting from trade unions' activities. This is through creating harmony between employees/workers and employers/firms. This helps to create peace and harmony among the employees.
- To motivate workers from rural areas not to move to urban areas in search for better paying jobs and good working conditions. This is through improving the working conditions of the workers in the rural country sides. This helps to improve the welfare of the citizens.
- To raise the productivity and efficiency of labour/employees/workers. This is through boasting the moral of the workers. This helps to improve the welfare of the workers.

<u>The dangers/demerits of minimum wage legislation</u>

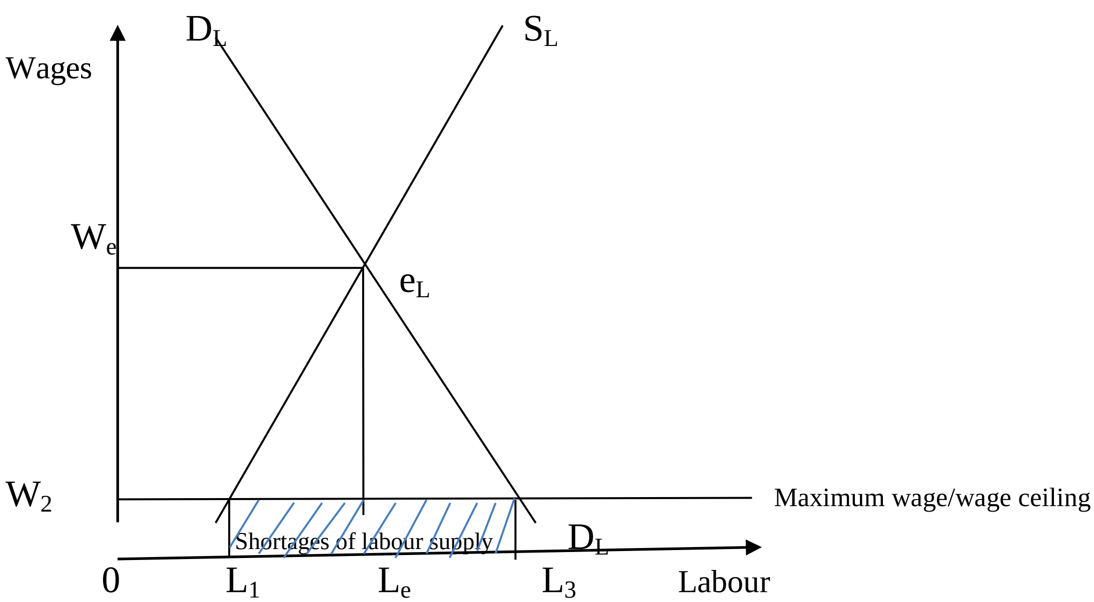
- Creates unemployment. This is because it is set above the equilibrium wage and hence creating a surplus labour supply in an economy. This leads to low incomes and thus low standards of living.
- Stimulates rural urban migration & its evils. This is because minimum wage legislation is effected mostly in urban areas. This results into open urban unemployment/decline in output (production) in the rural areas.
- Reduction in the level of investment. This is due to the increased cost of hiring labour in the production process. This leads to reduced output and hence low economic growth rates.
- Leads to inflation. This is due to wage–price dynamics. This thus leads to poor standards of living/high cost of living.

- Reduction of aggregate demands. This is because some workers are laid off by the firms which can't pay the minimum wage. This results into low incomes & hence poor welfare.
- Increased costs of administering minimum wage legislation by the government. This is through the government paying for the man power involved in the supervision and administration of minimum wage legislation. This leads to poor infrastructural development/service delivery.

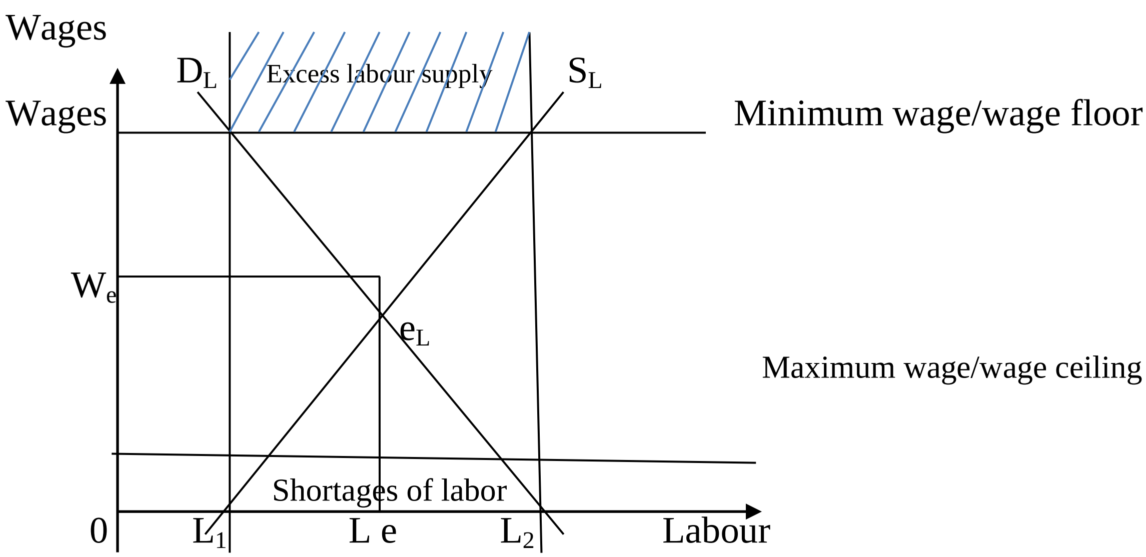
Maximum wage legislation/wage ceiling

A maximum wage legislation is one where the government sets a wage below the equilibrium wage above which the employer/firm is not allowed to pay the workers at.

The maximum wage legislation/wage ceiling.



The minimum & maximum wage legislations



Foot note:
OL_1 denotes employed labour force
L_1L_2 denotes the unemployed labour force
D_L denotes the demand for labour
S_L denotes the supply of labour
e_L denotes the equilibrium wage.

The reasons for setting maximum wage legislation in developing countries.

- ✓ To protect employers/firms from being exploited by the workers. This is because trade/workers unions are strong in negotiations of wages for workers & conditions/terms of work. This helps to protect the employers/firms from exploitation by the representatives of the trade/workers unions.
- ✓ To reduce the costs of hiring labour. This is through setting maximum wage legislations in an economy. This helps to improve on the profitability of employers/firms.

The dangers/demerits of maximum wage legislation (wage ceiling)

- Promotion of excess capacity in production. This is because the maximum wage set encourages inefficiency and low productivity in the production process. This leads to low output and thus low economic growth rates.
- Encourages exploitation of workers. This is due to the low wages given to workers by the employers/firms. This leads to low standards of living.
- Reduces labour efficiency. This is due to the low wages which demotivate workers. This leads to low/poor quality outputs/poor service delivery.

- Encourages brain drain. This is due to the low wages and poor conditions of workers in the domestic economy. Thus leading to low output and low economic growth rates. (This leads to poor/low output & inadequate skilled labour at home).
- Encourages industrial unrest. This is because of the low wages enforced. This leads to low output and hence low economic growth rates.

(3) By signing contracts between the employees and employers. This spells out the wage to be paid to the employees for a given period of time.

(4) Through individual bargaining. This is where the individual worker negotiates with the employers/firms the wages she/he is to be paid in a given period of time.

(5) Through the market forces of demand and supply of labour. This is through the interaction of the forces of demand and supply in the labour market.

(6) Through wage leadership. This is where small firms set their wages following the wages paid by large/efficient firms to their workers. The large/efficient firms, therefore, determine the wages to be paid to the workers by small firms.

(7) Through piece rate. This is where wages are paid according to the amount of work done (or as per the output produced by the employee/worker) in a given time. e.g. Ushs. 20,000 for one thousand bricks laid. This method of wage determination is common with unskilled labour force.

The benefits of piece rate

- Increased output. This is because workers aim at income maximization and thus devote much of their time working. This leads to economic growth.
- Minimization of discrimination and nepotism involved in payment. This is because workers are paid according to their individual abilities. This leads to peace and harmony between employees and employers.
- Minimization of costs of supervision. This is because it ties payment directly to performances. This leads to increased self-esteem.
- There is less time wastage. This is because workers use most of their time working so as to earn more income. This leads to increased productivity/improved service delivery.
- Promotes team work spirit. This is due to the need to earn more wages. This leads to increased output produced.
- Easy to calculate the wage. This is because output (work done) is measurable. This leads to efficiency in payments.

- Encourages innovativeness and creativity. This is due to the need to produce large output of goods and services. This result into increased out/better service delivery
- Easy to forecast/predict output. This is because the work done is measurable. This leads to the ease of planning for both the workers & employees.
- Identification of suitable workers. This is because payment of wages is based on the amount/quantity of work done. This leads to better service delivery.

<u>The demerits of piece rate.</u>

- Weakens the health condition of workers. This is due to over working by labourers so as to earn more wages. This leads to poor standards of living due to leisure foregone.
- Instability in workers' earnings over time. This is because workers are not assured of a regular and defined incomes as the payments are not time based. This leads to poor planning on the part of the workers.
- Leads to trading off quality for quantity. This is because workers are more interested in quantity than quality produced. This leads to poor quality output produced/service delivered.
- Over production/excess supply in the market. This is due to the desire to earn more wages. This leads to reduction in prices, profits, dividence and thus reduced revenue.
- Increased income inequalities among workers of the same firm. This is because payments are ability based. This leads to poor standards of living/class distinction.
- Slow but careful and efficient workers are discouraged. This is due to the production of low output levels and goods produced. This results into low wages earned thus low standards of living.
- Undermines the role of trade unions. This is because payment of workers' wages is ability based. This results into poor standards of living for slow workers

(8) Time rate. This is where wages are paid to workers according to the number of hours worked for/duration spent at work e.g. Ushs. 2,000/= for four (8) hours worked. This is common with skilled/professional workers/labourers.

<u>The benefits of time rate</u>

- A worker is assured of a regular and defined payment. This is attributed to the amount of the time taken at work. This enables the worker to plan effectively.
- Leads to high quality output. This is because employees/workers/labourers are motivated by the regular and defined payments. This results into better welfare standards of the employees/workers/labourers.
- Minimizes income inequalities among workers in the same firm/union/organization. This is because all the workers are paid a uniform wage basing on the number of hours worked. This leads to improved standards of living.
- It is easy to understand and calculate the time & or wages by both parties (employers & employees). This is because of the time dimension involved. This leads to increased quality output produced.
- It is applicable where output cannot easily be measured quantitatively. E.g. the services of a teacher, doctor, lawyer, engineer etc. This results into high quality service offered.
- It is suitable for organizations where team work is emphasized. .This is attributed to the time dimension involved. This leads to increased quality output produced.
- Creates a sense of responsibility. This is because of the adequate time given to accomplish a task. This leads to the efficiency in production/service delivery.
- Protection of slow and efficient workers. This is due to the adequate time given to do a given task/work. This leads to peace and harmony at work place among workers and employers.
- Reduces over working of workers. This is due to payments being time based. This leads to efficiency in service delivery/work done.

The demerits of time rate.

- It needs a lot of supervision (to see how work is done) This is so costly to the management hence leading to increased cost of production.
- Encourages production of low quality products. This is because it does not consider how work is done but rather the period worked. This results into poor standard of living.
- Leads to low output. This is because of the tendency of workers to dodge or do little work as they are assured of their wages at the end of the time period. This leads to low economic growth rates.

- Promotes inefficiency in work. This is because hard working and lazy workers are all paid the same amount of wages at the end of the period. This leads to poor quality work done.
- It is time wasting. This is due to the existence of slow and inefficient workers. This leads to low output produced/poor service delivery.
- Leads to industrial unrest. This is because both the employees & the employers are bound by a contract. This results into low output & hence low economic growth rates.

The theories of wages

(a). Early theory of Wages

The early theory of wages include: subsistence theory (the iron law of wages), wage fund they, residual theory, bargaining theory, market/modern theory and marginal/labour productivity theory of wages.

(1) Subsistence theory of wages (The iron Law of wages).

According to this theory, workers should be given a wage which is just enough to enable them acquire the basic needs/necessities of life.

It states that workers should be paid the bare minimum so that they can work harder after experiencing hardships, hunger, & starvation.

It stresses that the wage level should correspond with the subsistence level of living at which people could just maintain the existing population.

It maintains that above the subsistence wage, population would increase and below it, standards of living would be too low that people might die thus reducing the population.

This theory was used to justify payment of low wages during the industrial revolution. (17 century)

A subsistence wage is the reward given to a labour/an employee/worker which is just enough to enable him to meet his basic human needs.

It is the minimum possible pay to a worker to induce him to work harder but not to afford any luxury of life.

The iron law of wages was developed by French economists who had been greatly influenced by the writings of Rev. Thomas Malthus.

Criticism of the subsistence theory of wages

- It ignores the demand side of labour and concentrates only on the supply side of labour (following the Malthusian theory). This makes it difficult to use in wage determination.
- The subsistence level of wage is not constant. It varies from time to time depending on price levels, & economic conditions.
- The theory relates wage rates to birth rates/population growth rates. This is not the case in Uganda's labour markets. This is because increase in wages does not necessarily increase birth rates/population growth rates.
- The theory is only applicable to the subsistence sector (in subsistence level of living) but not to the commercialized sectors of Uganda's economy which use other considerations in wage determination.
- The influence of trade unions in wage determination is not taken into consideration by the theory. Yet trade unions do determine wages of workers in most developing nations
- Contrary to the assentation/assumption of the iron law of wages, employees work harder when paid higher wages and do not work hard when paid (very) low wages. This is because high wages paid acts as a motivational factor to workers.

(2).The wage fund theory

This theory states that the wages offered depend on the fund available. That wages are increased when more funds are available and reduced when funds reduce.

According to this theory, a wage fund is created out of which the wages are paid. This fund is accumulated from the profits realized from production.

It maintains that wage level depends on:

- ✓ The amount in the wage fund created for the payment of wages.
- ✓ The actual number of workers employed i.e. the wage paid is equal to the total wage fund divided by the number of workers.
- ✓ The number of workers who are looking for employment.

Criticisms of the wage fund theory

- ✓ That employers/firms do not create wage funds for workers. They may secure some funds/loans from microfinance institutions to pay
- ✓ the workers dues.

- ✓ The number of employees does not determine wages. If more workers are needed, the employer/firm can get more capital to pay the workers from elsewhere.

(3). Residual theory

According to this theory wages are the left over after other factors of production have been paid. Where the left overs are more, higher wages are paid to workers and where the leftovers are less, low wages are paid to workers.

(4).The bargaining theory of wages

This states that wages are determined by the relative strength of the trade unions and employers' association concerned. To arrive at a given wage involves negotiations between management and the trade union (workers) representatives.

According to this theory, wages depend on the hours of work and conditions of work determined by the relative bargaining strength/power of laborers' (trade unions) and capital owners/employers.

It also maintains that workers have a weak bargaining position. This is due to their financial weakness, low skills, and poor art of bargaining.

(b).The modern theory of wages

(4). Market theory of wages.

According to this theory, wages are determined by the market forces of demand and supply for labour in the labour market. If there exists excessive supply of labour in the market, wages fall and if there is excessive demand for labour, wages increase.

(5). Marginal productivity theory of wages.

This states that labour should be paid a wage which is equal to the value of its marginal product; that is the value of the additional unit of the output produced by the extra unit of the labour employed). Hence the wage should be equal to the marginal revenue product of labour (MRP).

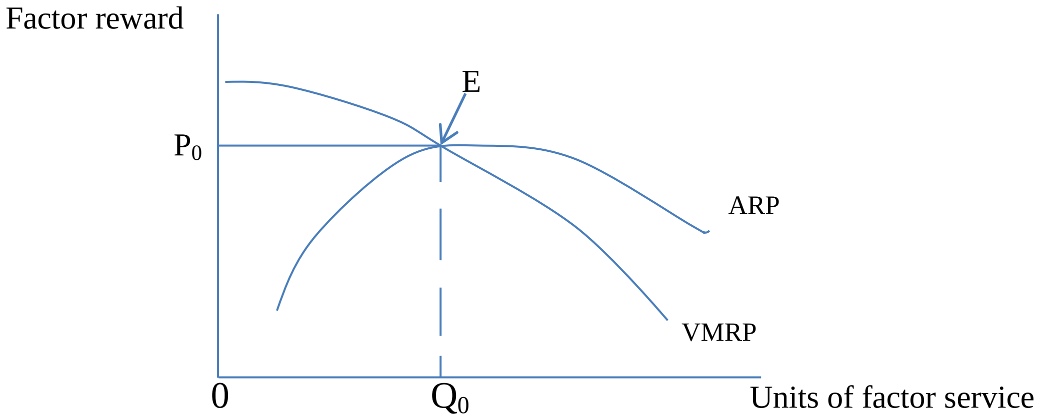
Or

It states that a factor of production should be paid a reward equal to the monetary value of its marginal (physical) product.

The value of marginal product of labour = marginal product of labour x price of output $(MP_L)P$

Wage = value of marginal product of labour (VMP_L)

= marginal revenue product of labour (MRP_L)



Where

ARP is average revenue product.

VMRP is the value of marginal revenue product

OQ_0 is the unit of factor service employed

OP_0 is the factor price

E is the equilibrium point.

The assumptions of the marginal productivity theory of wages

- ✓ It assumes perfect competition among the workers for jobs in the labour market
- ✓ It assumes full employment of factors inputs.
- ✓ That there is no government intervention in the labour market (in the determination of factor rewards/wages).
- ✓ Employers know the marginal productivity of their workers i.e. Perfect knowledge in the factor market.
- ✓ Marginal productivity is measurable by both employers & employees
- ✓ Labour can measure its marginal product i.e. Output can be quantified in the measurable units.
- ✓ It assumes that labour is perfectly mobile.
- ✓ All units of labour are homogeneous & divisible in nature.
- ✓ There is equal bargaining power between the employers and employees.
- ✓ It assumes the existence of excess capacity in the production process.
- ✓ Assumes the operation of the law of diminishing returns

Criticism/limitations/weaknesses of the marginal productivity theory

- ✓ It assumes no government intervention in the labour market. Yet governments in developing countries being the major employers do intervene in the labour markets by fixing the wages paid to workers.
- ✓ It assumes perfect mobility of labour. Yet there exists high levels of immobility of laborers in the labour markets, both geographically & occupationally.
- ✓ It assumes perfect knowledge of employers about the marginal productivity of labour. But this is not true as most employers do not have enough information to assess the marginal productivity of their workers.
- ✓ The theory assumes conditions of perfect competition in the labour markets. In the real world, there exist imperfections in the labour markets e.g. discriminations, tribalism, racism, nepotism etc. do exist in the labour markets.
- ✓ The units of labour are not homogeneous as the theory assumes. This is because of the difference in educational levels, abilities, skills and efficiencies, fertility of land, etc.
- ✓ It is difficult to measure the marginal productivity of labour as an individual factor. This is because marginal productivity is as a result of all factors of production.
- ✓ The theory maintains that labour should be paid equal to the value of its marginal product. This is unrealistic as the theory ignores the role of trade unions in bargaining for high wages, individual bargaining strength/power of workers, the forces of demand and supply etc. in wage determination
- ✓ Marginal productivity change overtime. This is due to economies and diseconomies of scale. Therefore, it can lead to instability in wages if it is used as the basis of wage determination.
- ✓ The theory is irrelevant under conditions of full employment where there is no room for the extra workers to add on to the total output.
- ✓ The theory assumes free and fair competition among workers for jobs. Yet there are a lot of discriminations in the labour market based on gender, religion, tribe, political differences etc.
- ✓ It does not consider the high levels of unemployment and under employment which tend to force workers to accept wages even below the value of their marginal product.
- ✓ The bargaining power varies between employers and employees. This is due to the differences in bargaining skills, educational levels, qualities, & personalities.

- ✓ The theory does not put into account the exploitative habits of employers which makes them to pay their workers below the value of their marginal products (under payment of workers).
- ✓ This theory was put forward to show that the payment for labour should correspond to how much that labour contributes to the total output i.e. wages should be equal to the marginal productivity of labour. This is not realistic as there exists many methods of wage determination in the labour market.
- ✓ The theory stipulates that when the law of diminishing returns starts to apply, i.e. when the marginal product starts to fall, wages should also be reduced by the same amount. But this does not apply in most developing nations due to the pressure of trade unions for upward revision of wages.
- ✓ It also stipulates that labour should not be paid more than what it really produces. That its marginal product also needs to be taken into account from the MR productivity of labour (MRP).

  This means that before a laborer is paid, it is important not to only consider how much that labour has put in (marginal product) but also how much that additional unit can be sold at the current market rate (price). Wages should be determined basically by the MR productivity of labour. This is not realistic as the marginal product of labour cannot be measured
- ✓ It assumes that all units of labour are homogeneous in nature. But this is not true as labour varies in skills, abilities, productivity, & educational levels,

<u>Factors that determine the level of wages in developing countries.</u>

- The level of experience, expertise, & responsibility. Workers with high level of experience, expertise and responsibility command high level of wages. This is because they are capable of doing better quality work/they are efficient in work. Whereas those with no expertise, experience and responsibilities command low wages. This is because they are not capable of better quality work/they are inefficient in work.
- The strength of workers' trade unions. Where the workers' trade unions are strong, they negotiate for high wages for their members. This is because they can negotiate for better wages. But where the workers' trade unions are weak, low level of wages are paid to workers. This is because their unions cannot negotiate for high wages.
- The ability of workers to do work. (Piece rate): workers who are able to do a lot of work receive high wages. This is attributed to their physical strength and abilities. However, those unable to accomplish a lot of work are rewarded less. This is because of their physical inabilities and strength

- The level of talents/natural gifts. Those with natural talents earn high wages. This is attributed to their natural monopolies over others. While those without talents earn less wages. This is due to their being natural talent deficit in nature.
- The number of hours worked (Time rate): where workers are able to work for many hours, they are rewarded with high wages. This is due to their ability to work for many hours. However, where less number of hours is worked for, low reward is given to workers. This is due to their inability to work for many hours.
- Employers' ability and willingness to pay.
  Given that the employer is able and willing to pay workers, high wages are received by workers. This is attributed to the existence of a wage fund set aside to pay the workers/ the existence of the ability to secure some capital from elsewhere to pay the workers.
  . However, where employers do not have the ability and willingness to pay, low wages are received by workers. This is due to the absence of a wage fund set aside/the in ability to secure some capital from elsewhere to pay the workers.
- The government policy on wages. Given the government sets minimum wages, high wages are paid to workers. This is due to the government's desire to protect labourers. However, where the government sets maximum wages, low wages are received by workers. This is due to the government's desire to protect the employers'.
- The bargaining strength of individual workers. Individuals with strong bargaining power are paid high wages. This is due to their possession of better negotiation power/lobbing skills. However, those with weak bargaining strength are paid low wages. This is due to their poor low bargaining power/lobbing skill.
- The level of education and training skills Workers' with high levels of education and skills are paid high wages. This is because of the possession of knowledge and skills of production process/service delivery. Workers with low level of education and training are paid low wages. This is because of the possession of poor and low levels of skills and knowledge in the production process/service delivery
- The market forces of demand and supply of labour. Where many labour forces are supplied onto the market, low wages are paid to workers. This is attributed to their low demand (surplus labour force) in the production process/service delivery. However, where less labour is supplied onto the

market, high wages are paid to workers. This is due to their high demand (scarcity of labour force) in the production process/service delivery

- The cost of living. Where the cost of living is high, the workers are paid high wages. This is (due to the decline in real wages) to enable them meet their cost of living. However, where the cost of living is low, workers are paid low wages. This is due to the increase in real wages.

<u>Wage differentials in developing countries</u>

Differences in salaries and wages rates in developing countries are due to the following:

- Differences in the nature of jobs. Workers employed in risky or temporary/contract jobs command higher salaries/wages. This is due to the dangers involved in the job. Workers engaged in easy, pleasant & permanent jobs command lower salaries/wages. This is attributed to the low degree of risks involved in the jobs.
- Variations in the levels of skills/education/training/experience/expertize. Highly skilled/educated/trained/experienced workers receive higher wages/ salaries. This is true especially in public service where salaries are paid basing on salary scale. However unskilled, uneducated, untrained, inexperienced/newly qualified workers doing the same job are paid lower wages/salaries. This is attributed to the fewer number of years of experience, & low level of skills/knowledge acquired.
- Differences in bargaining strength of individual workers and trade unions. Workers/trade unions with strong bargaining power are highly paid. This is attributed to their exceptional/strong bargaining/lobbing skills. However, workers/trade unions with weak bargaining power are paid low salaries/wages. This is due to their poor/weak negotiation/lobbing skills.
- Differences in employers' abilities and willingness to pay workers employed. The workers of employers who have the abilities and willingness to pay receive higher salaries. This is attributed to some funds set aside for workers' payments. However, workers employed by employers who do not have the abilities and willingness to pay earn low wages/salaries. This is because of there being no funds set aside to pay workers'.
- Differences in cost of living. In areas where the cost of living is high, the workers are paid high wages. This is (duet to decline in real wages) to enable them meet their cost of living. In areas where the cost of living is low, workers are paid low wages due to the increase in real wages.
- Differences in the number of hours worked/the case with time rate. Workers who are able to work for more hours are paid more wages. This is because (they are more efficient) wages are time based. However, workers who can't

manage to work for more hours earn less wages/salaries. This is because (they are less efficient) wages are time based.

- Differences in elasticity of supply of labour. Workers who have inelastic supply are paid high wages/salaries. This is because it is difficult to train them/takes long to train/supply/replace them. However, workers with elastic supply earn low wages/salaries. This is because it is easy to train/supply/replace them.
- Variation in strength of labour organizations/trade unions. Strong and well organized trade unions negotiate for higher wages for their members. This is attributed to their better lobbing skills. Workers in labour organizations/trade unions with weak bargaining power are paid low wages. This is due to their weak/poor bargaining/lobbing skills.
- Variations in people's ability to work (the case with piece rate). Workers who are strong and capable of accomplishing/doing a large piece of work within a short duration are paid more wages. This is because (they are more efficient) wages are task based. However, workers who are weak and unable to do a large piece of work within a short duration earn less wages/salaries. This is because workers are (less efficient) paid depending on the amount of the work done.
- Variations in job status/responsibilities. Workers in high positions with more responsibilities tend to be paid higher wages. This is attributed to the additional responsibilities performed by them. Workers in low positions with fewer responsibilities tend to be paid low wages. This is due to the fewer responsibilities performed by them. E.g. A manager is paid more than a cleaner working in the same organization.
- Variation in the health conditions/status. Strong and healthy workers who have the ability to do more work earn more wages. This is attributed to their physical fitness and strength. Workers who are weak and sickly and who do not have the ability to do work earn low wages. This is because of their inability to do work.

Labor organizations

Trade unions.

A trade union is an association of/organization formed by workers to collectively bargain for increased wages, improved conditions of work, improved skills of members etc.

The types/forms of trade unions include the following: industrial unions, craft unions, white collar union, general trade union, closed/open trade unions, etc.

The examples of trade unions in Uganda, among many include the following: Uganda Medical Workers Association (UMWA), Uganda National Teachers Union (UNATU), Uganda Law Society (ULS), Makerere University Academic Staff Association (MUASA), Makerere University non-Academic Staff Association (MUNASA), Uganda Tax Operators, and Drivers Association (UTODA), etc.

The objectives of trade unions

- To bargain for better wages for their members. This is through discussions with the representatives of the employers trade unions.
- To demand for improved working conditions for their members. This is through negotiations with the representative of the employers trade unions.
- To organize workshops, seminars and refresher courses for their members.
- To protect workers from unfair dismissals from jobs (job security). This is through ensuring that ensuring that employees are given appointment & contract letters by their respective employers before commencement of any duties.
- *To advise the government on policies concerning man power planning, empowerment policies and wage determination.
- To create friendly/social relations between employers and employees. This is by organizing talk shows, workshops & or sensitizations for both the employees & employers in different firms/industries & companies.
- To help and look for employment opportunities for their members when laid off from other firms. This is through liaising with other employers/firms so as to absorb any contracted worker who has lost his job.

The types/forms of trade unions

- ✓ Craft Unions. Is one which organizes workers according to their particular skills/talents. E.g. Lawyers, doctors, nurses, teachers, engineers, social workers, carpenters, businessmen/women, farmers, etc.
- ✓ Industrial unions. Is one which attempt to organize workers in a particular industry regardless of the type of work done by the workers. Members are accepted regardless of their place of work, nature of work, qualifications etc. e.g. UNATU, UTODA, Uganda tax operators, and drivers association etc.
- ✓ Closed shop trade unions (monopoly unions). Is one which requires employers to employ only the workers who are members of the trade union e.g. Uganda law society, Uganda Teachers Union, etc.
- ✓ Open Shop trade unions. Is one where workers are free to get employment irrespective of whether they are members of the trade union or not.

- ✓ General trade unions. Is one which represents workers from all industries and companies, rather just one, with the aim of uniting all the trade union societies.
- ✓ Etc.

<u>The determinants of the membership and strength of trade unions</u>

- The level of productivity of workers. Where the output per head of workers is high, this leads to the formation of a strong union. This is because of the presence of basis/grounds for wage increment. But where the productivity of workers is low, this leads to a weaker trade union. This is due to the absence of basis/grounds for wage increment.
- The prevailing economic situation in a country. High level of inflation in a Country increases the chances of members joining trade unions. This is due to a decline in real wages. However, low level of inflation in a country leads to fewer workers joining trade unions. This is due to an increase in real wages.
- The nature of employment. The existence of full time employment encourages workers to join trade unions. This is because members are more cohesive in nature. Whereas the existence of part time employment discourages workers from joining trade unions. This is because it is very difficult to unite the members.
- The cost of joining the union. Given a high cost of entering a union in form of membership and subscription fees, this discourages workers from joining trade unions. This is attributed to the high level of unemployment/underemployment and hence low incomes earned by most members. While low cost of joining a union in form of membership and subscription fees encourages workers to join trade unions. This is because most members are low income earners.
- The size of membership. Given a bigger number of workers in a trade union, this leads to the formation of a stronger union. This is due to enough capital/incomes generated from membership & subscription fees for running the activities/affairs of the unions
- The existence of a smaller number of workers in a trade union leads to the formation of a weaker union. This is due to low level of incomes generated from membership & subscription fees for running the activities/affairs of the unions
- The nature of leadership skills, organization and management. The existence of well trained and skilled leaders to manage the union and present the workers' aspirations leads to the establishment of a stronger union. This is

due to the existence of organizational & managerial skills/capacity development. However, the existence of untrained and unskilled leaders to manage and present workers aspirations makes the union become weaker. This is due to lack of knowledge/organizational & managerial skilll/capacity development to handle the affairs of the unions.

- The elasticity of labour force. Workers with inelastic supply lead to the formation of a stronger union. This is because they cannot be easily substituted/replaced in the production process/service delivery. Whereas the existence of labour/workers with elastic supply leads to the formation of weak unions. This is because they can be easily substituted/replaced in the production process/service delivery.
- The legal environment regulating employer–employees (union) relationships. (E.g. clear labor laws, the right to work etc.). Where the legal environment promotes the activities of unions in an economy, they become stronger. This is because they have a legal reference point in case of need for an appeal. However, in situations where the legal establishment does not favor unions, they become weaker in nature. This is because they have no reference point for appeal in case (of need) they are abused.
- The amount of funds and financial strength of the union. Given a stronger financial state of a union, this makes the union stronger. This is due to the availability of funds to run the activities of the union. Where a union has a weaker financial state, this makes it weaker in nature. This is attributed to the in availability of funds to run the activities of the union
- The nature of political climate. The existence of political stability encourages workers to form/join unions. This is attributed to the prevalence of relative peace, confidence to their life & safety of property. Whereas the existence of political instabilities discourage workers from forming/joining trade unions. This is attributed to the fear of their life and destruction of property.
- The level of unemployment in an economy. Given a high level of unemployment in an economy, this leads to the formation of a weaker trade union. This is due to the inability to contribute subscription & membership fees However, given a low level of unemployment in an economy, this leads to the formation of a stronger trade union. This is due to the availability of incomes/funds to generate for subscription & membership fees for running the activities of the union.

<u>The tools/methods used by trade unions to achieve their objectives/aims.</u>

There are two main ways through which trade unions can achieve their objectives. These are:

(i) Peaceful settlement and
(ii) Use of force/strikes.

(a) Peaceful settlement includes the following methods:

- ✓ Collective bargaining. This refers to round table negotiations between the employers and representatives of the trade union concerning the conditions of work and wages paid to the workers.
- ✓ Mediation. This is an intervention in an industrial dispute by an independent impartial (fair) third party who examines the arguments of both sides and makes a recommendation for resolving the dispute. E.g. the commission set by the government to solve the wrangles concerning wages/salaries in Kyambogo and Makerere universities in the 1990s.
- ✓ Arbitration. This is where both parties present their offers to an objective and impartial third party (arbitrator) who is effectively the judge. In this case he/she compares the offers of the two sides'. After studying both sides, he comes up with a recommendation for resolving the dispute which then binds both parties.

(b) Settlement by force. This includes the following ways:

- ✓ Violence/sabotage. This involves putting down tools, destruction of property, buildings/infrastructure etc. so as to compel employers to accept the demands of workers.
- ✓ Slow down strike. In this case, workers report for work but work at a slow pace. They may decide to work either for less hours or do less amount of work.
- ✓ Sit down strike. Here workers report to their places of work but do not do anything. They may also refuse to leave the work place till when their grievances are attended to.
- ✓ Boycotting the product of the industry. This is where union members may boycott the consumption of the products of the industry (primary boycott or convince the public not to buy the product of the industry (secondary boycott)
- ✓ Picketing. This is where those who want to work are prevented from doing so. Or it is done by deploying members of the union (strike police).to punish those who want to work or who are working.

<u>The conditions/circumstances that force workers to demand for higher wages</u>**.**

- When there is a rise in the cost of living. This is because a rise in the general price levels reduces the real wage of the workers.
- When workers compare their wages with workers in other sectors/industries. (Inter firm comparison of wages/salaries). This is because of the need for all workers doing similar/same jobs in another sector/industry to get the same level of wages/incomes

  This is based on the conviction that it is fair for workers doing similar/same jobs to get similar rewards.
- In case there is increased workload or number of hours worked. This is in the event of rewarding workers using piece and time rate systems of payment.
- In case of increased job risk. E.g. Sinking pit latrines, mining, construction of storeyed building etc. These types of job demands for increased wages as a lot of risks are involved.
- When there is an increase in the profitability of the industry. Here workers usually ask to share part of the increased profits earned by the industry inform of increased wages.
- When the government sets a high minimum wages. This is because the private employers/firms may be paying a wage which is below the one set by the government.
- When there is increase in the productivity of the workers. This is due to additional training and other qualifications of the workers. This makes workers to demand to share part of the increase in the products produced.
- In case the employers fail to pay the wages agreed upon in the contract signed between the workers and employers. This may force the workers to demand for higher wages.

<u>The challenges faced by trade unions</u>

- Limited funds. This is as a result of higher levels of poverty among the workers due to low salaries/wages/payments. Therefore, such members cannot sustain the activities of trade unions.eg subscriptions, membership fee etc.
- High level of unemployment. This is attributed to the existence of low levels of economic activities/investments. This makes trade unions weak as workers fear to go on strike for fear of losing their jobs. Besides, there are no strike funds to sustain them during the striking periods
- Limited leadership skills. This is because of lack of qualified and experienced leaders to present workers problems and aspirations properly to management. This thus adversely affects the operation of trade unions.

- Low level of accountability. This is attributed to poor record keeping, supervision & management by the trade union leaders. This discourages the members and hence weakening the unions.
- Disunity of members/poor organization of trade unions. This is because they are organized on the basis of tribe, religion and political affiliations. This weakens the operations of the unions.
- Limited members' skills. This is attributed to the high levels of illiteracy & or the existence of defective education among the members. This makes it difficult for the members to understand the importance of, & how trade unions operate.
- Political interference (in union activities). This is because the union leaders tend to use their positions for achieving big posts in the government. This makes trade unions political groups and renders them inactive.
- Poorly developed infrastructure. This makes it difficult for the workers to properly move, coordinate and organize the activities and achieve the objectives of the trade unions. This increases the average cost of running the unions.
- Limited commitment of members. This is due to the existence of transitory incomes (alternative source of incomes). This makes members to mind less about the activities of trade unions.
- Limited membership/low unionism. This is due to the temporary nature of the employment of most workers. Most workers are employed on contract/temporary basis and their conditions are fixed and therefore cannot form trade unions. This makes members to be less interested in union activities, and weakening the strength of trade unions.
- Apathy/ignorance of workers about their rights. This is attributed to the high level of illiteracy/low levels of education of workers in developing countries. This makes it difficult for them to understand their rights, the operations, & importance of trade unions.
- High proportion of wage bill to total costs of running the union. This is because the government is the biggest employer and always refuses to approve wage increases as an anti-inflationary measure. This weakens the activities & operations of trade unions.

THE STRUCTURE OF UGANDA'S ECONOMY

An economy is an institutional arrangement where the human and natural resources of a country cooperate with each other to produce goods and services. It is the administrative frame work and resource base of a country.

The structure of an economy refers to the basic/salient features of an economy, its major sectors and their composition. It includes the pattern of social & economic organization, the stock of human & non-human resources, the ownership of resources & major means of production.

The nature of Uganda's economy

Uganda is a mixed economy, consisting of the government resource ownership as well as the private resource/s ownerships. (Mixed economic system)

Within the public sector, the government makes direct plans & investments. While in the private sector, the government influences their activities through monetary & fiscal policies

Currently, the government is pursuing the policies of economic liberalization & privatization of most economic activities, & inefficient public enterprises. Therefore, there is more participation in production, trade, communication, distribution, allocation, transport, marketing, & so forth than ever before.

The basic features of Uganda's economy

The following are the basic features of the structure of Uganda's economy:

- Dominance of Agriculture. Agriculture forms the backbone of the economy & major foreign exchange earner contributing to over 60% of the gross domestic product. It is also the biggest employer of the labour force directly or indirectly in the agricultural sector, agro based industries & other related sectors.
- Small but growing industrial sector. This is attributed to the existence of inadequate capital. It is mainly dominated by small scale industries & comprises mainly processing industries which are mainly concentrated in the urban areas. The few large industries are foreign owned.
- The existence of dualism. This is where there is the co-existence of two contrasting sectors where one is modern, desirable. While the other is traditional & undesirable. This is in the fields of technology, exchange,

culture, & economic organizations. Uganda is socially, economically, technologically, regionally dualistic in nature

- Mixed economic system. It has both public & private sectors. This is due to her pursuing economic liberalization & privatization.
- An open economy. This is due to the existence of economic interdependence with other trading partners. There exists both import & export trade with other countries.
- It is highly dependent. This is associated with heavy reliance on other developed economies for technology, trade, & resources. This is because of the existence of inadequate resources in the economy. She has a very low degree of independence with few developing countries
- High level of illiteracy. This is due to the existence of poor/defective system of education characterized by abundant supply of unskilled & semi-skilled labour
- Wide spread unemployment & underemployment. This is due to the poor education system which turns out job seekers other than job creators
- High population growth rate. This is attributed to the high fertility rates & inadequate family planning programs. Her population grows at the rate of 3.2% per annum as per the year 2010 population censors. This leads to dependence burden & pressure on social services.
- There is generally Poor developed infrastructure. This is due to the existence of limited capital leading to the construction of poor communication facilities. Most of the roads are murram surfaced which are poorly constructed, rehabilitated, & maintained.
- Excess capacity production. This is due to the use of poor methods of production. This exists in many of the sectors of the economy & hence resulting into the underutilization of the existing available resources/low output.
- Large informal sector. This is the most dominant sector in the economy. It includes the self-employed persons, like street hawkers, shoe shiners, taxi drivers, tailors, etc.
- It is dominated by a large subsistent sector. This is because most of the activities are undertaken for own consumption. This sector is greatly reducing due to increased monetization of the economy.

The implications of the features of the structure of Uganda's economy

(a) The positive implications:

- Leads to increased use of resources. This is because most of the small scale industries use the locally available resources. This leads to the provision of employment opportunities & thus improved standard of living
- Provision of employment opportunities. This is due to the increased use of the available local resources/the use of labour intensive techniques of production. in the agro based industries/economy. This leads to the acquisition of incomes & thus improvement in the standard of living
- Provision of foreign exchange earnings. This is due to the exportation of agricultural products/raw materials to other countries. This thus leads to improved balance of payments position.
- Encouragement of intra sectoral linkages This is through forward & backward linkages as most of the industries are agro based. This leads to increased output & hence increased economic rates.

Agro based industries are those that relate with the agricultural sector mostly by using agricultural produce as their raw materials, e.g. food processing industries, coffee hullers, ginneries etc.

- Provision of food both at domestic & international levels. This is because most of the industries are agro based/agriculture is the backbone of the economy. This results into better standards of living.
- Source of cheap labour force. This is because of the existence of high population growth rate in the economy. This results into increased output & hence high economic growth rates.

(b) The negative implications

- Leads to balance of payments problem. This is due to the reliance on poor quality agriculture products for exports on the world market. Besides, the poor quality agricultural products are also faced with stiff competition & price fluctuations on the world market. This leads to low foreign exchange earnings.
- Low productivity/low level of gross domestic product. This arises from excess capacity production/underutilization of resources & the use of poor methods of production. This leads to low economic growth rates.
- High rate of capital outflow. This is due to the reliance on other economies for technology, trade, resources, & economic decisions. This leads to low capital formation/accumulation.
- Limited savings/investments. This arises due to the existence of wide spread unemployment & underemployment of resources/low incomes. This leads to low output & thus low economic growth.

- Poor terms of trade. This is because she relies on the exportation of poor quality agricultural products which are faced with a lot of competition from the world market. This leads to low revenue & thus poor infrastructural development.
- Leads to economic instability. This arises out of the reliance on poor quality agricultural exports which are faced with price fluctuations on the world market. This leads to poor planning in the agricultural sector.
- Low incomes. This is due to the existence of wide spread unemployment & underemployment of resources. This leads to poor/low standards of living
- Low tax revenue. This is because agricultural products fetch low prices & most of the labour force are unemployed/& underemployed in the production process. Thus less tax is imposed on their incomes. Besides, there is the existence of high level of tax avoidance & evasion. This leads to poor infrastructural development.
- Low quality products. This is attributed to the use of simple/poor techniques of production in the agricultural sector. This leads to poor standards of living.
- Worsening income & wealth inequalities. This is because of the disparities in the ownership of land & other resources in the economy. This results into poor standards of living.
- Limited exploitation of the available natural resources. This is due to the use of poor technology in agriculture & other agro based industries. This leads to low output in the economy.
- Limited modernization in the agricultural sector. This is due to the existence of high degree of conservatism/rigidity. The leads to poor quality output in the economy

The structure of agriculture in Uganda.

Agriculture is production that relies essentially on the growth and nurturing of plants and animals, essentially for food, usually with land as the most important input.

The agricultural sector is one that part of the economy comprised of farming, fishing, forestry, and hunting.

- The presence of large subsistence sector. This is due to existence of low level of monetization of the economy/This means that much of the domestic produce is for own consumption & the incidental surplus is for sale.
- The existence of high level of unemployment & underemployment of resources. This is due to the underutilization of resources/production at

excess capacity. This leads to low productivity/output in the agricultural sector.

- The existence of <u>mainly</u> small scale production. This is due to the fragmented nature of agricultural land. This causes population pressure beyond the capacity of the agricultural land. This results into low output.
- The use of <u>mostly</u> family labour. This is because usually women & children are the major suppliers of labour for agriculture/the use of poor technology. Hence leading to low output.
- The existence of <u>mainly</u> poor technology. There is wide spread use of rudimentary tools & techniques of production. eg hand hoes, axes, slashers, pang knives, and so forth.
- The existence of <u>mainly</u> poor land tenure system. (Land tenure system refers to the structure, ownership, & use of land). This is attributed to the communal ownership of land. e.g. customary land tenure system in Teso, & Karamoja, the mailo land system common in Buganda, lease hold land tenure system in Buganda, Ankole, Bunyoro & Toro regions.
- The existence of <u>mostly</u> small peasant holdings. This is due to the existence of low incomes/poverty among the citizens. Most of the farms are less than ten hectares. In addition, there exists few large farms/plantations of sugar, tea, coffee, cotton etc., most of which are foreign owned.
- <u>Generally</u> low output. This is as a result of the use of poor techniques of production & over reliance on nature. This results into low economic growth rates.
- <u>Mainly</u> depends on natural factors. This is attributed to the low level of technology, research, inventions, & innovations in the agricultural sector. This includes sunshine, rainfall, soils, etc. This leads to low economic growth.
- Undertakes <u>mainly</u> mixed farming. This includes both planting crop & animal rearing in the rural areas.

<u>Note</u>:

- ✓ Free land tenure system is where individuals own land (Kibanja) through inheritance or purchase.
- ✓ Poor land tenure system is the communal ownership of pieces of land by the community/society

<u>The implications/consequences of the structure of agriculture in Uganda</u>

- Low output. This is due to the existence of large subsistence sector/use of family labour/use of poor techniques of production. This results into low economic growth rates

- Low incomes. This arises due to the existence of large subsistence sector/use of family labour/limited economic activities. This leads to low standard of living.
- Low revenue. This is due to the limited tax base/wide spread unemployment & underemployment of resources/existence of large subsistence sector. Thus leading to poor infrastructural development.
- Poor quality products. This arises out of the use of poor technology/tools leading to the stagnation of the economy/poor welfare of the welfare
- Economic instability. This is due to the fluctuations in the prices of agricultural prices leading to fluctuations in government revenue.
- Low capital accumulation. This arises out of the existence of large subsistence sector. This leads to low output & thus low economic growth rates.
- The existence of income & wealth inequalities. This is due to the existence of disparities in land/resource ownership. This results into low standard of living.
- Seasonal unemployment. This is attributed to the seasonality of agricultural activities. This leads to low incomes & hence low standard of living of citizens.
- Inadequate raw materials. This is due to agriculture being a seasonal activity in nature. This leads to low industrial output & hence low economic growth rates.
- Poor terms of trade. This is due to the production of poor quality agricultural products most of which are exported in raw forms. This leads to balance of payments deficits in the economy.
- Improves B.O.P position. This through the exportation of agricultural products as raw material to other countries. This leads to the generation of foreign exchange earnings.
- Provision of employment opportunities. This is because agriculture is a labour intensive activity. This leads to the acquisition of incomes & thus improvement in standard of living.
- Provision of revenue. This is through imposition of taxes on agricultural products & the incomes of the labour force employed in the agricultural sector. This results into infrastructural development in the economy.
- Provision of raw material. This is through the existence of forward & backward linkages in the economy. This leads to increased output.
- Provision of food. This is because of the existence of large subsistence sector in the economy. This leads to improved standard of living.

- Promotion of self-reliance. This is attributed to the production for own use & the incidental surplus for export. This leads to economic independence/high standard of living.

The subsistence sector

The subsistence sector is one that produces for own use/consumption. Subsistence production is one for own use/consumption

In the agricultural sector, the majority of the farmers strive to produce for own consumption/use & the incidental surplus is sold off to meet the basic needs of life e.g. shelter, clothing, health etc.

The characteristics of subsistence production

- The use of mainly poor/simple/backward/ & outdated tools, implements and techniques of production. This includes hand hoes, pangas knives, sickles, slashers, etc.
- The existence of mainly small scale holdings. This is due to the use of poor methods of production/family labour.
- Cultivation is usually intensive & personal in nature. This is because production is for basic family survival.
- High dependence on family labour. This is because of the use of simple tools with occasional assistance from neighbours.
- Inadequate specialization & division of labour. This is because of the existence of subsistence production. This leads to low output.
- The primary motive of production is own consumption/use though the incidental surplus is sometimes taken to the market.
- There is the absence of profit motive. This is because production is for basic survival/due to the low level of monetization of the economy.
- Exchange is mainly by barter especially in the rural areas. This attributed to the low level of monetization of the economy
- Exchange is marginal & incidental depending on the availability of marketable surplus.
- There is generally low productivity of labour. This is due to the use of poor techniques of production & hence low output.
- High degree of conservatism/rigidity. This is because production is greatly influenced by social attitudes & beliefs/due to the existence of high levels of illiteracy among farmers. Thus farmers are not receptive to modern methods of production.

- The use of limited scientific methods of production. This is because of low levels of education among the farmers. Therefore the success of production depends on natural conditions.
- There is limited government interference in production. This is through the use of taxation, subsidization, grants, tax holidays, incentives etc.
- There is predominance of communal/poor land tenure system as opposed to individual/free land hold system. This is due to production being for own use.

The benefits of agricultural subsistence sector

- Provision of food in the economy. This is attributed to the use of local available resources. This leads to better standards of living in the economy.
- Provision of employment opportunities. This is due to the use of simple methods of production/labour intensive techniques of production. This thus leads to acquisition of incomes & hence improvement of standard of living of the citizens
- Ensures food security in the economy. This is as a result of production for own use. This leads to improved welfare standards in the country.
- Encouragement of responsible land use. This is attributed to the communal ownership of land.
- Provision of government revenue. This is through the taxes imposed on the incomes of those employed in the agricultural sector. This leads to the development of infrastructure in the economy.
- Provides market for the industrial sector. This through the agricultural sector using the final products of the industrial sector as inputs e.g. farm equipment, fertilizers, tools etc. This increases agricultural productivity, peoples incomes etc. which increases their purchasing power & demand for industrial products This leads to increased agriculture output

The demerits of a large subsistence sector in an economy

- Low quality output. This is due to the use of poor techniques of production in the production process. This results into poor standards of living of the citizens.
- Low output produced/productivity. This arises out of the use of mainly family labour/rudimentary methods in the production process. This leads to low economic growth rates.
- High levels of underemployment/seasonal unemployment. This is due to the seasonality of agriculture/excess capacity in the production process. This leads to low output & hence low economic growth rates.

- Low tax revenue. This is due to the production for own use/where there is limited incidental sale of the surplus output/due to limited commercial production. This thus leads to poor infrastructural development.
- Under exploitation of natural resources. This is as a result of the use of poor tools/techniques of production/underutilization of resources/excess capacity production. This leads to low output & hence low economic growth rates l
- Limited specialization/division of labour and trade. This is because the major aim of production is own use. This results into low output in the economy
- The existence of high risks. This is because of over dependence on natural factors such as rain fall, sunshine, etc. This leads to great losses and fluctuations in output levels & consumption.
- Limited inventions & innovations in this sector. This is attributed to the existence of high levels of illiteracy in this sector/defective education system. This leads to low standards of living.
- Low supply of raw materials. This is due to inadequate incentives/the use of poor technology for increased output in this sector. This leads to low industrial production.
- Limited research, inventions, & innovations. This is due to the existence of limited resources/poor technology in this sector. This hence leads to low output in this sector.
- Leads to low levels of foreign exchange earnings. This is attributed to absence of profit motive in the production of goods & service. This leads to balance of payments deficits.
- It discourages hard work & expansion of production. This is due to the absence of profit motive in this sector. Thus leads to low levels of output in this sector.

Note:

- ✓ Land tenure system is the structure, ownership, & use of land.
- ✓ Free land tenure system is where individuals own land (Kibanja) through inheritance or purchase.
- ✓ Poor land tenure system is the communal ownership of pieces of land by the community/society

The reasons for using Agriculture as the leading sector in developing countries

- To provide employment opportunities to people. This is because agriculture is labour intensive in nature. This helps to provide incomes & hence improving peoples' welfare.
- To ensure fair/equitable distribution of incomes. This is because agriculture is basically labour intensive in nature. This helps to provide incomes so as to improve their standards of living.

- So as to avail revenue to the government. This is by taxing the incomes of those employed agricultural sector and outputs of this sector (through licenses & market dues). This helps to develop socio economic infrastructure in developing countries.
- In order to provide market for the industrial sector. This is because as agricultural productivity increases, peoples incomes, purchasing power & aggregate demand for the products also increase. Also, with modernization practices, the demand for industrial products inform of farm equipment, fertilizers, etc. increase. This helps to increase output.
- For the purpose of generating foreign exchange. This is through producing mainly agricultural exports. This helps to facilitate the importation of the capital needed for industrial development.
- To supply factor inputs to the industrial sector. This is by producing agricultural raw materials which helps to develop the industrial sector
- So as to contribute to the gross domestic product. This is through the increased utilization of resources. This helps to increase economic growth in developing countries.
- For the purpose of encouraging rapid infrastructural development. This is because as agricultural productivity increases, this encourages the construction, rehabilitation, & maintenance of communication facilities. This helps to ease the transportation, distribution, & marketing of goods & services.
- To provide food in both rural & urban areas. This is because agriculture is the source of food for the ever increasing population in developing nations. This helps to improve the welfare of the respective citizens in developing nations.
- To promote balanced regional development. This is because agriculture is practiced in all regions. This helps to minimize rural urban migration with all its associated evils.
- So as to increase rural incomes. This is attained through encouraging commercial agricultural production. This helps to minimize income inequalities/improve the welfare of the citizens in developing nations.
- To accelerate rural transformation. This is through encouraging agricultural modernization. This helps to improve infrastructural facilities in developing nations.

<u>Measures to improve agricultural output/contribution to GDP in Uganda</u>

- Provision of incentives/subsidies to farmers. This is attained through giving credit facilities, loans, grants etc. to farmers. This helps to lower the average costs of production.
- Diversification of output. This is through the introduction of variety of economic activities in this sector. This helps to avoid losses & stabilizes the incomes and revenues of farmers.
- Expansion of the market. This is done through market research, joining regional groupings/economic integration.eg the East African Community (EAC), Economic Committee of West Africa States.(ECOWAS), European Economic committee (EEC), the SADIC, etc. this leads to increased output and hence economic growth rates
- Further liberalization of the agricultural sector. This is attained through the removal of the unnecessary barriers that interfere with trade/business. This helps in creating efficiency & competition in agriculture sector & hence improving the quality of agricultural output.
- Promotion of research in agriculture. This is through provision of education/extension services to farmers. This helps to improve the quality of output produced in this sector.
- Land reform measures. This is through changing poor land tenure system from communal ownership to free hold, & individual land ownership. This enables mechanization & investments leading to high levels of output.
- Provision of extension serves. This is by educating/training farmers on best practices such as agricultural crop husbandry, crop rotation, application of fertilizers, farm yard manures etc. This helps farmers to acquire modern methods of production, etc. that help to increase output.
- Provision of credit facilities. This is through lowering interest rates on loans, reducing the long formalities of acquiring loans etc. for farmers. This helps to lower the average cost of production for farmers.
- Development of infrastructure. This is attained through the construction, rehabilitation, & maintenance of communication facilities/networks. This helps to easen the transportation, distribution, & marketing of goods & services from the areas of plenty to the areas of scarcity.

The structure of industry in Uganda

An Industry refers to the combination/collection of all/many firms producing related or similar products. E.g. the tourism industry of a country is made up of hotels, tour guides, airlines, park owners, travel operators, transporters etc.

The features of the structure of the industrial sector in Uganda

- It is small but growing in nature. Most of the industries are processing ones. E.g. milk processing, cotton ginning, soft drink production, beer production, wood & furniture making, fish net making, clay molding etc.
- It is mainly dominated by small scale industries. This is due to the existence of inadequate raw materials for investments in the industrial sector. This includes cotton ginning, milk processing, furniture making etc.
- It mainly comprises processing industries. This is due to the availability of market for the processed products of this sector. E.g. soft drinks firms, fishnet making, fish processing, soft drink, milk processing, beer production, clay molding, etc.
- Most of the firms are privately owned. This is because of the pursuance of economic policies of privatization and liberalization in the economy. E.g. Madhivani tea estates, Mukwano soap & oil firms etc.
- There is the use of simple technology/labour intensive technology in most of the firms. This is attributed to the existence of limited capital for industrial development.
- The sector is basically urban based. This is due to the the favourable conditions that exist in the urban areas e.g. availability market, cheap labour, security, power supply, communication facilities, raw materials, water supply, etc. in urban areas for the industrial production. These industries are mostly based in Jinja, Nakawa-Ntinda areas (Kampala, Wakiso, & Mukono)
- It mainly produces low quality products. This is due to the use of labour intensive techniques of production/inadequate competition in the sector. Most of the products are for domestic consumption & less is exported to external; markets.
- Many of the industries are agro based in nature. This is due to the use of agricultural products as raw materials in these industries. E.g. sugar canes, tea, timbers, cotton, coffee etc.
- The durable consumer goods industries are mostly assembling plants. E.g. car assembling. This is because of inadequate local raw materials to be used in these industries.
- It mainly produces consumer goods. This is due to the existence limited external markets for Ugandan produce abroad. These consumer goods include: cooking oil, detergents, clothes, etc.
- The industries are mainly import substituting ones. This is because of the need to improve on her B.O.P position. The examples of these industries are sugar, tea, detergents industries.

- High level of imported raw materials & intermediary product contents. E.g. spare parts of vehicles, raw materials, nails, etc. This is due to the existence of limited natural resources.
- It produces at excess capacity. This is because the industries under utilize their productive capacities hence leading to low output.
- Many of the firms use semi-skilled & unskilled labour force. This is because of the low level education/skills possessed by the labour force.
- There exist linkages with other sectors of the economy. This is attributed to the existence many sectors in the economy

<u>The implications of the features of the structure of industries in Uganda</u>

(a) Positive implications.

- Increased exploitation & utilization of resources. This is due to the existence of many small scale industries. This leads to increased economic growth rates
- Less capital is required. The small scale industries are easy to start & manage. This leads to increased output.
- They are suitable for the economy. This is because of the small nature of the domestic markets. This leads to improved standards of living.
- Provision of employment opportunities. This is because of the existence of many small scale/the use of labour intensive techniques of production/increased use of resources in the economy. This leads to acquisition of incomes & hence better standards of living in the economy
- Promotion of intersectoral linkages. This is attributed to the existence of agro based industries within the economy. This leads to increased output/integrated economy
- Saves the country's scarce foreign exchange. This is because most of the industries are import substituting industries. This reduces her balance of payments deficits.
- Promotes self-sufficiency/reliance. This is because most of the industries use the available local/natural resources. This results into increased output
- Builds managerial & entrepreneurial skills which are inadequate in the economy. This is attained through on job training in the labour intensive industries. This leads to increased quality output.
- Produce wide variety of local consumer goods & services. This is due to the existence many small scale industries which are agro based in nature. This leads to large freedom of choice for consumers/improved welfare of the citizens.

- Provision of government revenue. This is attained through levying taxes on the industrial outputs/incomes of those employed in this sector of the economy. This leads to improved infrastructural development in the economy.
- Acts as training grounds for the labour force. This is through acquiring skills from the industries/on job training in the industries. This leads to managerial capacity development.
- Provision of market. This is due to the reliance of the agro based industries on the locally available agricultural raw materials. This leads to increased output & thus economic growth rates
- Encouragement of capital inflow & technological transfer. This is due to most of the large scale industries being owned by foreigners who bring in capital & efficient techniques of production. This leads to increased output.
- Improvement of welfare. This is because most of the industries mainly produce consumer goods and services which directly contribute to the welfare of the citizens

(b) Negative implications;

- Inefficiency in production. This is attributed to the existence of inadequate competition .among firms/the use of labour intensive techniques of production in Uganda. This leads to poor quality output.
- Poor quality products. Most of the agro based industries use labour intensive techniques of production & are affected by unfavourable natural factors (earth quarks, dry spell, landslides, pests and diseases) leading to poor standards of living.
- Increased capital outflow. This is due to over dependence on imported raw materials, capital, technology and inputs. In addition, most of the large & medium scale industries are owned by foreigners. This leads to low capital accumulation/formation
- The emergency of rural urban migration and its evils. This is due to the concentration of most industries in the urban areas. This leads to a decline in production in rural areas/open urban unemployment, development of slums, high rate of crimes, etc.
- Leads to profit repatriation. This is because most of the industries are foreign owned, dependent on imported raw materials, skills, & technology. This leads to low capital accumulation/formation.
- Low output (high costs experienced). This is because most of the small scale industries are labour intensive in nature and operate at excess capacity. This leads to low economic growth rates

- Leads to regional imbalance/unbalanced growth. This is because most of the industries are urban based in nature. This leads to rural urban migration & its evils.
- Limited markets. This is due to the existence of low levels of incomes/poverty among people/low purchasing power. This leads to low levels of output & hence low economic growth rates.
- Limited employment opportunities. This is because of their small scale of operation/production at excess capacity/the increased use of capital intensive technology in the medium & small scale industries. This leads to low incomes & hence low standards of living.
- Leads to over dependence. This is because most of the industries rely on imported raw materials, technology, skills & expatriate etc. from other economies. This leads to weak intersectoral linkages/low capital accumulation/formation within the economy
- Leads to increased balance of payments deficits. This is because most of the industries are mainly dependent on imported raw materials, technology, expatriates, skilled manpower, raw materials, power supply etc. from other economies. This leads to low foreign exchange earnings

Small scale industries in Uganda

A small scale industry is one which employs low levels of technology, and limited resources/capital in the production process.

The reasons for the dominance of small scale industries in Uganda

- Inadequate capital. This is attributed to the low levels of incomes/high levels of poverty. This limits the expansion of industrial output as a result of high average costs production.
- Inadequate managerial abilities by most local investors. This is due to the existence of defective education system. This makes it difficult to mobilse & organize resources for production. This limits the expansion of most of the industries.
- The small scale industries are easy to run & plan for. This is because they require less resources to be used in production. Thus lowering the average costs of production. This has led to the emergence of many small scale industries.
- There are limited raw materials to support medium & large scale industries. This is due to the low rate of exploitation of local natural resources. This suits the development of small scale industries in Uganda.

- Limited use of capital & power which are found in many parts of the country. Sometimes such industries use engines & motors as sources of power. This best suits the operations of small scale industries.
- Favourable government policy on industrialization. This is attained through the provision of subsidies, grants, tax holidays, & adequate good political will. This has favored the emergence of small scale industries in Uganda.
- The existence of political instabilities in some parts of the country. This discourages many potential industrial investors from engaging in big industrial investments for fear of their lives & destruction of property & hence big losses in large scale industrial investments. This thus encourages investments i20n small scale industries.
- The presence of surplus labour. The small scale industries easily secure unskilled labour & semi-skilled labour which is readily available in all parts of the country. This reduces the average cost of operation which thus reinforces small scale production.
- Limited market. This is attributed to the existence of low incomes to enable them purchase the industrial products domestically. Hence the small scale industries just find enough & ready market.
- Production of poor quality products. This is due to the use of simple methods of production/limited competition within the economy. This discourages large scale industrialization & hence encouraging small scale industrialization

Due to the mentioned factors/reasons, small scale industries have grown up in many parts of Uganda, but most especial the southern/central region.

The role of small scale industries in Uganda

(a) Positive role:

- Provides employment opportunities. This is because of existence of many economic activities/use of labour intensive techniques of production. This avails incomes and thus improves the citizens standard of living.
- Development of infrastructure. This is associated with the construction, rehabilitation, & maintenance of communication facilities. This leads to easy transportation, distribution & marketing of goods & services.
- Promotes industrial development. This is through forming the foundation on which the modern large scale industries are established in the long run. This thus leads to increased output and economic growth
- They are suitable for the economy. This is due to the small nature of the domestic markets. This leads to improved standard of living.

- They save the country's scarce resources. This is as a result of the increased use of local natural resources/raw materials. This reduces balance of payments deficits
- Promotes self-sufficiency & reliance. This is because they mainly use locally available resources. This results into increased output & hence economic growth.
- Produces wide variety of goods & services. This is attributed to the existence of many small scale industries which produce a variety of goods & services. This widens the choice of the citizens & hence improve standard of living.
- Builds entrepreneurial skills. This is through on job training in the small scale industries. This leads to improved managerial capacity development
- Provision of revenue to the government. This is through the taxes imposed on the goods & services produced & the incomes of those employed in (various economic activities) the small scale industries. The revenue realized is used for the development of socio-economic infrastructure.
- Less capital is required. This is because they are easy to start & manage. This leads to reduced average cost of operating the small scale industries.
- Act as training grounds. This is through engaging in on job training in the small scale industries. This leads to managerial capacity development & entrepreneurial skills.
- Provides market. This is due to the reliance of the agro based industries on the locally available agricultural raw materials/outputs. This leads to development of the industrial sector/increased output & hence economic growth.
- Creating a class of entrepreneurs. This is because they act as training grounds for individuals through which they acquire the necessary practical skills needed to operate modern machines/industries. This leads to managerial capacity building.
- Promotes intersectoral linkages. This is attained through the provision of inputs & market for other sectors of the economy. This thus leads to increased output.
- Encouragement of capital inflow. This is as a result of the existence of private foreign direct investments in small scale industrialization. This leads to increased output & hence economic growth rates.
- Facilitates technological transfer & development. This is attained through inventions, innovations, & research into better methods of production. This leads to increased efficiency & production of better quality goods & services.

- Facilitates the exploitation of & use of idle local resources. This is through the use of better techniques of production. This leads to the production of more goods and services & hence increased economic growth rates.
- Promotes balanced regional development. This is because the small scale industries are widely distributed all over the economy. This leads to equitable distribution of incomes & wealth
- Promotes urbanization & monetization of the economy. This is through the encouragement of trade and commerce. This leads to increased output and hence economic growth.
- Improvement of balance of payments position. This is attributed to the increased production of goods & services for exports. This saves the scarce foreign exchange earnings in the long run
- Improvement of welfare. This is through the production of a variety of goods & services in the economy. This widens the choice of citizens/consumers at reduced prices.

(b) Negative role:

- Leads to low economic growth & development. This is due to underutilization of resources/the use of poor techniques of production. This thus results into low output.
- Promotes underemployment of resources. This is because of operating at excess capacity as capital is limited. This leads to low output & low economic growth rates.
- Leads to wasteful competition .This is through duplication of goods & services. This leads to misallocation of resources in the economy
- Leads to environmental degradation. This is attributed to the production of noise, air, & water pollution. This negatively affects the society & thus leading to low standards of living.
- Increased administrative costs. This is because of operating at excess capacity due to limited capital. This leads to low output & low economic growth.
- Generation of low revenue to the government. This is because they are associated with small tax base & high levels of tax evasion. This leads to poor infrastructural
- Congestion in the semi-urban areas. This is due to the development of slums as a number of low income earners migrate to towns. This leads to increased cost of living & crimes.
- Provision of limited foreign exchange. This is due to the production mainly for domestic consumption. This limits export potentials & hence leading to balance of payments deficits.

- Production of Poor quality output. This is attributed to the use of simple technologies which produce poor quality goods and services. This thus results into poor standards of livings in the economy.
- Production of poor quality goods & services. This is due to the absence of competition/the use poor techniques of production. This results into poor welfare standards.

The problems facing small scale industries/industrial sector in Uganda

- Limited entrepreneurial skills. This attributed to the existence of defective education system. This makes tit difficult to mobilize, organize the factors of production, & to successfully manage the small scale industries. This leads to low profit margins & hence closure of the small scale industries.
- Seasonality of activities. This is because most of the small scale industries are processing industries which use agricultural products as inputs; and yet agriculture is a seasonal activity. This makes it difficult for the small scale industries operate efficiently.
- Inadequate accountability. This is due to the existence of poor record keeping & supervision. This leads to inefficiency in production as funds are diverted for personal use. This makes it difficult to expand the small scale industries.
- In adequate capital. This is due to low incomes required to purchase inputs & also pay workers. This increases the average costs of production & limiting the performance of the small scale industries in Uganda.
- Inadequate foreign exchange earnings. This is due limited exports produced in these industries. Hence limiting the purchase of the necessary capital for expansion, rehabilitation, & maintenance. This leads to inefficiency in production.
- High cost of production. This is due to the importation of most of the raw materials, capital, & technology from other economies. This increases the average costs of production & hence increased prices of goods & services. This thus hinders efficiency in production.
- Inadequate protection. This is due to the existence of foreign products which are usually cheaper, better in quality & low prices. This limits the expansion of the small scale industries.
- The existence of political instabilities in some parts. This scares away investors in small scale industries due to the fear of losing life & destruction of property. This forces some industries to close down operations.
- Unfavorable government policies on industrialization. This is attributed to the existence of high taxes, limited tax holidays, unclear investment policies,

long formalities in the establishment of small scale industries etc. This increases the average costs production & adversely affects the pricing of their products, economic growth & development. This makes it difficult it difficult to expand the small scale industries.

- High level of profit repatriation. This is attributed to the importation of most of the raw materials to be used/the existence of foreign direct investment in this sector. This increases the average cost of running the small scale industries & hence making it difficult to operate/run the small scale industries.
- Low level of technology. This is due to the use of simple methods of production that produces poor quality products. This makes it difficult to expand the small scale industries.
- The existence of excess capacity. This is due to the underutilization of resources in the production process. This increases the average costs of production & makes them not to benefit fully from economies of scale.
- Inadequate skilled manpower. This is because of the poor education system. This makes it difficult to operate the machines in the industries & hence leading to poor quantity & quality output produced.
- Inadequate credit facilities. This is attributed to the rigid credit policies, high interest rates, limited credit worthiness, & collateral securities. This increases the average costs of production & thus making it difficult for entrepreneurs to expand & maintain the small scale industries.
- Inadequate supply of raw materials. This is due to the seasonality of agricultural activities/unstable supply of raw materials. This makes it difficult to expand the industrial sector
- Poor economic climate. The existence of high prices of raw materials, high interest rates on loans, high rates of inflation, high exchange rates, etc. increase the average costs of production. This leads to the slow growth of the small scale industries.
- Poor infrastructure. This is due to the existence of poor communication networks. This increases the average costs of production in the small scale industries; and hence making it difficult to transport, distribute and market goods and services.
- Limited markets. This is due to the production of poor quality goods & services & low aggregate demand resulting from high levels of poverty. This discourages the production of high volume of output & thus leading to low profit margins.
- The existence of stiff completion. This is because of the presence of imported goods & services which are cheap, & of high quality. Hence

ending up outcompeting the locally produced goods & services by the small scale industries. This increases the average cost of production & making it difficult to expand the small scale industries.

- Poor investment climate. This due to the absence of tax concession. This increases the average costs of production & thus discouraging small scale industrialization.

<u>The measures to improve the small scale industries/industrial sector in Uganda</u>

- Ensure government protection. This is by providing tax holidays, tax concessions/reliefs, subsidies, grants etc. so as to lower the average cost of production & establish a firm industrial/market base
- Provision of favourable credit facilities. This is attained through providing easy access/conditions for credit facilities. This helps to encourage more borrowing of funds for industrial investments/expansion.
- Improvement of infrastructure. This is through the establishment/construction, rehabilitation, & maintenance of the communication facilities. This helps to easen the transportation, distribution & marketing of goods & services.
- Maintenance of political stability. This is attained through conducting peace talks, granting amnesty to those who surrender, democratic/good governance so as to ensure safety of life and property
- Provision of man power development programs. This is through the provision of industrial, technical, & managerial trainings to the industrial sector. This helps to improve on the management, production, & performance of the industrial sector.
- Improvement of infrastructure. This is through the establishment of roads, railways, industries and other economic infrastructures so as to ease the transportation, allocation, distribution & marketing of goods & services.
- Maintenance of political instability. This is enhanced through conducting peace talks/negotiations, granting amnesty to those who surrender, good democratic governance, etc. so as to ensure safety of life, property & sustainable industrial growth in the economy

<u>The informal sector.</u>

The formal sector is one that lies between the traditional & formal modern sectors

Or it is one that exists between the traditional subsistence backward & modern monetary sectors

It is mainly found in the outskirts of urban areas operating mainly outside government control.

The sector mainly includes self-employed people like street hawkers, shoe shiners, taxi drivers, barbers, the underemployed on the streets, tailors, etc.

The activities of this sector is usually ignored and rarely supported by the government; and sometimes it operates outside government regulations

The sector uses appropriate technology i.e. one which is suitable to the conditions of developing countries in regard to the existing resources, level of development, & socio-economic conditions.

The appropriate technology uses local resource/materials, produces for the local market, & suits the capacity of the economy.

The major economic activities in this sector include handcrafts making, furniture marking, road side venting, domestic metallic ware making, petty trade, restaurant businesses, tailoring, local beer brewing/making, black smiting, carpentry etc.

The features/characteristics of the informal sector

- There is easy entry in business activities. This is because licenses do not either exist, are cheap, or forged in the process of acquiring them.
- The existence of on job trainings. This is because most of the labourers engaged in this sector are unskilled/semi-skilled who tend to acquire skills through doing the work/business.
- It mainly uses simple technology. This is due to the existence of surplus unskilled/semi-skilled labour.
- It operates mainly at excess capacity. This is due to the limited capital used in the production process/business activities.
- It uses mainly local available resources in the production process. This is due to the existence of limited funds for the importation of foreign capital/equipment.
- The existence of mainly low quality output. This is due to the use of poor techniques and limited competition in the production process
- It is organized mainly on the basis of sole proprietorship This is because of the small size of starting/& or working capital in business.
- Business activities are mainly operated in the open space & semi-permanent structures. This is due to limited land for expansion.
- It mainly operates on small scale with low output levels. This is because of limited capital for the enterprises to use.

- The business activities are mainly in semi urban based areas/outskirts of urban areas & some rural areas. This due to the existence of market in these areas.
- The sector is dominated by both semi-skilled & unskilled labour force. This is attributed to the low level of education/training in most developing countries
- Production of goods and services is mainly for the local market. This is because of they are of low quality output.
- There is the existence of self-employment. This is due to the existence of small amount of capital required for start it.

<u>The role/contributions/impacts/effects/implications of the informal sector in an economy</u>

(a) Positive role/contributions.

- Facilitation of modern industrial sector. This is due to the existence of both forward and backward linkages created between the modern & traditional sectors. This leads to the establishment of small scales industries & thus increased output.
- Provision of revenue to the government. This is through taxing the incomes of those employed & the output of this sector. This results into infrastructural development in an economy.
- Provision of training grounds for local entrepreneurs. This is attained through engaging in the various economic activities. This promotes managerial capacity development.
- Promotion of fair income/wealth distribution. This is because the informal sector requires little capital to set up. This leads to improved standard of living.
- Provision of employment opportunities. This is due to the existence of many business activities/use of labour intensive techniques of production. This leads to the generation of incomes & hence improved standard of living.
- Provision of variety of goods & services. This is due to the existence of many small scale industries & or business activities. This widens consumer choices & thus improving the standard of living.
- Reduction of capital out flow. This is because of producing goods & services locally using local available raw materials. This improves balance of payments position.
- Facilitation of exploitation & use of available local resources. This is due to the use of the local available resources in the production process. This

leads to increased productive capacity/output & hence increased economic growth rates.

- Development of infrastructure. This is through the construction, rehabilitation & maintenance of communication facilities. This easens the storage, transportation, allocation, distribution, & marketing of goods & services.

(b) The negative role/contributions.

- Duplication of goods & services. This is because of the existence of many small scale business activities that produce similar products. This leads to resource wastage through competition
- Provision of low government revenue. This is because it is associated with a small tax base & high levels of tax evasion. This makes it difficult for the government to generate revenue needed for the provision of social services to people. This leads to poor infrastructural development.
- Leads to environmental degradation & pollution. This is due to the existence of many small scale industries. This leads to poor standards of living.
- Acceleration of rural urban migration & its evils. This is because most of the informal sectors are urban based. This leads to regional economic imbalance/low standards of living.
- Produces low output. This is due to the underutilization of resources & use of poor methods of production. Thus leading to low economic growth rates.
- Encourages underemployment & unemployment. This is because the sector operates mainly at excess capacity & on a small scale. This leads to low incomes & hence poor standard of living
- It limits foreign exchange earnings. This is because it does not encourage production for export purposes. This leads to poor infrastructural development.
- Increased administrative costs. This is through the provision of basic socio economic infrastructure. This makes it difficult for the government to carry out proper planning due to uncoordinated developments.

The problems facing the informal sector

- Inadequate capital. This is due to the low level of savings & incomes. This increases the average cost of operating economic activities. This makes it difficult for the business enterprises to expand.
- The existence of political instabilities in some parts. This discourages potential investors from setting up business enterprises due to the fear of loss

of life & destruction of property. This increases the average cost of production

- Inadequate supply of raw materials. This is because of the use of inappropriate technology in their exploitation/operation at excess capacity. This forces them to import some of them hence increasing the average cost of production.
- Low levels of technology. This is due to limited research, inventions, & innovations. This leads to the production of poor quality products Hence low standards of living.
- Poor infrastructure. This makes it difficult to allocate, distribute, transport store & market goods & services produced. This increases the average cost of production & thus limits the expansion of the informal sector.
- Limited markets for the products. This is due to low aggregate demand resulting from high levels of poverty/low incomes among the citizens. This leads to low outputs & hence low economic growth rates.
- Limited access to credit facilities. This is due to the existence of inadequate collateral securities needed to secure loans/high interest rates. This increases the average costs of production & thus makes it difficult to expand their business activities
- Limited entrepreneurial skills. This is due to the existence of poor education system/training. This leads to difficulties in mobilizing & organizing the factors of production. This further makes it difficult to expand/manage the sector.
- High risks of uncertainties involved in investments. This is due to poor planning/lack of proper business plans/poor record keeping. This thus leads to high failure rates of business activities.

Measures to promote the informal sector

- Reforming the education system. This is through the introduction of vocational subjects/skills in developing nations. This helps to equip the local man power with the needed entrepreneurial skills necessary for efficient allocation of resources.
- Provision of protection to the informal sector. This is achieved through the imposition of taxes on foreign competing firms, provision of subsidies, grants & tax holidays to the informal sector. This helps to reduce the average cost of production for the informal sector and thus stimulating its growth.
- Ensuring of political stability. This is through conducting peace talks, with rebellious groups, extending amnesty act to rebellious groups, etc. This helps

to create a conducive environment for the business activities of the informal sector.

- The use of appropriate technology. This is through the use of cost effective techniques which are in line with the socio economic needs of the society. This helps to increase the quantity and quality of output produced in the informal sector.
- Development of infrastructure. This is attained through the construction, rehabilitation & maintenance of the existing transport facilities, electricity, water supply, storage facilities, banking institutions, etc. This helps to facilitate the production, allocation, distribution, & marketing of goods and services produced.
- Provision of credit facilities. This is by easing accessibility of loans by softening the conditions for acquiring them e.g. reducing the margin requirements, interest rates, etc. This lowers the average costs of operating economic activities in the informal & thus helping the people involved in this sector to expand their business activities. & hence increase in output.
- The use of expansionary monetary policies. This is through raising wages of the workers/employees in the informal sector. This helps to raise the aggregate demands for goods and services produced by this sector.
- Expansion of market. This is attained through the formation/joining of regional groupings/markets, market research, promotion of trade fairs/exhibitions, economic diversification, inventions, and innovations. This helps to increase the economic activities in the informal sector
- Increasing the exploitation of natural resources. This is through the use of appropriate technology. This leads to increased quantity & quality of output produced in the informal sector.
- Adopting favourable investment policies. This is achieved through reducing taxes, providing subsidies, grants, tax holidays, etc. on raw materials, & other inputs. This helps to reduce the average costs of production in this sector & hence increasing the economic activities in this sector.
- Economic liberalization. This is through the removal of unnecessary barriers/obstacles to trade & or economic activities. This helps to allow people involved in this sector to undertake business activities with limited interferences.
- Formation of cooperatives & associations. This is through the mobilization & organization of the people involved in this sector to secure credit facilities from financial institutions & marketing of their products. This helps to increase the level of output in this sector.

The formal sector

The formal sector is one which encompasses all jobs with normal hours, regular wages & is recognized as income sources.

The characteristics of the formal sector in developing countries

- Production is mainly for commercial purposes/mainly profit oriented. This is because the business activities are profit driven.
- Mainly provides salaried employment. This is because its business activities are predominantly registered formally with the government.
- Dominated by corporate ownership of resources. This is because of the existence of adequate capital with investors.
- Mainly urban or suburban based. This is attributed to the existence of markets for the industrial products/communication facilities in the urban areas that easens the transportation, distribution & marketing of goods & services.
- Has proper record keeping. This is associated with training of the labour force/the existence of formal education system in my country
- Mainly uses better/improved modern technology/capital intensive technology. This is due to the existence of foreign direct investments/technological transfer in my country
- Mainly produces better/improved quality output. This is as result of foreign competition in the market/the use of appropriate technology.
- Mainly uses skilled labour. This is due to the transformation/vocationalisation of the education system in my country
- Made up of predominately registered businesses. This is attributed to the existence of government laws/legislation in the operation of businesses.
- Has an employees & employers union. This is due to the existence of government laws/act of parliament on industrialization/This is because of the need to protect employees/consumers from exploitation of employers through paying low wages/salaries.
- Businesses are mainly governed by laws/Acts of parliament. This is because of the need to protect employees/consumers from exploitation of employers through charging high prices of goods & services

Economic dualism

Dualism refers to the co-existence of two contradicting/contrasting socio-economic phenomena/situations where one is modern & desirable while the other is backward & undesirable

A dual economy is one where there is the coexistence of two contradicting sectors where one is modern & desirable while the other is backward and undesirable

The examples of dualism include the following among many:

- Market/monetary sectors versus subsistence sector
- Rural sector versus urban sector
- Modern culture/sector alongside traditional sector
- The rich/affluent alongside the poor
- The literate versus the illiterate
- Capital intensive technology versus labour intensive technology
- Skilled labour versus Unskilled labour

The types of dualism in developing countries

- Social dualism. This refers to the co-existence of two contrasting social economic classes of people in an economy e.g. the rich co existing alongside the poor, the illiterate coexisting with the literate etc.
- Cultural dualism. This refers to the coexistence of two contradicting beliefs in the economy e.g. the modern/western culture versus the traditional cultures
- Regional dualism. This refers to the coexistence of two regions at different levels of development in an economy e.g. the rural areas versus urban areas
- Technological dualism. This refers to the coexistence of two contrasting technologies of production in the economy. e.g. labour intensive technique versus capital intensive techniques of production in an economy.
- Industrial dualism. This is the coexistence of two contrasting types of industries in an economy.eg the coexistence of inefficient small scale firms versus large scale efficient firms.
- International dualism. This refers to the coexistence of developing countries alongside more developed countries.
- Economic/financial dualism. This is the coexistence of two contrasting financial markets in the economy. e.g. the coexistence of the informal alongside formal financial markets in an economy
- Sectoral dualism. This refers to the coexistence of two contradicting sectors at different levels of development e.g. monetary sector coexisting alongside the subsistence sector, industrial sector with high incomes coexisting alongside the agricultural/subsistence sector with low incomes.

The causes of dualism in developing countries

- The existence of high levels of poverty. This makes some parents to fail to educate /train their children. While the rich/affluent parents do educate/train their children thus leading to social dualism
- The existence of unequal socio economic infrastructure. This leads to the emergence of income & wealth disparities between the rural & urban areas.
- The existence of unequal income & wealth distribution. This leads to economic dualism & hence leading to the emergence of socio economic gap between people in an economy.
- Conservatism/rigidity. This is due to the unwillingness to change from traditional – cultural practices to modern ways of doing things. This thus leads to cultural dualism.
- Unbalanced natural resource endowments. This leads to regional & international dualism.
- Political instabilities in different parts of an economy. This scares away investors due to the fear of life & destruction of property. This leads to regional imbalance in growth. & development.
- Importation of inappropriate technology. This is through technological transfer, the existence of foreign direct investment etc. This leads to technological dualism.

The dangers/problems of dualism

- Discouragement of production & investment. This is due to the existence of low aggregate demand for goods and services as the majority of the people are poor and a few are rich. This leads to low outputs and hence low economic growth rates.
- The emergence of regional imbalances. This is due to the existence of unfair distribution of natural resources. In this case the rural sector always lags behind the urban sector.
- Difficulties in planning. It makes it hard to decide on which sector to develop first. eg in the case of agriculture & industry. This is due to the existence of scarcity of resources.
- The emergence of rural urban migration & its evils. This is due to the concentration of economic activities/jobs & other benefits in urban areas. This leads to decline in the production of the rural areas/open urban unemployment in urban areas.

- Reduction in government revenue. This is due to the existence of the majority poor with no incomes (taxable capacity) & the existence of a large subsistence sector. This leads to poor infrastructural development.
- Leads to socio-cultural dualism. This breeds conflicts in beliefs & cultural values thus leading to social disharmony in society.
- Leads to technological unemployment. This is due to the use of capital intensive technology in the areas of abundant labor force. This results into low level s of incomes and thus low standards of living

The measures to minimize dualism in developing countries

- Ensurance of political stability. This achieved through conducting peace talks, granting amnesty to those who surrender, ensuring good/democratic governance. This is aimed at promoting production/investments in all parts & minimizing expenditure on the importation of military hardware.
- Provision of affordable/free education. This helps to reduce illiteracy & hence social-cultural dualism.
- Promotion of economic diversification. This is through the encouragement of the introduction of variety of economic activities & production for exports so as to minimize dualism
- The employment of appropriate technology. This is attained through the use of suitable methods of production that is in line with the social & economic requirements of the society.
- Monetization of the economy. This is through modernization & commercialization of agriculture. This aims at minimizing the subsistence sector.
- Widening markets. This is through economic integration/market research/trade fairs, exhibitions etc. so as to promote trade in the economy.
- Delocalization of industries. This attained through the decentralization of industries. This helps to minimize regional imbalances resulting from the concentration of industries & services in urban areas.
- Fair income & wealth distribution. This is attained through the use of progressive taxation. This helps to address income & wealth inequalities between the rich and the poor/narrows the economic gap between the rich & the poor.
- The development of rural areas. This is through the construction, rehabilitation, & maintenance of rural communication facilities, education, banking services etc. so as to control rural urban drift.

- Land reform policy. This is through land consolidation, redistribution, individual ownership/free hold etc. aimed at changing the land tenure systems to enable the landless to have access & rights to land.

Forms of economic dependence

Trade dependence. This refers to the extent to which a country relies on imports and exports, exportation of few products, & geographical concentration of trade for survival.

Trade dependence may be as a result of reliance on exports of:

- ✓ Primary products which fetch little income on the world market
- ✓ Dependence on imported capital & manufactured goods
- ✓ Geographical concentration of trade i.e. trading with few countries
- ✓ Inadequate diversification of exports i.e. reliance on few traditional exports

External resources dependence. This refers to the reliance on foreign capital, technological transfer & foreign investors/expatriates, foreign factor inputs.

Direct economic dependence. This refers to the reliance on foreign decision.

Or it is a situation where most of the economic decisions are taken by foreign individuals, companies, & governments.

Sectoral dependence. This refers to the reliance on the agricultural sector.

The concepts of economic dependence, economic interdependence, economic dependence & economic independence

Economic dependence. This refers to a situation where an economy relies on another for survival or development.

Economic interdependence. This refers to a situation where two or more economies rely on each other for mutual benefit of all

Economic independence. This refers to a situation where an economy is mainly self-sustained in terms of resources & economic decisions for its survival

The ways through which Uganda is dependent economically.

- Social-cultural dependence. This is through the influence of the western cultures/civilization.

- External resource dependence. This is through heavy reliance on foreign aid in terms of foreign capital, grants, & manpower/personnel for growth & development.
- Trade dependence. This is through relying on international/foreign trade with other countries in terms of imports, & exports for her survival and or development.
- Sectoral dependence. This is through relying heavily on agricultural sector for growth and development as compared to other sectors.
- Direct economic dependence. This is where my country's political and economic decisions are influenced by foreign nations & institutions like the World Bank, international monetary fund, African development bank etc.

<u>The negative implications of economic dependence on Uganda's economy</u>

- Leads to capital outflow. This is due to over dependence on foreign private investment/foreign direct investments; the private investors tend to repatriate their profits back to their mother countries. This leads to low capital formation/accumulation.
- Worsens balance of payments position. This is due to heavy reliance on imports, technology, & skilled personal from other countries. This leads to low foreign exchange earnings
- Leads to imported inflation. This is due to the heavy dependence on imports especially petroleum & its products from countries suffering from inflation. This leads to increased average costs & hence poor standards of living.
- Fluctuations in incomes & foreign exchange. This is due to over dependence on primary/agricultural exports whose prices do fluctuate so much on the world market. This leads to low infrastructural development.
- Increased debt burden (on the future generation). This is due to the dependence on foreign loans/foreign aid/grants etc. from foreign countries. This leads to increased vicious cycle of poverty/low output and hence low economic growth rates.
- Neglect of local resources. This is attributed to over reliance on foreign external resources. This thus leads to low levels of output and hence low economic growth rates.
- Discourages/kills local initiatives/encourages laziness/stagnates the development of local technology.
- The economy is subjected to inappropriate and undesirable decisions.
- Leads to underemployment & unemployment. This is due to heavy reliance on foreign skilled manpower/dependence on imported raw materials & or

advanced technology from other nations. This leads to low incomes and thus poor standards of living.

- Leads to development which is not in line with the socio-economic requirements of the country. This is because economic & political decisions are made externally without the participation of the indigenous people. This leads to poor standards of living.
- Leads to price fluctuations.
- Limits import capacity. This is due to low export earnings.
- Leads to political interference in the economy by foreigners.
- Distorts (economic) planning.
- Leads to poor terms of trade.
- Underutilization of idle/natural resources.
- Leads to cultural erosion.
- Leads to dumping. This is due to the heavy reliance on cheap imports from abroad. This retards the development of the industrial sector.

The positive implications of dependence on Uganda's economy

(Not to be emphasized)

The ways of reducing economic dependence in developing countries

- By adopting an outward looking development strategy. This is through setting up domestic industries to produce goods & services for export. This helps to minimizes heavy reliance on importation of raw materials, technology, manufactured products, skilled manpower etc. from abroad/other countries.
- Through the formation/joining regional integration. This is through joining economic groupings that aims at enlarging markets for the domestically produced goods and services. This helps to encourage economic interdependence among the integrated member countries.
- By encouraging export promotion policies. This is by establishing domestic industries to produce for exports. This aims at increasing the quantity & quality of exports through value addition. This helps to increase on the foreign earnings
- By ensuring political stability. This is through conducting peace talks, granting amnesty to rebellious groups who surrender good/democratic governance, etc. This helps to promote investments & production of goods & services.(Thus reducing expenditures on military hard wares)

- By employing appropriate technology. This is through the use of labour intensive techniques of production. This helps to increase production, generation of employment opportunities, & incomes thus leading to improved welfare of citizens.
- By adopting favorable government policies on investment. This is through the provision of subsidies, grants to local investors, tax holidays, & setting up institutions to streamline the requirements/needs of investors e.g. the establishment of Uganda investment authority (UIA).
- Through infrastructural development. This is by constructing, rehabilitating, & maintaining communication facilities. This helps to ease the transportation, distribution & marketing of goods and services in developing countries.
- Through increasing the exploitation and utilization of natural resources. This is by using appropriate methods of production. This helps to minimize over dependence on the agricultural sector & widening the scope of exports.

<u>The development of infrastructure</u>

Infrastructure refers to the underlying/basic facilities, services, & institutions needed for the functioning of a community, society, or an economy.

The examples of infrastructure, among many, include the following:

(a) *Economic infrastructure: Roads, flyways, railways, airways, airports, industries, firms, etc.
(b) Commercial infrastructure: financial institutions/banks/microfinances, insurance companies/firms, warehousing/storage facilities, markets, etc.
(c) Social infrastructure: schools, hospitals, swimming pools, entertainment/recreational facilities, churches, etc.

<u>The role of infrastructure in economic development process.</u>

- Promoting investment/capital flows. This is through the <u>establishment of socioeconomic facilities</u>/provision of tax incentives in an economy. This leads to increased output & hence economic growth.
- Promoting the development of labour skills. This is through technological transfer/on job training etc. This leads to increased <u>managerial</u> capacity building/<u>development</u> in an economy.
- Promotion of trade/accessibility to markets. This is through the construction, rehabilitation, & maintenance of communication facilities. This leads to easy transportation, distribution, & marketing of goods & services.

- Provision of employment opportunities. This is due to increased exploitation & utilization of resources. This avails incomes & hence better standards of li standard
- Promotion of savings. This is through the establishment of commercial infrastructure such as financial & insurance firms/institutions. This leads to increased investments.
- Improving social welfare of the people. This is achieved by easing accessibility to quality goods & services in an economy.
- Promoting industrial development. This is attained through increased exploitation & utilization of raw materials. This results into increased output & hence economic growth rates.
- Increasing productivity. This is attributed to the increased exploitation & utilization of resources. This leads to economic growth.
- Monetization of the economy/agricultural/monetization. This is due to the establishment of many financial institutions that engage in credit creation process. This leads to increased investments in an economy.
- Facilitation of inventions, & innovations/research/technological transfer. This is through reforming/vocationalizing the education system. This results into better welfare of the citizens.
- Fighting (structural) inflation. This is through increased production of goods & services. This results into low prices of goods & services & better standards of living.
- Promoted diversification. This is attained through the introduction of a variety of investments/ventures/economic activities in an economy. This widens the choice of the citizens & thus leading to improved welfare.
- Promoting entrepreneurial skills. This is attributed to the existence of foreign direct investments/on job training in industries/construction sites/service centers etc. This leads to improved managerial capacity building in an economy.
- Generated revenue to the government. This is as a result of imposing taxation on the incomes of those employed in the infrastructural sector & the outputs produced by the same sector. This leads to infrastructural development in an economy.
- Leading to increased foreign exchange. This is due to increased production of quality exports. This results into improved balance of payments position in an economy.
- Etc.

The strategies for improving on infrastructure in developing countries.

- Developing/constructing infrastructure. This is achieved through the construction, rehabilitation/renovation, & maintenance of socioeconomic facilities. This helps to ease the transportation, distribution, & marketing of goods & services.
- Contract private firms to develop infrastructure. This can be by signing agreement with private firms to construct, rehabilitate/renovate & maintain socioeconomic facilities. This will help to ease the transportation, distribution, & marketing of goods & services
- Set up supportive institutions. This can be attained through the act of parliament enabling the establishments of supportive institutions such as Uganda National Road authority-UNRA. This helps in service delivery in this sector.
- Provide capital. This is through securing foreign aid from more developed countries, Multinational Corporations, the World Bank, International monetary bank, African development bank etc. This helps to develop socioeconomic infrastructure in developing nations.
- Improve labor skills. This is achieved through training, vocationalizing the education system/education reform. This helps to provide the needed mobilization & organizational skills/increase managerial capacity building in production.
- Import modern technology. This is through the transfer of better methods of production. This helps to improve on socioeconomic infrastructural developments in developing countries.
- Liberalize investment in sector/economy. This is through removing the unnecessary barriers to investments in infrastructure. This helps to increase output & hence economic growth rates.
- Provide incentives to investors in the sector. This is attained through the provision of tax incentives (e.g. Tax holidays, subsidies, grants, etc.). This helps to reduce the average costs of infrastructural development.
- Diversify the sector. This is achieved through the introduction of a variety of sectors in an economy. This leads to increased investments in an economy.
- Develop/decentralize the sector of infrastructure. This is through providing infrastructural equipment to the local authorities. This helps to facilitate the development of infrastructure
- Change the land tenure system/provide/acquire land for infrastructural development. This is attained through reforming the ownership of land from poor land tenure system (communal ownership) to free land ownership

(private/individual) ownership so as to ease accessibility of pieces of land for the development of infrastructure.

- Improve political atmosphere. This is attained through conducting peace talks, granting amnesty to those who surrender, ensuring good/democratic governance, etc. so as to give confidence for life & safety of property of the investors in this sector.
- Fight corruption. This is through proper record keeping, & strict supervision of public officials. This helps to improve on the efficiency in the use of public funds in this sector.
- Publicize the opportunities for infrastructural investment. This is through advertising infrastructural investment opportunities in the media, e.g. newspapers, internet, radios etc. This helps to create awareness/market for infrastructural development.

<u>The structure of Uganda's foreign sector</u>

Uganda's foreign sector consists of both exports & imports

<u>(a).The imports.</u>

- She mainly imports manufactured consumer goods. These include drugs, cosmetics, foods & beverages. etc.
- She also imports capital goods like machine, computers, electric equipment etc.
- She imports skilled man power inform of expatriates. This is because her education system is still poor.
- She imports military hard wares inform of guns, ammunitions, bullets war jet fighters, APCs vehicles, tear gas, etc. This is because dating back since political independence times; she had had political instabilities to control.
- She imports agricultural products such as rice from Pakistan & India, apples from South Africa etc.
- Most of her imports are highly priced. This mainly comes from china, Japan, Italy, Germany, etc. This is attributed to high value addition to these products.
- She imports refined fuel & petroleum products expensively from the oil producing & exporting countries. (i.e. the middle East)

(b). Export

- This mainly comprises primary agricultural products & semi processed products. This is due to the use of poor technology in the production process. This contributes to over 60% of the gross domestic product.
- She exports a few services. This is because her service sector is not yet well developed e.g. tourism, transport, security, tourism, & electricity.
- She exports minerals on a very small scale. This is because she is not well endowed; & coffee, tobacco, with minerals. e.g. copper, cobalt, gold, etc.
- She has a small range of both traditional & non-traditional export crops. e.g. cotton, coffee, simsim, soya beans, ground nuts, sunflower, fruits. Others are fish, skin, & hides etc.
- Her exports are mainly of poor quality with low value addition. This is because they are mainly exported in raw form
- She exports few manufactured consumer goods like soap, plastics, cement, sugar, textiles, mattresses, etc. especially to the neighboring countries.
- The prices of agricultural export products are usually low & keep fluctuating on the world market. This is because the prices of Uganda's agricultural exports are determined externally/attributed to the poor quality export products

The implications of the features of Uganda's foreign sector.

(a). Positive implications:

- Increased revenue. This is because of the introduction of some non-traditional export crops. This has resulted into improved infrastructural facilities.
- Leads to technological transfer/development. This is due to the research, inventions, & innovations. This leads to the acquisition of new skills, new methods of technology etc. This leads to increased output & hence economic growth rates

(b). Negative implications:

- Leads to unfavorable terms of trade. This is due to high import prices & low export prices. This leads to low tax revenue generation.
- Limited level of industrialization. This is due to the predominance of agricultural exports. This leads to low level of industrial output & hence low economic growth rates.

- Balance of payments deficits. This is due to the increased import expenditure & reduced revenue from exports. This leads to low foreign earnings.
- Limited & unstable foreign exchange earnings. This follows the fluctuating prices of agricultural products/exports on the world market. This leads to poor standards of living.
- Low levels of economic diversification. This is due to the dependence on a few traditional cash crops & non-traditional exports. This leads to low levels of output/unemployment & hence poor welfare.
- Increased economic dependence. This is because of the reliance on the importation of producer goods, petroleum, & its products, raw materials technology etc. This leads to a narrow range of choice & increased profit repatriation/capital outflow, & low capital formation.
- Increased capital outflow. This is due to her reliance on expatriates, raw materials, technology, & foreign direct investments. This leads to low economic growth rates.
- Poor provision of public goods & services. This is due to low government revenue generated from exports. This leads to poor standards of living.
- Risk of imported inflation. This is attributed to the heavy reliance on expensive imports from countries prone to inflation. This leads to high cost of living.
- High levels of unemployment. This is due to the heavy dependence on the importation of machines/capital, & the use of capital intensive technology which in the long run substitutes human labor. This leads to low incomes & hence poor standards of living.

The measures to improve on Uganda's foreign sector

- Establish training institutions. This is by constructing schools, institutions & colleges as a comprehensive policy. This helps to reduce reliance on expatriates.
- Improve balance of payments position. This is through value addition to agricultural exports. This helps to increase foreign exchange earnings.
- Provide value addition to export products. This is attained through the procession of agricultural products. This helps to increase exports prices & export earnings.
- Establishment of import substituting industries. This is by establishing local industries to produce locally what was formerly imported. This helps to minimize import expenditures.

- Widening the export market. This is done through undertaking research & joining regional integration. This helps to increase output.
- Establishment of export promotion industries. This is through setting up domestic industries to produce for export. This helps to increase foreign exchange earnings.
- Diversify the economy. This is through the introduction of variety of products/economic activities/ventures. This helps to reduce over dependence on a few agricultural exports (economic dependence).
- Provide favorable investment policies. This can be achieved through signing international commodity agreements. This leads to increased output produced.
- Encourage the exportation of non-traditional crops. This is through the introduction of non-traditional cash crops e.g. Groundnuts, soya beans, simsim etc. This helps to diversify Uganda's exports abroad. Thus leading to increased export earnings.
- Improvement of infrastructure. This is through the construction, rehabilitation, & maintenance of communication facilities. This helps to facilitate the transportation, distribution & marketing of goods & services for export.
- Provide favourable investments policies. This is achieved through putting in place tax concessions. This helps to attract both local & foreign investors.
- *Signing international commodity agreements.
- Procession of further agricultural raw materials. This can be done through increased industrialization within the agricultural sector. This helps to increase foreign exchange earnings for the economy.

Structural adjustment programme (SAP).

The structural adjustment programme refers to the package of policy measures & other institutional reforms recommended by the international monetary fund-IMF- & World Bank to the governments of the developing countries with the aim of improving on the performance of their respective economies.

The aims/objectives of the structural adjustment programs

- To stimulate economic growth. This is through further liberalization/privatization of the economies of the developing countries. This helps to increase output.
- So as to expand the private sector. This is privatizing/liberalizing the economic enterprises in the developing nations. This helps to improve the efficiency in the production of goods & services.

- In order to increase employment opportunities in developing countries. This is enhanced through the creation of many investments/ventures/economic activities. This helps to avail incomes to people.
- For the purpose of reducing government/public expenditures. This is enhanced through the retrenchment of civil servants/demobilization of the soldiers. This helps to promote economic growth
- To increase government revenue. This is achieved through expanding the tax bases/imposition of taxes on employees/outputs produced. This helps to improve infrastructure.
- To improve on resource utilization & allocation for sustainable development. This is attained through the use of appropriate technology. This helps to increase output & hence economic growth & development
- In order to improve on the balance of payments position. This is through the production of high quality export products. This helps to increase on the foreign exchange earnings.
- For the purpose of ensuring equitable distribution of incomes & wealth. This is through the use of progressive taxation. This helps to minimize the economic gap between the rich & poor/improved standard of living their respective economies.
- To control (structural) inflation. This is this through increased production of goods & services by the private sector. This helps to restore confidence in the local currencies, increase output, reduce prices & hence better welfare.
- So as to reduce on the foreign economic dependence. This is through diversification of economic activities in the developing countries. This to enhance self-reliance in the developing economies.
- Improving agricultural productivity. This is enhanced through modernization of agriculture. This helps to increase economic growth rates.
- Reducing on the large subsistence sector. This is through monetizing the economies. This helps to promote trade in the economies.
- To promote technological progress in the economy. This is through research, inventions, innovations, & technological transfer. This helps to increase output & thus economic growth rates in the developing economies.
- For the purpose of reducing poverty in developing countries, especially for the vulnerable groups of people like children, women, & the handicapped. This is enhanced through increased utilization of resources. This helps to improve on the welfare of the citizens of the respective developing nations.

<u>The policy instruments undertaken by the government of Uganda under the structural adjustment programs.</u>

- Privatization of public enterprises. This through the transfer of ownership, control & management of public assets/state enterprises to private individuals, companies, & or organizations.
  This is aimed at strengthening the private sector.
- Cost sharing in social service delivery in higher learning institution/schools, hospitals, etc. This is by the public contributing a certain percentage/proportion of the cost of operation in the higher learning institution/schools, hospitals, etc. This is aimed at lowering government expenditure.
- Retrenchment of civil servants. This is by laying off non performing government employees. This is aimed at reducing the size of civil servants/government expenditure.
- Demobilization of soldiers. This is through laying off/retrenching of the non performing soldiers. This is aimed at reducing government expenditure.
- Economic liberalization. This is enhanced through the removal of the unnecessary barriers; (setting up free foreign exchange & interest rates, prices, taxes etc.) to trade This is aimed at efficient resource allocation etc. so as to allow the market forces of demand & supply to operate freely.
- Tax administration reforms. This is through changing the tax structure, collection & administration. This is aimed at improving tax collections. This led to the formation of Uganda Revenue Authority-URA-in 1987
- Infrastructural development policy. This is through the construction, rehabilitation, & maintenance of communication networks. This is aimed at rehabilitating & maintaining all high ways, feeder roads, railways, ferries, airports, storage facilities, financial institutions, etc.
- Monetary policy reforms. This is through controlling money supply, encouraging deposits, developing security markets, strengthening the supervisory role of the central bank, encouraging & the establishment of private financial institutions. This will help to stabilize the country's currency.
- Export promotion programmes. This is through export diversification & value addition to export products. This is aimed at improving on the quality, & periodic devaluation of the Ugandan currency & or shillings etc.

Uganda as a mixed economy

- Uganda is a mixed economy. Resource ownership, allocation, & management of business enterprises are done by both the government & the private companies, organizations, & or individuals.

- Within the government sector, she makes direct plans & investments. While in the private sector, the government influences the activities/operations of the private sector. This, she does through the use of monetary & fiscal policies.
- Currently, the government is pursuing the policies of liberalization & privatization of most economic activities. Hence there is now more private participation in production, trade, communication, transport, (economic activities) etc. than ever before

<u>The private sector in Uganda</u>

The private sector is that part of the economy whose economic activities, resources allocation, & management of business enterprises are under the control & direction of non-governmental economic units such as households, or firms. Each economic unit owns its own resources & uses them mainly to maximize its own well-being.

<u>The features of Uganda's private sector.</u>

- It is small but slowly growing. This is because many of the sectors are owned, controlled, & managed by the government.
- It is still a weak sector. This is due to the limited capital owned by the private companies, organizations, & or individuals.
- It mainly comprises enterprises producing consumer goods for the domestic markets. This is due to the poor quality output produced by them/low foreign demand for them.
- Large scale business enterprises/investments/ventures are mainly owned by foreign investors. This is because of the existence of high level of poverty among the citizens who can't afford to own large scale enterprises.
- The sector is profit geared/motivated.
- There exists low production capacity in the sector. This is due to the use of poor technology, limited resources, limited skills, & low levels of investments.
- The business enterprises in this sector are mainly urban based. This is due to the availability of markets, well developed infrastructure etc. in the urban areas
- There is limited involvement in long term risky ventures by individuals, companies, & or organizations. This is because of profit maximization drive objective/goal.
- It is dominated by small scale import substitution industries. This is due to the existence of limited capital for the establishment of large scale investments.

The implications of the private sector in the development process of developing countries (Uganda)

(a). The positive implications:

- Creates more employment opportunities. This is through increased use of local resources/labour intensive technology in the production process. This avails incomes & thus improved standards of living to the citizens.
- Creation of efficiency in resource allocation. This because of profit maximization drive/strict supervision & accountability of resources in the production process. This leads to increased output & thus economic growth.
- Creates a class of entrepreneurs. This is due to foreign investors coming with their own technology, skills, & technological transfer. This thus leads to the acquisition of skills required for the operation of machines & modern business enterprises by the indigenous labour force/managerial capacity building.
- Promotion of competition in business activities. This is because of the need to earn more profits thus leading to the production of better quality goods & services/efficiency in the production process.
- Promotes industrial development. This is through the existence of forward & backward & forward linkages created in the economy. This hence leads to increased output.
- Leads to increase in the gross domestic product. This is through widening economic activities in the economy. This leads to economic growth.
- Provision of government revenue. This is attained through taxing the incomes of those employed/output produced by the private sector. This leads to improve d infrastructural development.
- Promotes technological transfer/development. This is attained through market research, inventions, & innovations/ the existence of foreign direct investments. This leads to the production of better quality goods & services/increased output.
- Leads to increased capital inflow. This is through attracting foreign investments in the economy especially in high risk ventures where local private entrepreneurs cannot invest. This increases the levels of output/increased capital accumulation in the economy.
- Reduction on the level of corruption & embezzlement of public funds. This is achieved through strict supervision, record keeping & management. This promotes accountability in resource allocation/utilization*/leads to efficiency in production.

- Production of variety of goods & services. This is due to the existence of various economic activities, enterprises, investments/ventures in an economy. This widens the choice of consumers thus improving their standards of living.
- Improves the country's balance of payments position/reduces balance of payments deficits. This is because of increased production* of goods & services for the domestic market. This, therefore,* save the scarce foreign exchange earned which would be used for import purposes.
- Facilitates the exploitation & use of idle local available resources. This is through the use of*use of efficient technology in the production process. This improves on the productive capacity in an economy & hence increased *output/economic growth rates.
- Diversification of the economy/reduces dependence. This is attained through the introduction of various sectors in the economy. This thus leads to increased output & hence economic growth.
- Increases the skills of the labour. This is achieved through the existence of on job training in the production process. This thus leads to better quality output.
- Improves the quality of goods & services. This is because of the use of efficient techniques of production. This leads to better standards of living among the citizens.
- Provision of capital, both local & foreign. This is through the existence of foreign direct investment. This leads to increased output.

(b). Negative implications:

- Emergence of private monopolies. This is due to the protection given to private enterprises by the government at infancy stages. This increase consumer exploitation since private monopolies restricts output & charge high prices with the aim of profit maximization. (This leads to poor standards of living among the citizens).
- Difficulties in planning. This is because it makes it difficult for the government to coordinate, & carry out proper planning for a large private sector which is still non-responsive. This leads to low output & hence low economic growth rates.
- Increased dependence. This is due to the foreign ownership of most of the domestic enterprises/importation of most of the raw materials used in the private sector. This leads to foreign domination & control of the economy through foreign direct investments.

- Leads to technological unemployment. This is due to the increased use of capital intensive techniques in the production process mainly by foreign investors/inefficient firms being pushed out of the production process.as a result of stiff completion in the industry. This leads low incomes & hence poor standards of living among the citizens.
- Leads to rural urban migration & its evils. This is because most of the business enterprises/investments/business activities, communication facilities, etc. are urban based.(due to rural-urban economic imbalances) This leads to further congestion, open urban unemployment, high cost of living etc. in the urban areas/decline in production levels in the rural areas.
- Low levels of economic growth. This is due to the low levels of capital in the private sector to invest in business/economic activities, & or for expansion. This leads to the underutilization of resources in the economy.
- Leads to profit repatriation. This is due to the dominance of the private sector by foreign investors. This leads to low capital formation/accumulation in the economy.
- Undermines the provision of basic essential goods & services which are non-profit making. This is because the private individuals, companies & or organizations aim at venturing into activities where they maximize profits. This leads to low standards of living among the citizens.
- Some key areas such as production of fire arms can't be left in the hands of private individuals. This causes insecurity in the country.
- Leads to divergence between private & public interests. This is because private individuals, companies, & or organizations maximize profits at the expense of the society in terms of externalities (social costs). This results into poor standards of living.
- Leads to wasteful competition. This through the existence of
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  persuasive advertising, duplication of goods & services, etc. This leads to misallocation of resources in the economy.

The problems/challenges facing the private sector in Uganda

- Poor & inadequate infrastructure. This is reflected in the form of poor transport,& storage facilities, & limited financial institutions. This increases the average costs of investments and thus making it difficult to transport, distribute & market goods & services by the private sector
- Unfavorable government policy on investments. This is attributed to high interest rates on loans, high taxes, long formalities of awarding investment

opportunities to potential private investors, high exchange rate, etc.* This reduces the profit margins & kills the initiatives of the private sector thus discourages private investments.

- Stiff competition from imported manufactured products. This is because the imported products are cheap & are of high quality. While the locally produced products are expensive & are of low quality. Therefore, they out compete the locally produced goods by the private sector.
- Limited entrepreneurial skills. This is due to the existence of poor education system which leads to the poor mobilization & organization of factors of production. This further leads to low profit margins and in many cases closure of business enterprises.
- The existence of inadequate capital. This is mainly due to the low levels of incomes, & limited access to credit facilities from financial institutions brought about by inadequate collateral securities. This increases the average costs of private sector investments/business operations.
- Political instabilities in some parts. This is due to the fear of life & destruction of property. This discourages private investors from setting up meaningful business enterprises/ventures/investments in Uganda.
- Low levels of technology. This is attributed to the use of simple tools/methods by especially local private investors. This increases the average costs of production & thus leading to the production of low & poor quality outputs.
- Inadequate supply of raw materials. This *is because most of the inputs required for production are imported from other economies. This increases the average costs of production & hence discouraging the private sector investments.
- Limited market. This is due to the low aggregate demand in the economy resulting from high levels of poverty/high levels of unemployment. This increases the average costs of production & thus discouraging investments
- Poor investment climate. This is attributed to the existence of high rate of inflation, exchange rate fluctuations, low tax concessions etc. This increases the average costs of investments and thus discouraging private investments in Uganda
- Poor manpower/Limited labour skills. This is due to the existence of defective education system. This makes the labour force less inventive, innovative, & creative in nature. This thus making the operation & management of modern machines & expansion of the private sector difficult.
- Poor economic climate. This is attributed to the existence of high rates of inflation, high exchange rates, high taxes, etc. This increases the average

costs of production/reduces profit margins & bogs down private sector initiatives to invest thus discouraging the growth of the private sector.

- The existence of poor land tenure system. This is due to the existence of communal ownership & management of land. This makes it difficult for private individuals, organization, & companies to access land for investment. Hence discouraging the growth of the private sector in Uganda.
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The measures to promote the private sector in developing countries/Uganda.

- Ensure political stability. This is achieved through conducting peace talks, granting amnesty to those who surrender democratic/good governance, etc. This helps to create confidence for life, & safety of property (conducive environment for investment) hence encouraging private investment.
- Improvement in the level of technology. This is attained through research, inventions, innovations, & technological transfer. This helps to increase the quality & quantity of output produced.*
- Widening/expansion of the market, both local & foreign. This is through joining regional/economic integration, promoting trade shows/fairs, exhibitions, & encouraging economic diversifications. This helps to facilitate private sector investment.
- Encourage economic liberalization. This is through removing the unnecessary barriers/restriction etc. to trade/economic activities so as to allow people engage in the private sector investments freely with limited interferences.
- Establishment of organizations to promote private sector investment. This is achieved through forming up specialized institutions to promote private sector investments e.g. Uganda investment authority (UIA), private sector foundation, (PSF), Uganda manufacturers association (UMA), etc. This helps to secure the needed raw materials for production.
- Increasing the exploitation & use of available local resources. This is through the use of efficient techniques of production. This helps to secure the raw material & increase output.
- Protect infant domestic private industries. This is by imposing high tariffs on foreign imports. This helps to protect the infant private domestic industries & reduce competition from high quality & quantity imported products.
- Development of infrastructure. This is through the construction, rehabilitation, and maintenance of communication, storage, water, power,

electricity, banking etc. facilities. This helps to facilitate the production, transportation, distribution, & marketing of goods & services invested in.

- Provide credit facilities. This is achieved through relaxing/easing interest rates on loans for investments in the financial institutions. This helps private investors to access credit facilities/loans for investments/expansion of their businesses.
- Provide favorable government policies on investments. This is attained by giving private investors tax concession e.g. tax holidays, subsidies, grants, & other investment incentives. This helps to reduce their average costs of production.
- Undertake privatization policy. This is by transferring ownership, controls & management of the inefficient government parastatals/firms/enterprises to private individuals, companies & organisations. This helps private sector/individuals/companies/organizations to get involved in economic activities & thus enabling the growth & development of the private sector.
- Training the local labour force. This is through engaging in on job training during the investment process/reforming the current education system. This helps to equip the labour force with the required production/investment/entrepreneurial skills necessary for efficient management & allocation of resources
- Encourage proper accountability. This is through proper record keeping, & strict supervision of business investments. This helps to lower the average cost of production & thus encourage the expansion & growth of the private sector.
- Undertake international campaigns & publicity. This can be achieved through advertising private investment opportunities in the media such as internet, radios, newer papers, journals, business magazines, face book, etc. This helps to create both local & international awareness of the t existing investment opportunities
- Ensure price stability/fight inflation/promote foreign exchange rate stability. This is through setting up price legislation. This helps to lower the average costs of production & hence encouraging private sector investments.
- Provide land for development. This is through reforming the land tenure system. This will enable potential investors to access land for private investments.
- Improve entrepreneurship skills. This is through reforming the education system. This will help provide people with the skills needed for the mobilization & organization of the resources for production.

<u>The public sector in developing countries/Uganda</u>

This is part of the economy where resources are owned, controlled, allocated & managed by the government on behalf of the citizens. i.e., the government owns, & controls the means of production & carries out the major economic decisions on behalf of the people.

The public sector consists of establishments that are owned by the government & are engaged in commercial activities. Such establishments may take any of the following forms:

- ✓ Public corporations
- ✓ Local authorities (e.g. city, municipal, or county councils-may supply water, operate bus services, primary schools, sports stadiums, etc.)
- ✓ Parastatal bodies.

<u>The role of public sector in developing countries.</u>

(a). Positive role

- Equitable redistribution of resources (incomes & wealth)/balanced regional development. This is through levying progressive taxation on incomes & outputs. This leads to infrastructural development.
- Ensure consumer protection against exploitation/undesirable goods e.g. Uganda national bureau of standards (UNBS). This is through the establishment of price legislation at which goods & services are sold & bought. This leads to improved standards of living of the public.
- Provision of infrastructure. This is through the construction, rehabilitation, & maintenance of communication facilities. This eases the transportation, distribution, & marketing *<u>of</u> goods & services.
- Avoiding foreign domination of the economy. This is through the nationalization of private enterprises. This leads to self-reliance/sufficiency.
- Promotes technological transfer/development. This is through market research, inventions & innovations. This leads to increased quality output/efficiency in production.
- Improvement of balance of payments position. This is through increased production for exports. This leads to increased foreign exchange earnings.
- Generation of employment opportunities. This is through the establishments of economic activities/the use of labour intensive techniques of production/increased resource utilization. This results into the provision of incomes & hence improved welfare of the citizens.

- They are source of government revenue. This is attained through the imposition of taxation on incomes & outputs of people. This results into infrastructural development.

(b). Negative role:

- Promotes regional inequality. This is attributed to the concentration of economic activities in the urban areas neglecting rural areas, basing on some political reasons. This leads to poor welfare of the citizens.
- Emergency of state monopolies. This is through the over protection of government parastatals/enterprises. This results into low quality output.
- Low productivity of workers. This is attributed to inadequate motivation of the workers & relaxed supervision by the government officials. This leads to low economic growth rates.
- Inefficiency in production. This is due to the existence of inadequate competition in the public sector. This leads to poor quality output.
- Budgetary deficits/balance of payments problems. This is as a result of increased government expenditure on subsidization of parastatals which are not economically productive.
- Poor administration & management. This is because some of the appointments for the management of the parastatals are politically motivated/political interferences. This leads to low output.
- Limited variety of goods & services. This is due to the emergence of state owned monopolies. Hence limiting the choices, tastes, & preferences of the citizens
- Poor accountability by public officials resulting into more losses. This is attributed to poor record keeping & poor supervision of the official in the public offices. This bogs down development initiatives & thus leading to low economic growth rates.
- Provision of poor quality goods & services. This is as a result of lack of competition in the production process. This results into poor welfare of the citizens.
- High level of bureaucracy in decision making. This is due to the long formalities involved in public sector. This leads to delays in decision making, planning, & implementation of investment policies in developing nations. This negatively affects the efficiency of the production process.

<u>The problems facing public sectors.</u>

- Inadequate capital. This is mainly due to the low levels of incomes, & limited access to credit facilities from financial institutions brought about by inadequate collateral securities. This increases the average costs of public sector investments/business operations. Thus discouraging investments.

- Limited markets for the products. This is due to the existence of low aggregate demand arising from high levels of unemployment, & poverty/low incomes in an economy. This thus discourages investments in the public sector.
- Poor infrastructure. This is attributed to the existence of poor communication, financial & social facilities. This increases the average costs of production & thus discouraging investments in the public sectors.
- Low levels of technology. This is due to the use of labour intensive techniques of production. This increases the average costs of production & thus discouraging investments in the public sectors
- The existence of economic instability. This is due to the existence of high rates of inflation, high exchange rates, & high interest rates on development/investment loans. This results into increased average costs of production & hence discouraging investments in the public sectors.
- The existence of stiff competition from the private sector. This is
- because the private sector is more efficient & competitive in terms of resource allocation, production, & supervision. Therefore, parastatals face a threat of being out competed by the private sector.
- The existence of high level of corruption & embezzlement of public funds. This is due to poor record keeping, & poor supervision. This leads to resources being misallocated for personal gains at the expenses of the public. This increases the average costs of production & thus discouraging investments in the public sector.
- The existence of political instabilities in some parts/countries. This creates fear of life, & destruction of property. This discourages potential investors from setting up meaningful investments in the public sectors.
- Limited manpower. This is due to the existence defective education system. This leads to poor administration, & management of public enterprises. Hence increasing the average costs of production in the public sectors.
- Foreign interference. This is through the adaptation of foreign economic policies e.g. privatization, liberalization etc. of public enterprises. This leads to poor planning, implementation, etc. of production/investment policies.
- Bureaucratic tendencies. This is due to a lot of formalities to be followed in securing investment opportunities. This leads to delays in decision making, planning, & implementation of investment policies in developing nations.

- Limited commitment & interest on the part of management. This is because appointments are usually politically motivated. This leads to poor record keeping, supervision, & performance of the public sector.

Parastatal organizations in developing countries

A parastatal organization is a state owned firm/enterprise set by an act of parliament/government decree to carry out some vital specific functions/activities (without putting much emphasis on profits. Or

It is an organization set up by a government to perform certain functions. These functions may not necessarily be commercial functions, nor may the body aim at making profits.

Nevertheless many such bodies provide commercial services & may actually make profits e.g. all marketing boards.

They do not have any share capital.

The government contributes capital towards the formation of these parastatals & appoints a board of directors to run them on-commercial basis.

The types of parastatal organizations:

(a). Financial parastatal.

These are institutions owned by the government to provide financial and technical services to the public on soft terms e.g. low interest rates, longer repayment periods etc.receive deposits, give out loans, but do not create credit

The examples of financial parastatal institutions include:

- ✓ Development banks
- ✓ State cooperatives,
- ✓ Insurance companies,
- ✓ Housing corporations
- ✓ *Post office savings banks
- ✓ Uganda cooperative bank. (Now not in existence).
- ✓ etc.

*****(Refer to money & banking for detailed explanations)

(b). Non-bank financial organizations.

These are financial institutions which receive deposits, give out loans but do not create credit e.g. development banks, cooperatives, Insurance companies etc.

The functions of the non-banking financial intermediaries in Uganda, among many, are the following:

- ✓ Giving loans/mortgaging
- ✓ Promote/encouraging savings
- ✓ Encouraging investments
- ✓ Provision/ensuring social security (NSSF)
- ✓ Encouraging trade
- ✓ Indemnifying (compensating) in the case of insurance companies. This is through pooling of risks using the contributions of the insured)
- ✓ Safeguarding peoples deposits.

*****(Refer to money & banking for detailed explanations)

(c). Marketing parastatals.

These deal in marketing & distributing of mainly agricultural products. E.g. The Uganda tea authority, (UTA), former coffee marketing board (CMB), former cotton marketing board (CMB), former lint marketing board, (LMB) etc.

(d). Service parastatals.

These are organizations which provide services to the public e.g. Uganda telecommunications ltd (UTL), the national water *<u>&</u> sewerage cooperation (NWSC), Uganda electricity distribution company limited (UEDCL, (Umeme) etc.

<u>Public corporations in developing countries.</u>

A public corporation is a business organization/enterprise in which government holds either <u>all</u> <u>the shares or majority of its share capital.</u>

It is a joined stock company in which a government holds all the shares capital, or a majority of it.

It is <u>created by an act of parliament</u> which clearly defines its aims and objectives e.g. National water & sewerage corporation, National Housing Corporation etc.

It operates as an ordinary joined stock company an*<u>d</u> aims at making a profit out of its operations. These profits are of course surrendered to the government.

Public enterprises/parastatals are organizations set up by the government through the act of parliament to provide certain services to the citizens.eg National water &

sewerage corporation (NWSC), Uganda revenue Authority (URA), National social Security fund (NSSF), etc.

<u>The role of public corporation in developing countries</u>.

(a). Positive role

- Equitable redistribution of resources (incomes & wealth)/balanced regional development. This is achieved through the imposition of taxation on incomes & output produced by the corporations. This results into infrastructural development.
- Ensure consumer protection against exploitation/undesirable goods. e.g Uganda national bureau of standards. This is attained through the use of bureau of standards, price controls, sales of goods Act, 1883, trade descriptions act, food & drugs act, weights & measures act etc. This leads to improved standards of living
- Development of infrastructure. This is through the construction, rehabilitation, & maintenance of communication facilities. This eases the transportation, distribution 7 marketing of goods & services.
- Avoiding foreign domination of the economy. This is Uganization of the economy. This results into self-reliance/sufficiency.
- Promotes technological transfer/development. This is enhanced through market research, inventions & innovations. This leads to increased output & economic growth rates.
- Improvement of balance of payments position. This is by producing high quality products for exports. This results into increased foreign exchange earnings.
- Generation of employment opportunities. This is as a result of the establishments of many economic activities by the public corporations. This avails incomes & thus improving the welfare of the citizens.
- Promoting economic growth & development. This is as a result of increased exploitation & utilization of resources. This leads to increased output.
- Provision of essential services to the public at affordable prices.
- Undertaking strategic investments/projects of national importance
- Provision of non-profitable but essential goods & services e.g. garbage collection/merit goods. This results into better standards of living of the citizens
- They are source of government revenue. This is as a result of levying taxes on the incomes & outputs of the corporations. This results into improved infrastructural development in the economy.

- Helps in controlling private monopoly. This is enhanced through imposing high taxes on private firms/companies. This results into better standards of living among the citizens
- Raising large capital/undertaking large scale operations. This is through inviting the public to buy share in the corporation. This results into increased out & hence economic growth & development.

(b). Negative role:

- Promotes regional inequality. This is because most of the public corporations are urban based. This leads to the underdevelopment of the rural areas.
- Emergency of state monopolies. This is attributed to the government protection of public corporations at infant stages that makes them grow up as state monopolies. This leads to the production of poor quality output & thus poor standard of living.
- Low productivity of workers. This is as a result of using simple techniques of production. This leads to low output & hence low economic growth rates.
- Budgetary deficits/B.O.P deficits/Strain the government budget is. This is attributed to the high government expenditure on managing public corporations. This leads to low foreign exchange earnings.
- Provision of poor quality goods & services. This is attributed to lack of competition in the public corporations. This results into poor welfare of the citizens.
- Over exploitation of the citizens. This is because the public is highly taxed on their incomes & economic activities so as to cover the losses made by these public corporations. This results into low standards of living.
- Limited flexibility in operation changes i.e. slow adaptation to changes/development. This is due to the existence of poor entrepreneurial skills in the economy. This leads to low output & hence low economic growth rates.
- Shortages occur in times of breakdown. This is attributed to the existence of state monopolies in production/economic activities. This leads to poor standards of living among the citizens
- Poor administration & management. This is because of political interference as the board of directors is usually. Politically appointed. This leads to inefficiency in production.
- Poor accountability by public officials resulting into more losses. This is attributed to poor record keeping & poor supervision of public officials. This results into low output & thus low economic growth rates.

- Tend to discourage private investments. This is attributed to low tax concessions given to the private sector investments. This results into low output & hence low economic growth in the economy.

- Inefficiency in production. This is attributed to the absence of competition in the public sector investments. This results into poor quality output & hence poor standards of living in the economy

The problems facing public corporation in developing countries.

- Inadequate capital. This is mainly due to the low levels of incomes, & limited access to credit facilities from financial institutions brought about by inadequate collateral securities. This increases the average costs of investments/business operations. Thus discouraging public corporation investments.
- Limited markets for the products. This is due to the poor quality products produced by the public corporations, the existence of high levels of unemployment & low levels of incomes among the public. This leads to increased average costs of production in the public corporations & thus discouraging large scale investments.
- Poor infrastructure. This is due to the existence of poor economic, commercial & social facilities. This increases the average costs of investments/production and makes it difficult to transport, distribute & market goods & services.
- Low levels of technology. This is attributed to the use of simple techniques in the production process. This increases the average costs of production & thus discouraging public corporation investment.
- The existence of economic instability. This is due to the existence of high rate of inflation, high exchange rates & high interest rates on investment loans. This increases the average costs of investments & thus discouraging growth & development of public corporation.
- The existence of high level of corruption & embezzlement of public funds. This is attributed to poor record keeping & supervision by public officials. This increases the average costs of production & thus giving disincentives to investments.
- The existence of political instabilities in some parts/countries. This is due to the fear of life, & destruction of property of investors. This discourages investments in public corporations in Uganda.
- Limited manpower. This is attributed to the defective education system which makes it difficult to mobilize & organize factor resources for production. This discourages investment in the public corporations.

- Foreign interference. This is due to the use of foreign economic policies such as privatization of public enterprises, retrenchments of civil servants, demobilization of the army, economic liberalization, etc. This leads to increased average costs of the implementation of the foreign policies & as a result discouraging public sector investments in the economy.
- High level of bureaucracy in decision making & implementation of policies. This is due to the existence of many formalities in securing investment opportunities. This negatively affects the efficiency of public corporations

Privatization in developing countries.

Privatization is the transfer of ownership, control & management of public assets/state enterprises to private individuals, companies, & or organizations.

It is aimed at building a strong private led sector so as to promote efficiency in resource allocation & service delivery.

Nationalization is the process by which the government/state takes over the ownership, control & management of privately owned enterprises to be run in public interests

The forms of privatization.

a) Partial privatization/joined ventures. This is where the government sells some of its shares to the private sector. Under partial privatization, both the government and the private sector own shares in an enterprise but with private sector owning majority of the shares e.g. Uganda government owns 49% of the shares in Barclays bank ltd, and 51% is owned by PLC London; also in Kinyara Sugar, the government 48% of the shares and Raila investments owns 52% of the shares.
b) Repossession. This is where the government returns some enterprises to former owners. E.g. the Asians, Indians etc. in Uganda
c) Contracting out/privatization of auxiliary services. This is where the government retains the ownership of enterprises but provision of services is transferred to the private sector e.g. road maintenance, catering in government owned institutions, cleaning government markets, etc.
d) Leasing. This is where the government rents/tenders out public enterprises to the private sector for a given period of time. The government still remains the owner of the enterprise but the management is privatized. E.g. tendering

a market, national game parks, taxi & bus parks; power generation & distribution, etc.

e) Liberalization/deregulation/demonopolization. This is where the government removes undue/statutory restrictions to entry by the private sector to certain investment activities e.g. Trade liberalization, marketing of coffee, cotton, power generation, telecommunications sector, broadcasting sector, foreign exchange sector etc. This is aimed at increasing competitions in the economy.
f) Divestiture/denationalization. This refers to outright sale of all government shares in an enterprise (public enterprise) to the private individuals or companies e.g. the government sold all her shares in sell Uganda, all her shares in Kakira works, & Nile Breweries.
g) Cost sharing. This is where the government retains ownership of the enterprises but the beneficiaries contribute to the running costs, e.g. Cost sharing in public universities, government hospitals, etc.
h) Privatization of management/contracting management. This is where the government leaves the management in private hands while retaining ownership. This involves signing of management contracts e.g. In Uganda, Sheraton Hotel being managed by Sheraton International

The reasons/objectives for the privatization of state/public enterprises in Uganda

- For the purpose of creating efficiency. This is enhanced through competition in these sector*s. This will help produce better quality output.
- To reduce corruption & embezzlement of funds that is so rampant in the public sector. This is attained through proper record keeping, management, & supervision. This helps to ensure accountability & transparency in management & allocation of resources/funds in the economy.
- Attracting capital inflow. This is through the existence of foreign direct investments. This helps to encourage increased output & hence economic growth in the country.
- To minimize government expenditure (public debt) on subsidization. This is by way of the private individuals, companies, & organization taking over management, control & responsibilities and thus allowing the government to concentrate on service provisions. This helps to improve balance of payments position.
- So as to fulfill the conditionality of the international monetary fund (IMF). This is in regard to creating a private sector led economy. This helps to ease securing foreign aid from the donor countries.

- Increasing government revenue. This is through creating a private sector led economy which widens the tax bases in form of employment, & business activities established. This helps to improve infrastructural development.
- For the purpose of improving/increasing on the level of resource utilization. This is through the existence of competition & profit motive in the private sector. This helps to increase output & hence economic growth rates.
- To reduce on bureaucratic tendencies. This is because there is no need for consultations in the private sector. This helps to minimize on unnecessary time wasting.
- Encouraging creativity. This is through research, inventions, innovations, & technological transfer. This helps to increase output.
- To allow the government concentrate on the provision of essential services. This is enhanced through the transfer of ownership, control & management of the inefficient public assets/enterprises. This helps to improve the standard of living of the citizens.
- Creating more employment opportunities in the long run. This is through the use of labor intensive technology/increased use of resources/the existence of many economic activities. This helps to avail incomes to people & hence improving their welfare.
- Improving the balance of payments position. This is by producing better quality export products. This helps to increase foreign exchange earnings.
- To control (structural) inflation. This is through increased production of goods & services by the private sector. This helps to reduce bottlenecks/rigidities that cause structural inflation/improve the welfare of the citizens.
- For the purpose of economic diversification. This is through the introduction of a variety of economic activities/investments/ventures in the economy. This helps to increase output & hence economic growth.
- To promote technological transfer. This is through research, inventions, innovations, creativity, & the existence of foreign direct investments. This helps to increase output & hence increased economic growth rates in the economy.
- Widening consumer choices. This is because privatization encourages the production of a variety of goods & services. This helps to improve the welfare of the citizens
- Developing infrastructure. This is through the construction, rehabilitation, & maintenance of communication facilities, learning institutions, hospitals, recreational facilities etc. This helps to ease the transportation, distribution, & marketing of goods & services.

- To promote industrial development. This is through the establishment of small scale industries which later develop into large scale industries. This helps to increase output & hence economic growth.

The impacts of privatization.

(a). Positive impacts:

- Leads to quick decision making. This is because bureaucracies/red tapes are greatly reduced in the private sector. This results into better service delivery in the economy.
- Increased government revenue. This is attributed to the taxes levied on the incomes & output produced by the private sector. This results into infrastructural development in the economy.
- Leads to improved balance of payments position. This is due to increased production of quality exports products. This leads to increased foreign exchange earnings in the economy.
- Leads to reduced (structural) inflation. This is due to the increased production of goods & service in the economy. This results into improved welfare of the citizens.
- Provision of employment opportunities. This is due to the increased levels of investments ventures/economic activities in the economy. This avails incomes & thus improving the standards of living among the citizens.
- Increased output. This is because of the increased exploitation & utilization of idle resources. This leads to economic growth.
- Widens consumer choices. This is attributed to the production of a variety of goods & services in the economy. This leads to better welfare of the people.
- Increased quality output. This is due to the existence of competition/profit motive in the private sector. This results into improve d standards of living among the citizens.
- Improved efficiency in production/resource allocation. This is attributed to the profit & self-motivated nature of the private sector/the existence of competence in the private sector. This results into better quality products & hence improved welfare of the citizens
- Improved labor skills. This is due to on job training & technological transfer. This leads to increased managerial capacity development.
- Leads to reduced government expenditure. This is through enabling the government to concentrate its spending on the provision of social services to the society e.g. education, medical services, & security etc. This leads to self-reliance/sufficiency.

- Leads to increased levels of investments. This is because e of the existence of foreign direct investments in the economy. This leads to increase output & hence economic growth.

(b). Negative implications:

- Increased consumer exploitation/monopolistic tendencies. This is attributed to private individuals, companies, & or organizations restricting output, & charging high prices for goods & services with the aim of making profits. This leads to poor welfare for the citizens.
- Leads to unemployment. This is due to retrenchment, substitution of labour with machines, & the existence of competition which pushes out inefficient firms. This leads to low incomes & hence poor standards of living.
- Leads to increased foreign control/domination of the economy. This is due to the existence of foreign direct investment & or technological transfer. This undermines national sovereignty in developing countries.
- Leads to irrational exploitation of resources. This is as a result of using capital intensive technology in the production process. This results into environmental degradation.
- Increased income & wealth inequalities. This is due to the concentration of incomes & wealth in the hands of a few private individuals, companies & or organizations, leaving the majority poor. This leads to poor standards of living.
- Leads to increased profit repatriation. This is due to the foreign ownership of most of the privatized public enterprises, & assets/the existence of foreign direct investments. This leads to low capital accumulation/formation. (Capital outflow/fight).
- Leads to wasteful competition. This is through the duplication of goods & services & persuasive advertising/publicity leading to misallocation of resources.
- Difficulties in planning. This is attributed to the fast growing non-responsive private sector in most developing countries where the largest part of the economy is outside the direct control of the respective governments. This leads to the underdevelopment of the developing countries.
- Leads to rural urban migration & its evils. This is due to the concentration of many lucrative business activities mainly in urban areas as most of the better amenities, & socioeconomic infrastructure are in urban areas. This results into decline in production in rural country sides.
- Reduced provision of essential goods & service which are non-profit making. This is because private individuals, companies, & or organizations

aim at venturing into activities in which they maximize profits. This leads to low standards of living.

The challenges/limitations faced in the privatization of public enterprises in Uganda.

- The existence of corruption in the privatization exercise/unit. This is due to the existence of poor record keeping, poor supervision, & lack of transparency over the floated public assets/enterprises. This leads to mismanagement & diverting of funds from the sale of the assets/enterprises. This increases the cost of the privatization process.
- Opposition from the public. This is attributed to the ignorance & general discontent of the public about the benefits of the privatization exercise. This discourages the potential investors from purchasing the floated public assets/enterprises.
- Poor/under valuation of the public assets/enterprises. This is attributed to lack of trained man power with technical & managerial skills to do the valuation of the floated public assets/enterprises. This makes the government to incur losses due to the public assets/enterprises being sold cheaply in case of undervaluation. While over pricing of the floated public enterprises/assets scares away the potential investors. This is due to over valuation of the enterprises.
- Poor state of the public assets/enterprises. This is because most of the floated public enterprises/assets are in a pathetic/dilapidated conditions/states where selling them means incurring costs of rehabilitations & or renovations which eventually increase their monetary values/market prices/selling prices; & hence scaring off the potential buyers/investors.
- Underdeveloped capital markets. This makes it difficult to sell the shares to the public
- The presence of unscrupulous/unserious buyers. This is due to the existence of many untrustworthy/false buyers who fail to meet their obligations of payments. Such buyers forge documents with the aim of manipulating the government for their own benefits. This increases the average costs of the privatization process to the government.
- Small/limited domestic market. This is due to the existence of low incomes/high levels of poverty (arising from high levels of unemployment)

to buy the goods & services produced. This scares away the potential investors from buying the floated public enterprises/assets.

- High cost of the privatization exercise. This is due to advertising/publicizing, sensitizing, etc.*of the floated public enterprise/asset to be sold off. This increases the average costs of the privatization process & the monetary value of the public assets/enterprises. This, therefore, discourages the potential investors from buying the floated public enterprises/assets.
- The prevailing poverty among the citizens. Most of the citizens are poor/unemployed & as such most of the floated public enterprises/assets have been bought by foreigners. This further results into foreign domination of the economy
- The existence of political instabilities in some parts. This is due to the fear of life & destruction of property of potential investors/buyers. This thus discourages & scares away potential investors from buying the floated public assets/enterprises.
- The resentment of the government by the public. This is attributed to the low levels of education, inadequate sensitization of the public, & advertising/publishing of the floated public enterprises/assets. This makes the government in power very unpopular.
- Limited capital. This is attributed to the existence of poverty/low levels of incomes arising from the high levels of unemployment. This discourages potential investors from buying the floated public enterprises/assets.
- Absence of well-developed financial infrastructure (institutions). This is in terms of good development banks, stock exchange markets, investment trusts etc. This makes it difficult for potential investors to raise investment capital in regard to purchasing the floated public enterprises/assets.
- Political sabotage. This is attributed to some individuals, & some members of the opposition who try to discourage, criticize & frustrate the efforts of the government by fighting, discrediting, & blocking the privatization process. This thus discourages & scares away potential investors from purchasing the floated public enterprises/assets.
- Inadequate entrepreneurial, managerial, & technical skills. This is because most of the available resources/labours are ill-trained as a result of the defective education system. This makes it difficult to do accurate valuation of the floated public enterprises/assets.