TOPIC 1: STRUCTURE OF UGANDA'S ECONOMY

What is meant by structure of an economy?

This refers the basic of salient features of an economy. When considering the structure of an economy are put into consideration the following

i. The major or dominant sectors of an economy
ii. The ownership and control of resources
iii. The sex, composition and strength of the sector sin the economy

Features of Uganda's economy

N.B When giving the structure of Uganda's economy (in relation to industrial, agriculture, informal and ex0port sectors) certain words which act as qualifiers/adjectives have to appear in the describing sentence or statement. These qualifiers are words such as mainly; predominantly or dominated by; many; small; high; low; most of…………;

Therefore, to the features are as follows;

- It is predominantly and agricultural economy/it is dominated by the agricultural sector. The greatest share of production for expert and domestic consumption takes place in the agricultural sector.
- It has a small but growing industrial sector. The industrial sector is steadily and slowly growing and expanding with emphasize on processing industries and a few manufacturing industries.
- It is a dual economy. A dual economy is one where there is existence of two contrasting phenomena existing side by side; one being desirable/developed and the other is undesirable/under-developed. For example the subsistence sector or production existing alongside the commercial sector or production.
- It is a mixed economy. Uganda's economy has both the public sector and private sector operating side by side. Production activities are carried out by the government entrepreneurs although the current rend puts emphasizes on expanding the private sector.
- It is an open economy. The country highly depends on foreign trade and participates in other international activities for development.
- It is a highly dependent economy.

1. Uganda relies mainly on agriculture as a sector
2. Uganda also depends on developed countries for decisions and resources for her economic survival. This economic dependence is manifested in the following

- Direct economic dependence. This is the reliance of a country on economic decisions made by foreign counties and international bodies such as IMF and World Bank

- External resource dependence. This is the reliance of a country on foreign factor services like technology, capital and labour skills (expatriates) to supplement its local productive resources.

- Trade dependence. This is the reliance of a country on other countries to provide market for her exports as well as getting imports from specific countries. This type of dependence involves geographical and commodity concentration of trade.

- Sectoral dependence. This is the reliance of a country a specific sector or a few sectors for her survival, for example, Uganda majorly reliance on agriculture sector.

- High levels of unemployment in the country. There is widespread unemployment and under employment. This is due to the abundant supply of unskilled and semi-skilled labour force in the country.

- High population growth rate. As per the 2002 population census, Uganda's population growth rate was at 3.4% per annum. Current projection or estimates puts it at about 3.6% per annum.

- High levels of illiteracy characterized by abundant supply of unskilled labour. This is due to low level of education in Uganda.

- Many firms produce at excess capacity. Many firms produce at less than full capacity due to inadequate technical knowledge and capital.

- It has poor infrastructure/under developed infrastructure. This is reflected in the poor state of roads, poor power supply, inadequate communication facilities etc.

Implications of the structure of Uganda's economy

N.B. We generate the implications from the features. The focus if one what comes out of the structure of the economy of Uganda. Since the structure of Uganda's economy is loop-sided, it obviously generates unfortunate implications and these are;

- Balance of payments deficit/unfavourable balance of payments position. Uganda mainly exports low priced agricultural products with low value added. At the same time it imports expensive manufactured goods and this increase import expenditure. Earnings from exports are lower than import expenditure hence causing a balance of payment deficit.

- Low personal income levels. Due to high levels of unemployment, many people receive low incomes. At the same time, the predominance of agriculture which is done or small scale creates to low incomes in the economy. (Many people are carrying out subsistence agriculture).

- Production of poor quality products. Products produce dint eh informal sector tend to be of low quality due to low value added. This is because the informal sector uses poor methods of production.

- There is under-utilization of resources. This arises from the existence of poor infrastructure. Due to poor infrastructure, some resources are not exploited and this leads to excess capacity.

- Low saving and investment levels. The low incomes earned by people give rise to low savings and finally there are low levels of investment.

- Low levels of government revenue from taxes. This arises from a small industrial sector, high levels of unemployment and a big informal sector which create a narrow tax base in Uganda. Therefore, government gets low (limited) tax revenue.

- Having predominantly unskilled labour. This arises from the high level of illiteracy and as a result many people do not acquire the necessary skills and training needed in the labour market.

- Low levels of technological development. This is caused by technological dualism in Uganda. There is still predominance of rudimentary skills of production because of the conservatism of people and limited capital. Capita is still limited, yet it is necessary to carry out research and development in new techniques of production.

- Low levels of capital accumulation. This arises from a high population growth rate which reduces capital accumulation. Money which would have been saved and invested is being used to cater for the growing population.

- Acute income inequalities arise. Due to high levels of unemployment, many people are not earning income while the few who are employed are earning high incomes. This causes income inequality in Uganda.

- Poor terms of trade, import prices of manufactured goods always rise faster than the export prices of agricultural goods. This gives arise to poor terms of trade in Uganda.

- Foreign domination of economy. This arises from reliance on decisions made by other countries as well as expatriates, foreign technology, capital etc.

- Repatriation of profits by foreign investors. Since the economy is open, there are foreign investors in Uganda. However, such foreign repatriate profits to their mother countries instead of re-investing such profits in Uganda. This has a danger of lowering investment levels in Uganda.

- Low labour productivity. This arises from labour having low skills as a result of high levels of illiteracy among people.
- Low levels of Goods Domestic Product (GDP). Low GDP arises from production at excess capacity where resources remain under-utilized and less goods and services are produced in Uganda.

Questions:

1 a) Describe the structure of the economy of your country

b) Explain where the economic implications that arise from the structure of Uganda's economy

2 a) Suggest measures that can be undertaken to improve Uganda's economy

b) In what ways is your country economically dependent?

The structure of the agricultural sector in Uganda

Explain the structure of the agricultural sector in your country.

The structure of the agricultural sector in less developed countries.

- Mainly on a small scale due to poor land tenure system.
- High dependence on family labour in production
- Basically rural based
- Uses mainly unskilled and semi-skilled labour
- Mainly uses simple/poor/rudimentally technology i.e. mainly labour intensive due to limited research and predominance of subsistence production
- Produces basically low quantity output due to over reliance on natural factors and the use of poor techniques of production
- Production is basically for the local market
- Dominated by subsistence production due to conservatism in rural areas
- Basically dependent on nature
- Narrow range of products for export
- Dominated by foodstuff/narrow range of cash crops
- Produces mainly low quality output because of limited competition n production and use of poor production techniques

Positive implications of such as structure

- Reduces dependence on food imports
- Provides employment opportunity
- Promotes growth of the industrial sector
- Provides market for the output of the industrial sector
- Leads to provision of revenue of the government
- Promotes economic growth
- Promotes development of infrastructure
- Increase foreign exchange earnings due to exportation of products
- Encourages utilization of land resources

Negative implications/demerits of such as structure

- Persistent price fluctuations due to dependence of nature
- Unfavourable balance of payments position hence low foreign exchange earnings due to low value, quantity and variety of exports from the sector.
- Instability in or unfavourable terms of trade due to low value and quality of exports from the sector which are sold at low prices
- Income inequalities are worsened due to subsistence production hence low incomes for people engaged in agriculture
- Susceptible to seasonal unemployment and under-employment due to dependence on nature.
- Limited innovation due to large subsistence sector
- Limited levels of economic growth due to low output levels yet employing large part of the population.
- Low levels of government revenue since agriculture provides a narrow tax base due to low levels of monetization of the sector (i.e. since it is mainly subsistence and organized on a small scale).
- Accelerates or exacerbates economic dependence due to the narrow range of exports from the agricultural sector and as such it contributes less foreign exchange to government. The country has to rely on other countries to fill this foreign exchange gap

- Persistent high poverty levels in Uganda due to subsistence farming
- Limited markets for products due to poor quality products from the sector
- Causes structural inflation due to dependence on nature for production
- Limited technological growth in the sector due to use of simple tools in farming.

Reasons for changing the structure of Uganda's agricultural sector

- To increase productivity/to increase output hence economic growth. This is attained through encouraging agricultural research into better yielding varieties and breeds thereby increasing agriculture output.
- To encourage monetization of the economy. This is because agricultural development encourages commercial production thereby reducing the size of the subsistence sector.
- To generate more employment opportunities and hence check the problem of disguised and seasonal unemployment. This is because undertaking agricultural modernization through irrigation reduces dependence on nature which is a cause of seasonal unemployment.
- To widen the tax base due to expansion of production for the market/to increase revenue to the government/to minimize fluctuations in government revenue. This is through encouraging commercial production that increases government revenue form taxes imposed on large scale firms.
- To increase rural incomes due to increase in the volume of production/to increase producer' sin comes. This is attained through encouraging commercial production that increases producer's incomes thereby minimizing income inequalities.
- To improve terms of trade/to minimize fluctuations in terms of trade. This is achieved through promoting agricultural research that results into production of high quality products that fetch high prices on the world market.
- To accelerate rural transforming/to improve the living condition and livelihood of the rural people. This is through encouraging agricultural modernization that has supportive policies like infrastructural improvement which results in better living conditions in the rural areas.
- To stabilize the balance of payments position. This is through increasing the volume off agricultural exports that increase the foreign exchange earnings of the country.
- To expand the market for industrial output, especially output used as inputs in

the agricultural sector like fertilizers. This is due to the linage effect between industry and agriculture in such a way that agricultural development results into increase in demand for industrial equipment like hoes, slashers, wheel barrows and pangas.

- To increase foreign exchange earnings. This is attained through encouraging agricultural diversification and the use of modern techniques in agricultural production which increase the agricultural output for export hence more foreign exchange earnings.

- To enable effective economic planning based on stable earnings from agriculture exports. This is due to the stabilized earnings expected from agricultural exports.

- To encourage investment in agriculture hence increase utilization of the land resources. This is achieved through reduction of dependence on a few products in the agricultural sector thereby promoting diversification of production.

- To fight/control structural inflation. This is attained through agricultural development and modernization that lead to increase in output hence stabilizing the domestic prices of food items.

- To promote the growth of the industrial sector by ensuring a steady source of raw materials through agricultural diversification

- To ensure food security and ensure a healthy population. This is attained through promotion of agricultural modernization programmes that provide better inputs to farmers hence production of a variety of food items.

a. Describe the features of the agricultural sector in your country.

b. What are the implications of such structure of agricultural sector to your country?

c. Why is necessary to change the structure of the agricultural sector in your country?

The structure of industry in Uganda

Features of the industrial sector in Uganda include:

N.B. When giving the features of the industrial sector in Uganda we include words that serve as qualifiers, for example, most, many, mainly, dominated by etc.

- It is dominated by small scale industries

- It is mainly comprised of processing industries

- Most of the firms in the sector are privately owned i.e. most of the industries are owned and run by private entrepreneurs

- There is use of simple labour intensive technology in most of the firms
- The sector is mainly urban-based
- The sector mainly produces low quality goods
- Many of the industries are agro-based i.e. many industrial firms use agricultural raw materials like tea leaves, cotton, sugarcane, cotton seeds etc
- Industries which produce durable consumer goods are mostly assembling plants. E.g industries that assemble small tractors
- It produces mainly consumer goods e.g. sugar, salt, soap, bread. The industrial sector is made up mainly
- They are mainly import substitutions industries
- The industrial firms mainly produce at excess capacitys
- The sector has high importer draw materials and intermediate product content
- Many firms use unskilled and semi-skilled labour
- It has limited linkages with other sectors of the economy

Effects arising out of the structure of the industrial sector

Positive effects

- Provides more employment opportunities since most small scale firms use labour intensive techniques
- Promotes utilization of the would be idle resources since many of the industries use local inputs in the production process.
- Reduces income inequality since most of the industries are labour intensive and small and small scale industries are owned by many people.
- Reduces external dependence since they are mainly import substituting industries
- Acts as a source of government revenue through taxation of both small scale and large scale industries.
- Contributes to the country’s GNP/GDP due to increase in the volume of output from the industrial operations.

- Reduces size of subsistence sector by encouraging commercial/monetary production.
- Widens variety of goods thus increasing consumer choices due to production of a range of manufactured consumer goods.
- Promotes infrastructural development due to the need to access areas of raw materials and market for the final industrial products
- Promotes market to agricultural products that are used as raw materials in the many agro based industries.
- Small industries act as a basis of research into better technology.

Negative effects

- Low levels of output due to dominance of small industries and operation at excess capacity
- Poor quality output on the market due to use of mainly simple technology
- Gives rise to regional imbalances since industries are mainly urban based
- Contributes low government revenue due to dominance of small scale industries
- Perpetuates Balance Of Payment (B.O.P) problems due to the high content of imported raw materials and low earnings from exports of industrial goods
- Limited levels of economic growth due to small market/excess capacity and use of unskilled labour
- Worsens problems of income inequalities. This is because areas with industries, people access employment and better earnings compared to other economic activities
- Encourages rural-urban migration and its negative effects. This I due to concentration of their activities in urban areas
- Encourages dependence on foreign markets for capital and intermediate goods. This is because the existing industries are mainly production consumer goods
- Leads to excessive protection offered to firms to survive, this is aimed at facilitating the growth of local industries
- Increased capital outflow in form of profit repatriation due to foreigner swooning large scale industries. The foreigners usually import raw materials and repatriate the profits.

- Narrow range of market due to production of poor quality goods. This is due to use of simple methods of production by many firms.

The concept of dualism in Uganda's economy

Dualism refers to the co-existence of two contrasting **socio-economic situations** (phenomena), one being superior and desirable and the other is inferior and undesirable. The tow situations exist side-by-side in an economy.

Forms/types of dualism

- Technological dualism
- Intra-sectoral dualism
- Literacy dualism
- Exchange dualism
- Income dualism
- Regional dualism
- Socio-cultural dualism

Features of dualism:

N.B: The features of dualism are extracted from the general forms of dualism i.e. we consider what makes up a given form of dualism

- Co-existence of modern technology alongside traditional technology. (Co-existence of capital intensive technology alongside labour intensive technology)
- Co-existence of commercial sector and subsistence sector
- Co-existence of literates and illiterates
- Co-existence of barter exchange and monetary exchange
- Co-existence of high income and low income earners (co-existence of the rich and the poor people)
- Co-existence of developed regions alongside under-developed regions
- Co-existence of traditionalists and modernists. For example the co-existence of traditional birth attendants in many rural areas of Uganda and the modern trained mid wives and nurses who work in hospitals, co-existence of tradition worshiping ad modern worshipping that embraces Christianity and Islam, etc

The meaning of **economic dualism**: This is the co-existence of tow contrasting **economic situations** in a country; one being superior and desirable while the other is inferior and undesirable.

The informal sector in Uganda

It is **an inter-mediate sector** which exists between the modern sector and the traditional sector. It is mainly made up of those activities which have slowly developed from the traditional form of production and are slowly being modernized.

Examples of activities/operators under the informal sector include;

i. Cloth tailoring/tailors
ii. Bicycle repairers
iii. Motorcycle mechanics
iv. Small food restaurants
v. Petty traders like hawkers, peddlers, street vendors, market stall vendors, chicken roosters
vi. Small meal welding units/metal scrap fabricators
vii. Small furniture making units and timber sellers etc.

Features/characteristics of an informal sector

1. Production is mainly on **small** scale
2. There is **mainly** use of **poor** or simple technology
3. **Mainly low** quality output is produced
4. It is **mainly** semi or sub-urban based
5. It is characterized by **poor** or no book-keeping/financial records
6. It is **basically**/**mainly** run by sole proprietors
7. It is **dominated** by semi-skilled and unskilled personnel
8. There is use of **basically** local resources
9. It **mainly** produces for the local market

The role/contribution/impact of the informal sector in Uganda's economy

It has both **positive** and **negative** impact and contributions:

The positive impact of the informal sector is as follows

- It creates more employment opportunities
- The informal sector creates jobs for many people since it is labour intensive. The employed people earn income and are able to sustain their livelihood.

- If facilitates the utilization of resources (it improves resources utilization)
- There is use of local raw materials in the informal sector e.g. scrap metals are being put to use, textile materials are being used by tailors to make clothes etc. this reduces resources wastage.
- It provides a cheap training ground for local labour
- As people work in the informal sector, they gradually learn new skills on the job. This leads to the development of local skills in the long run
- There is production of wide variety goods
- There are many activities in the informal sector which result into provision of a variety of goods to the public. This widens consumers' choice hence improving the welfare of the people.
- It promotes innovations and inventions i.e. it promotes technological development. In the long run, better and efficient techniques of production are developed in the informal sector which leads to technological developments
- It promotes entrepreneurial skills. Through the informal sector, people learn how to bear risks and how to organize the available factors of production. This gives them the confidence to invest hence promoting entrepreneurship in the economy
- To some extent, it contributes some revenue to government. The investors in the informal sector pay license fee to the government to be allowed to run their activities in a given area. They license fee to the government to be allowed to run their activities in a given area. They also pay some taxes to the government.
- It enhances fairer distribution of income. As people earn income from the informal sector, the income gap among people involved in other sector sin gradually reduced.
- It promotes commercialization of the economy. The informal sector produces goods which are sold in exchange for money, thereby expanding the commercial sector of the economy. This reduces the subsistence sector in Uganda
- It leads to greater diversification of the economy. This arises from the many activities carried out in the informal sector

- There is production of locally affordable goods. As people are able to afford the goods produced in the informal sector, their standard of living is gradually improved.
- In increases the country's GDP. More goods are produce in the informal sector and this increases the country's nations income/GDP
- There is a production in foreign exchange out flow. The informal sector produces goods that would have been imported, this cuts down on foreign exchange out flow

<u>The negative impact or contribution of the informal sector in Uganda</u>

- It creates congestion in urban or sub urban areas. This breeds rural urban migrations and its associated problems such as high urban crime rate, open-urban unemployment etc
- It has encouraged duplication of services/wasteful competition e.g. many people get involved in one line of activity within the informal sector but they all sere as small market. This creates wasteful competition which financially results into resource wastage.
- It causes public revenue instabilities. The informal sector is not a reliable and significant source of revenue to government since the operators within the sector earn unstable incomes. In addition, the operations in the sector do not keep proper accounting records hence creating difficulties in tax assessment (many operators in the informal sector evade tax payment)
- It hampers the development and maintenance of quality goods and services. This arises from the use of poor techniques of production in the informal sector. Such poor quality commodities are sold at low prices leading to low profits being earned by producers.
- It has given rise to disguised unemployment and under employment.N.B. Disguised unemployment is one where labour force papers to be actively involved at work but its marginal product is either zero or negative. Under employment is a situation where labour/resources are under-utilized.
- It is associated with high administration costs. Operators in the informal sector meet high expense like payment of license fee, high power cots, high transport costs etc and thee operational costs reduce their profits.
- It causes pollution of the environment (for example metal scrap fabricators pollute the environment through poor disposal of metal cuttings. This is common

in place like Katwe and Kisenyi where metal fabrication activities are largely carried out).

Relationship between the informal sector and small scale industries

- The two sectors produce low output since they operate on small scale
- The two sectors mainly use local resources
- The two sector mainly use labour intensive techniques of production
- The two sectors mainly require little capital for establishment and maintenance
- The two sectors mainly produced consumer goods for the local market
- There is low contribution to government revenue by the two sectors
- The two sector are mainly urban to semi urban based
- Private ownership of firms is dominant in the two sectors
- There is limited formal book keeping in the two sectors
- In both sectors, production units operate at excess capacity
- On-job training is a common aspect in both sectors i.e. there is apprenticeship of workers who acquire skills on the job through gradual training by more skilled workers

Questions

1 a) What are the features of the informal sector in your country?

b) Suggest the measures which can be undertaken to improve the performance of the informal sector in Uganda.

2 a) Assess the impact of the informal sector in your country.

b) Explain the impact of the factors that limited the effective operation of the informal sector in your country.

The concept of dependence in Uganda's economy

Meaning of economic dependence

It is a situation in which an economy **relies** either <u>mainly on a specific sector/sectors</u> or on other countries for <u>decisions and resources for her economic survival (development</u>).

1. Direct economic dependence

2. External resource dependence
3. Trade dependence
4. Sectoral dependence

1. **Direct economic dependence**

This involves reliance of an economy on economic and political decisions dictated by other countries or foreign funding bodies. For example some of the recently implemented policies in Uganda like privatization and cost sharing were given to Uganda as conditionality from World Bank and IMF in order for Uganda to get money from such bodies

2. **External resource dependence**

This is where a country relies on foreign factor services such as foreign technology, foreign skills (expatriates) and foreign capital from other countries to supplement her productive resources. The foreign capital is in form of foreign investments and loans secured from other countries.

3. **Trade dependence**

Uganda relies on international trade transaction by exporting primary products to other countries while importing products like petroleum, industrial machines, chemicals, vehicles, military equipment etc from other countries

4. **Sectoral dependence**

This is the reliance of a country on one major sector or a few sectors for her economic survival. In Uganda, there is sector dependence on agriculture.

Demerits/negative implications of economic dependence in Uganda

N.B: No single country in the world desires to be dependent or to rely on other countries for its survival. For that reason, economic dependence is one of the macro-economic problems confronting Uganda's economy. Since it is a **problem** to the economy, it generates **negative implications only/undesirable outcomes** i.e. economic dependence **does not** have the positive side. The negative side of economic dependence is explained below.

- It creates Balance of payments problems. This arises from import dependence which leads to rising expenditure on buying goods from other countries. However, Uganda has low earnings form abroad and this creates balance of payments deficit.

- It encourages laziness (It discourages local initiatives). The country always relies on foreign capital and technology. This skill the initiative to develop our local methods of production and the country continues to rely on other countries for such technology.

- Low volumes of import due to low export earnings. Since earnings from exports are low, Uganda gets difficulties in financing her import expenditure especially importation of vital goods.

- The economy is subjected to inappropriate and undesirable external decisions. Uganda relies on other countries for decisions which may not be desirable to the country e.g. foreign governments may dictate that priority should be given to industries yet hospitals and schools deserve to be given priority in funding. This frustrates the population.

- It accelerates capital out flows/it promotes profit repatriation. Uganda relies on foreign investors who bring in capital and invest in the various sectors of the economy. However, these investors repatriate profits to their mother countries and this slow down development process in Uganda.

- It worsens the external debt burden. This s caused by reliance on external resources in form of loans got from other countries, the World Bank (IBRD) and IMF. These debts accumulate and must be paid back with interest. The country has to sacrifice a lot to pay back these debts by foregoing the development of some sectors.

- It results in to fluctuation of prices of agricultural exports. This arises from dependence on exportation of a few agricultural products whose prices are unstable on the world market. These unstable export prices frustrate the exporters due to fluctuating incomes

- It results into underutilization of natural resources. There is reliance on external resources/goods which render exploitation of natural local resources to be neglected. For example Uganda’s dependence on other countries for importation of oil/petrol may cause underutilization of local oil deposits in western Uganda

- It worsens causes technological unemployment. This arises from reliance on imported capital in form of modern machines which replace manual labour in industries. The number of manual workers is reduced and this brings about technological unemployment.

- Ti breeds political domination of Uganda by foreigners. Direct economic dependence involves adopting political decisions made by foreign countries. This cause loss of political independence in Uganda since major political decision is got from other countries and donor agencies.

- It leads to economic domination of Uganda by foreigners. Foreign countries on which Uganda relies for external resources like technology and skills dictate economic policies such as cost – sharing in public universities and hospitals. Such policies must be implemented to secure external funding hence making Uganda to take on economic policies designed by foreigners.
- It leads to social cultural domination/cultural erosion
- It discourages domestic savings and investment. Since Ugandans is relying on buying goods and services from other countries, the capacity to save and invest is reduced.

Reasons why economic dependence is undesirable in Uganda

- It encourages high capital outflow in form of profit repatriation by foreign investors and the servicing of external debts by the government
- It leads to heavy debt servicing burden on the citizens because of reliance on foreign capital which leads to increase in taxes on citizens to pay back the debts
- It encourage resource underutilization due to the high reliance on foreign resources
- It discourages domestic savings and investments and people continuously expect foreign resources as the engine of economic growth.
- Leads to loss of local initiative and increased laziness among the citizens because they hope to get foreign assistance instead of working heard.
- Stunts local technological development. This is because reliance on foreign technology leads to limited innovations and creativity in the economy
- Leads to economic dominance by foreigners due to increased direct economic dependence where there is high foreign participation in the supply of capital
- Leads to balance of payment problems due to reliance on expensive imported manufactured goods.
- Leads to unfavourable terms of trade due to exportation of limited and poor quality goods
- Compromises political sovereignty because the political decision are influenced by the foreigners
- Leads to price and income instabilities in the foreign sector due to dependence on few primary exports. This affects the import capacity and planning process in the economy.

- Leads to unfavourable preconditions/donor decision. This is because the economy is forced to tolerate some of the undesirable conditionalities of foreign donors like retrenchment and privatization.

Account for the high level of economic dependence in your country

- Poor education system resulting in high levels of unskilled and semi-skilled labour. This encourages high dependence on foreign skilled labour.
- Poor infrastructure. There is high dependence on foreign capital by the government to expand the infrastructure.
- Occurrence of natural hazards resulting in high dependence on relief aid from world food programme and Red Cross.
- Underdeveloped technology. There is use of poor or rudimentary technology resulting into technological dependence.
- Low income. This leads to increased government borrowing and increase in economic dependence so s to overcome the high level of poverty.
- Poor industrial sector leading to dependence and importation of expensive manufactured goods.
- Low entrepreneurial ability. This causes high dependence on foreign investment.
- Low tax base and tax revenue. This leads to high reliance of foreign capital.
- Exportation of a limited variety of products which are basically of poor quality leading to low foreign exchange encouraging and therefore need for foreign resources.
- High population growth rate in the country resulting into low savings and low investment. This call for foreign resource sot improves the welfare of the local people.

Explain the ways of reducing economic dependence in your country.

- Encouraging economic diversification so as to reduce sector all dependence for example development of industry, tourism, banking and the service sector.
- Training of local labour so as to increase labour skills to reduce reliance on foreign skilled labour.
- Promoting and developing of local technology by encouraging innovations and creativity in the economy.
- Improving on the tax base and tax administration so as to increase tax revenue

which limits dependence on foreign capital.

- Controlling population growth rate so as to expand local savings and local investment as opposed to foreign investment.
- Undertaking proper planning by government and allocation of the economic resources to productive activities that can generate more income.
- Fighting against corruption and mismanagement of the limited funds so as to limit dependence on foreign capital.
- Maintaining political stability so as to minimize expenditure on imported military equipment
- Encouraging export promotion so as to increase foreign exchange earnings.
- Improving on the investment climate so as to reduce the cost of production, this can lead to increase in the amount of goods and services produced so that dependence on imported goods is reduced.
- Promoting import substitution industrial development strategy so that the expensive consumer goods formerly imported can be produced locally.

Suggest measures to reduce economic dependence in Uganda

- Diversification of the economy in order to reduce dependence agriculture.
- Promote import substitution strategy of industrialization.
- Training of local labour to reduce dependence of foreign manpower.
- Implement workable import restrictions e.g. total ban, import quotas.
- Provision of investment incentives to local producers.
- Develop local technology.
- Encourage local savings and investment.
- Improve the political climate.
- Carry out proper and effective planning.
- Diversification of markets (in order to reduce dependence on a few export markets).

Question

1 (a) Explain the forms of economic dependence in your country.

(b) Suggest measures that should be taken to reduce economic dependence in your country.

N.B: The meaning of **economic inter-dependence**:

This refers to a situation in which two or more economies rely on each other for mutual benefit of all. This is mainly achieved when countries agree to integrated their economies.

The structure of Uganda's imports and exports: foreign trade sector features of import and export trade in Uganda; a summary

Exports	**Imports**
Exports are mainly primary/agricultural products	Imports are mainly industrial products
Limited variety of exports	Imports are of wide variety
Basically semi-processed or unprocessed products are exported/exports are mainly of low value	Imports are mainly of high value/mainly fully processed
Limited range of markets for exports/exports are mainly to few countries	Imports are mainly from few countries (geographical concentration of trade)
Few manufactured consumer goods are exported	Imports are mainly manufactured consumer and intermediate gods
Exports are mainly of low quality	Imports are mainly of high quality
Few services are exported	Many services are imported
Prices of exports are mainly low and fluctuating	Prices of imports are mainly high and stable
Exports are mainly of low volume/quantity	Imports are mainly of high volume/quantity

Implications of the features of import and export trade in Uganda positive implications

- Foreign exchange earnings. This is got from the export of agricultural products.
- Leads to economic growth. There is widened market for locally produced goods in other countries, this increase output thereby contributing to economic growth

- Promote international friendship and trade (Co-operation). There is improvement in international relations because of the need to import form other countries as well as exporting locally produced goods to other countries

- Leads to utilization of idle resources. This is due to utilization of the land resources to produce more agricultural products for export.

- Provision of revenue to the government. Revenue is generated by the government through taxing some imports and export.

- Provides employment opportunities. there is provision of more employment opportunities in the import and export trade sector for example people involved in clearing goods and forwarding, insurers, transporters)

- Promotes innovations and inventions in order to compete in the global market. The importation of industrial machines leads to transfer of better technology from other countries, this facilitates increased output as well as improving the quality of goods in Uganda.

- Widens consumer choices due to importation of a variety of goods. High variety of goods imported leads to a wide consumer choice for goods and services in the country hence better standard of living.

- Fills the technological gap/resource gap due to importation of intermediate products and capital goods. It encourages technological development and technology transfer because of high importance of capital goods.

- Fills the manpower gap. It supplements the locally available skilled labour due to the importation of high level of foreign skilled manpower.

- Improved quality of output due to competition with high quality imports. The high quality manufactured imports help to improve the standards of living of the citizens

- Increased efficiency of local firms due to competition from better quality imports.

Negative implications

- Leads to poor terms of trade because of exporting mostly poor quality, unprocessed primary products that fetch low prices and importing expensive manufactured goods.

- Leads to unfavourable balance of payments position due to limited variety of exports and high variety of imported goods.

- Vulnerability to foreign domination due to geographical concentration of trade

- Underutilization of some resources due to narrow range of exports
- High level of unemployment due to collapse of local industries as a result of competition from high quality imports
- Dependence on some countries, for example, for markets, supplies etc. it leads to trade dependence where by Uganda relies on a few export markets in the developed counties. The developed countries in most cases dictate prices at which they buy Uganda's exports
- High level of capital/income outflow due to importation of intermediate goods
- Low foreign exchange earnings due to low price, low quality, low quantity and limited variety of exports
- Collapse of local firms due to competition from imports of high quality.
- Leads to income inequality. Falling export prices of agricultural commodities lead to declining incomes of farmers and exporters, this again worsens income inequalities in Uganda.
- Fluctuations in foreign exchange earnings due to fluctuations in prices of exports.

Measures aimed at improving the structure of the import-export trade in Uganda.

- Establishing import substitution industries with a view of creating self-sufficiency and saving the scarce foreign exchange
- Promoting and supporting export promotion industries which produce for the foreign market. Emphasis should be put on those industries that add value to the exports
- Improving the basic infrastructure such as roads and communication network
- Widening of foreign markets through regional economic integrations like COMESA, EA customs union.
- Attaining a stronger bargaining power on the international market. The aim is to get better improving the stabilize incomes from agricultural exports
- Improving the invisible export sector for example, by promoting tourism, export of Hydroelectric Power (H.E.P) and export of insurance services. The aim is to create diversification of export products.

Suggested measures to increase export earnings in Uganda

- Diversify export products. This can be achieved through production of a variety of products for the export market instead of relying on the traditional agricultural products

- Non-traditional products like flowers, horticultural products and vanilla among others can be exported and this can increase export earnings
- Diversify export markets. Uganda should sell her products to a wider market to increase the volume of exports. The government can look for new markets in Asia, Europe and Africa. This can increase the country's export earnings
- Join regional integration to widen market for exports. This can enable Ugandan producers sell off their products in the regional market and earn more revenue from the exports
- Increase volume of exports/produce more for export. Uganda can increase her export earnings through production of more goods for export to other countries. The increase in volume of exports can enable her accumulate more earnings
- Strengthen commodity agreements. Uganda can be an active member in international commodity agreements such as the international coffee agreement. This can enable her bargain for higher/better prices in the international market. This can enable her increase her export earnings.
- Allow the local currency to depreciate. The automatic fall in the value of local currency can increase the volume of exports. This is because the exports can ebb considered to be cheaper on the world market. This can increase export earnings.
- Process primary products to add value. The government can set up agro-based processing industries to add value to exports. This can enable Uganda to sell her products at higher prices abroad. This can lead to increase in export earnings
- Lower costs of production. The government can subsidize local producers so that they are able to produce more products at a minimal cost for sale to foreign markets. This can increase the volume of exports and can also increase the export earnings
- Intensify publicity of Uganda's products in the foreign markets. The government through the Uganda export promotion council and the ministry of trade should embark on a campaign to advertise our products in the foreign market to make them known to foreign buyers. This can increase the volume of goods sold abroad hence increase export earnings.
- Campaign for the removal of trade barriers in export markets such as removal of total ban, quotas, administrative controls etc. the government can negotiate with other trade partners to remove unnecessary restrictions on trade in goods form Uganda. This can increase the s of goods sold by Uganda to foreign markets

hence increase her exports earnings.

- Improve quality of the exports. Exporters can be encouraged to improve on the quality of their products through better sanitary standards, better packaging and better branding. This can enable exporters to sell their goods at higher prices and thus increase export earnings.

Questions

Differentiate between foreign resource dependence and direct economic dependence.

What are the demerits of economic dependence of your country on the More Developed Countries (MDCs)?

Examine the impactof Uganda's import-export sector on the economy.

TOPIC 2: DEVELOPMENT AND UNDERDEVELOPMENT

Development refers to general improvement in social, economic and political aspects of society that is in terms of security social institutions etc.

While

Under development refers to the underutilization of resources in a country.

SUB TOPIC: ECONOMIC GROWTH

Economic growth refers to the persistent/sustained/continuous increase in the quantity of goods and services produced in an economy during a given time.

Or

The study process by which the productive capacity of the economy is increased over time to bring about rising levels of national output and income

DETERMINANTS OF ECONOMIC GROWTH

Factors that determine the rate of economic growth include:-

- Level of technological progress (state of technology). The use of advanced technology creates an increase in output of goods and services which generates high rates of economic growth. However, use of poor technology gives rise to resource underutilization and there is low output of goods and services produced which caused low economic growth rate

- Level of existing capital stock. A large capital stock expands investment and more output of goods and services is produced which causes high economic growth rate while a small capital stock results into low levels of investment hence low output of goods and services which creates low economic growth rates.

- Political climate. A stable political climate gives confidence to both local and foreign investors resulting in increase in the volume to output hence high levels of economic growth. However, political instability scares investors and as a result low output of goods and services is produced which causes low economic growth rate.

- Level of development of infrastructure. Well-developed infrastructure stimulates investment and as a result the volume of goods and services produced increase which leads to high rates of economic growth. However, poor infrastructure discourages investment and reduces the level of output of goods and services thereby leading to low economic growth rate.

- Level of skills of labour. A big size of highly skilled workers is able to promote investment and production of more goods and services which creates a high economic growth rate. However, a small size of a skilled workforce reduces investment and there is low output of goods and services which creates low economic growth rate.

- Level of planning and plan implementation. Proper planning and implementation of projects encourages effective mobilization and allocation of resourceswhich increase the level of production of goods and services thereby leading to high rates of economic growth. However, poor planning and leading to high rates of economic growth. However poor planning and implementation of projects lowers the level of resource exploitation which leads to low productivity hence leading to low rates of economic growth.

- Degree of availability and utilization of natural resources. Greater and better exploitation of available natural resources increases the production of goods and services which creates high economic growth rate while low levels of resource exploitation brings about low volume of goods and services being produced which results into low economic growth rate

- Level of entrepreneurial ability/managerial skills. Better organization of factors of production by entrepreneurs results into better use of the available resources which increase the volume of goods and services produced and hence high economic growth rate is attained. However, limited entrepreneurship skills result into underutilization of resources and there is low output of goods and services and this causes low economic growth rate.

- Cultural factors, for example, conservatism. People with a positive cultural attitude are willing to change to modern methods of production and are able to produce more goods and services leading to high rates of economic growth. However, people with a negative cultural attitude are not willing to change from subsistence production and hence produce low volume of goods and services thereby leading to low economic growth rate

- The market size. A big market size encourages investors to increase production of goods and services which leads to a high rate of economic growth. However, a small /narrow market size discourages investors and results in a low volume of goods and services produced hence low economic growth rate

- Nature of foreign influence. Favorable foreign influence in terms of provision of more grants, donations and direct foreign investment encourages more production of goods and services which leads to high rates of economic growth. However, unfavourable foreign influence in terms of income and profit repatriation, tied aid and increased interference in economic decision making reduces the amount of goods and services produced thereby leading to low rates of economic growth.

- Rate of population growth rate. A stable or controlled population growth rate encourages savings and investment which results in more production of goods and services hence high rates of economic growth. However, a rapid population growth rate creates a heavy dependence burden which discourages saving and investment thereby leading to low rates of economic growth.

- Nature of government policies of taxation and subsidization (Existing government policy on investment and production). Favorable government policy such as provision of tax holidays brings about increased output of goods and services leading to high rates of economic growth. However, unfavourable government policy such as high taxation reduces the volume of gods and services produced due to the high costs of production which creates low economic growth rate.

- Level of monetization of the economy. A large monetary sector acts an incentive for expanding investment and increasing production of goods and services which results into high economic growth rate. However, a small monetary sector does not provide an incentive for increased investment, resources remain underutilized and there is low volume of goods and service spruced which causes a low economic growth rate.

- Level of savings. A high level of savings brings about increased investment and results into production of more goods and services leading to high economic growth rates. However, low savings bring about low levels of investment and less production of goods and services leading to low economic growth rate.

- Existing land tenure system. A favorable land tenure system encourages people to produce more goods and services which bring about high rates of economic growth. However, a poor land tenure system where people do not own land discourages investment and production of goods and services leading to low economic growth rate.

- The degree of corruption. A low level of corruption increase the money and resources available for investment which brings about production of more goods and services resulting into a high economic growth rte. However, high levels of corruption and embezzlement reduces the money available for investment and less goods and services are produced which creates low economic growth rate.

- The prevailing economic situation. Stable price in an economy encourage producers to invest and produce more goods and services which creates high rates of economic growth. However, high rates of inflation discourage investment and less output of goods and services is produced leading to low economic growth rate.

Factors necessary for enhancing the growth of an economy include:-

- Increased technological progress
- High rate of change of natural resource base
- Political stability
- Increased capital accumulation
- High level of entrepreneurial ability or vigor
- Low population and labour force growth rates
- Increased availability of market
- Existence of goods infrastructure for example good rods, schools, hospitals and storage facilities
- Removal of socio-cultural rigidities or hindrances
- Proper planning and implementation
- Favorable foreign influence
- Increased efficiency and quality of the labour force.
- Suggested ways of increasing the level of economic growth in Uganda
- Increase on the level of resource exploitation
- Improve/develop technology
- Equip labor with skills
- Encourage capital accumulation
- Expand local and foreign markets, for example, by joining regional economic co-operation
- Develop infrastructure
- Ensure political stability
- Encourage savings
- Offer investment incentives to local and foreign investors
- Control population growth rate
- Improve entrepreneurship skills

- Diversify the economy
- Modernize agriculture
- Control inflation/stabilize prices
- Liberalize the economy
- Undertake further privatization
- Improve land tenure system/carry out and implement land reforms

Distinguish between economic growth and economic development

Economic growth -is a persist quantitative increase in the goods and services produced in an economy as measured by GNP

Or

It is the persistent quantitative increase in the GDP/GNO of an economy over time

While

Economic development is the persistent quantitative and qualitative increase in the goods and services produced in an economy over time.

This is accompanied with structural changes like improvement in technology, having a more even income distribution, providing basic education etc

Or

Economic development is the quantitative and qualitative increase in the productive capacity of the economy

It involves positive structural changes in the political, social and economic set-up of the country.

Causes of low levels of economic growth rates in developing countries

- Small size of existing stock of capital
- Low level of technological progress/poor production techniques
- Low level of development of infrastructure/poorly developed infrastructures
- Low level of skills of labour
- Small size of the market
- Unfavourable political climate/poor political atmosphere

- High population growth rates
- Large size of the subsistence sector
- Low level of savings
- Low level of accountability
- Limited investment incentives/unfavourable government policy on investment
- Poor attitude towards work (high degree of conservatism)
- Low level of natural resource exploitation/narrow natural resources base
- Low level of entrepreneurial ability
- Poor land tenure system
- High levels of capital cut flow
- High levels of price instability
- Limited diversification of the economy

Implications of low economic growth rate developing economies

- It implies low levels of incomes
- Limited consumer choices due to limited variety of goods
- Underutilization of resources
- High levels of inflation
- Low revenue to the government
- High levels of dependence on imports
- High levels of unemployment
- Low levels of infrastructural development
- Limited labour skills
- Limited entrepreneurial ability
- Low levels of technological development
- High levels of conservatism

- Low levels of monetization of the economy
- Unfavourable Balance Of Payments (BOP) position

Reasons for the desirability of increase in the rate of economic growth

- It widens consumer choices due to production of a variety
- Increase utilization of natural resources
- Promotes price stability/controls inflation
- Increase revenue for government
- Increase employment opportunities
- Promotes infrastructural development
- Leads to increased labour skills
- Increased entrepreneurship ability
- Promotes technological development
- Breaks conservatism
- Monetizes the economy
- Improves the balance of payments position
- Promotes industrialization
- Increase producer incomes
- Leads to reduced dependence on imported consumer goods
- Increase leisure time
- Improve political atmosphere
- Promotes equity in income distribution

Review questions

Why is increase in the rate of economic growth desirable?

Benefits and costs of economic growth (implications of economic growth)

Economic growth has both positive and negative implications

Positive implications (benefits) of economic growth are those desirable things or

advantages which a country gets through the process of economic growth. They are as follows:-

- Creation of more employment opportunities due to increased investment. Economic growth involves expansion of production firms. As more firms are set up, more jobs are created for the people. The employed people earn income which is used to buy their necessities.

- Improved standard of living due to availability of a variety of goods and services. This arises because people are exposed to a variety of goods and services and they are able to make wider choices.

- Increased government revenue from taxes. The size of investment activities increase, such activities widen the tax base in the country leading to higher tax revenue for the government which it uses to finance its development programmes.

- Encourages the development or expansion of basic infrastructure. As more goods andservices are produced, there is need to improve the infrastructure in form of roads, communication facilities and storage facilities to support production improved/better balance of payments position due to increased exports and reduced imports. Through economic growth, export promotion industries are developed to increase the volume of exports and export earnings.

- At the same time, import substitution industries are set up to produce those goods and services that a country would previously have imported from other countries. This helps to reduce expenditure on imports while increasing exports revenue hence better Balance Of Payments (BOP) position

- Promotes political stability. As the rate of economic growth rises, the population becomes contented and this creates a peaceful atmosphere in the country

- Reduced income inequalities due to widespread employment opportunities. As a result of increased production of goods and services in the various sectors, there is better distribution of income among the producers and people involved in the various activities. This checks income inequality.

- Increased humanitarian activities. The increased income generated from the greater volume of output on market promotes a spirit of humanitarianism among the rich.

- Encourages the development of skills. Business firms train workers to acquire better and new skills for example, they are equipped with skills of operating modern machines. This enables workers to become more efficient.

- Facilitates promotion of industrialization. Investment in industries raises in order to increase production of industrial goods. Industrial centres develop due to localization of industries hence there is increased urbanization and its associated benefits.

- Increased enjoyment of leisure. This is because many leisure activities like sports and entertainment develop at a faster rate.
- Social transformation due to the removal of obstacles to growth. As the rate of economic growth rises, people become more progressive and tend to adopt new ways of doing things, that is, they become less conservative.
- Promotes price stability due to increased output. Increased output of goods and service causes a fall in the general price levels and a decrease in the cost of living. This helps to reduce scarcity inflation.
- Reduced external dependence. There is reduced dependence on imported goods because of increased domestic production.
- Encourages optimum exploitation and utilization of resources. Since output is being increased, resources that would have remained idle are put to use. This reduces excess capacity. For example mineral resources are exploited to get raw materials to be used in the production of industrial products.
- Improved technology/promotes innovations and inventions. In order to continue producing more volumes of goods and services, existing techniques of production are improved through research. This brings abut technological progress and production of output of high quality.

Negative implications (costs) of growth

Costs of growth refer to the undesirable or bad or negative outcomes that are generated as a country attains higher rates of economic growth.

They thus include;-

- Increased environmental pollution of noise, air and water/increased environmental degradation. As the economy grows, industrial activities also expand. This creates irrational disposal of industrial waste that gives rise to air and water pollution and reclaiming swamps to set up industries hence endangering the environment.
- Results into congestion. This I due to increased urbanization which increase the congestion of people and traffic in the towns.
- Causes over exploitation of resources leading to resource depletion. Non-renewable resources like minerals get depleted through over-exploitation. This over use creates scarcity of these non-renewable resources.

- High level of industrial hazards or occupational hazards. The increase in the pace of economic activities results into accidents and occupational diseases like influence, common cold and tuberculosis.

- Causes problems of rural-urban migration and the negative effects. Since many economic activities are urban based, people are attracted to move to urban areas/centres in search of jobs hence creating social evils such as crime rate and slums.

- Widens inequality in distribution of income. This happens when rapid economic growth is taking place in a few sectors while other sectors are stagnant. This creates uneven distribution of income among the various sectors since they are not expanding at the same pace.

- Leisure is foregone since economic growth requires hard work. People exert a lot of effort in production activities and even forego leisure in order to increase the volume of goods and services in the country. Un fortunately, this over-working reduces the quality of life of the people.

- Leads to technological unemployment due to technological progress. This is created by the use of capital intensive techniques of production where machines replace manual labour hence rendering some people jobless.

- Leads to erosion of socio-cultural values (there is cultural decay/ leads to deterioration in cultural values). As a country economically grows, people adopt new ways of life since they get used to new goods and services. For example due to new television technology and the internet, young people are exposed to programmes like Big Brother Africa and other immoral literature which corrupts their minds.

- Current consumption is sacrificed for future investment. Business people sacrifice of suspend current consumption in order to save for future investment. This has a danger of reducing the current welfare of the people since they are doing away with certain goods at the present.

- Worsens the debt burden and hence leading to increased external dependence. This is due to increased borrowing in order to sustain the existing rate of economic growth.

- Profit or resource repatriation where investments are foreign owned. Economic growth may arise from production of more commodities by foreign investors. Foreign investors repatriate profits to their mother countries hence reducing investment multiplier effects in the host country.

- There is displacement of people from their land in a drive to set up industries and to create space for large scale farming.

Rostow's stages of economic growth

Brief describe Rostow's stages of economic growth.

Professor W WRostow in 1961 explained the path of economic growth in a historicalperspective and classified societies according to their different levels of economic growth.

Rostow divides the economic growth process in five stages namely:

- The traditional society.
- The pre-conditions to take off.
- The take-off.
- The drive to maturity.
- The age of high mass consumption.

Traditional stage (primitive society)

According to Rostow's, this is the first stage in the economics growth process whereby the economy is in a pre-industrial stage. The economy is completely stationary or stagnant at the subsistence level with no or minimal surplus. It is characterized by:

- Existence of a large subsistence sector/dominance of subsistence agriculture sector where production is for own consumption.
- Hierarchial social structure in which family and clan connections play a dominant role.
- Political power is concentrated in the hands of the landed aristocracy.
- No or low savings, what is called savings is merely postponed consumption.
- High degree of super stitution and taboos
- Very high degrees of illiteracy and ignorance.
- Closed economy with no participation in foreign trade
- Use of poor techniques of production
- Low levels of monetization/ barter system of exchange
- Low level of economic activities as there is hardly any investment
- Very low labour skills

- Low levels of entrepreneurship
- Very low incomes/ high levels of poverty.

Pre-conditions to take-off stage

- This stage brings the society in the process of transition. It is a period when necessary conditions for development are established. It is characterized by:
- Existence of dualism, that is the economy develops two sectors namely the agriculture and industrial sectors but the agriculture sector dominates and the industrial sector is small and uses labour intensive techniques.
- Foreign trade emerges, that is, involvement in foreign transactions
- Removal of obstacles with hinder economic growth. Society breaks the ties of traditionalism sector is small and uses labour intensive techniques.
- Beginning of the application of modern science to agriculture, that is, adoption of better and efficient methods of production.
- Radical development of various sectors.
- Improvement of the social and economic infrastructure
- Presence of investors/ entrepreneurs who are prepared to give financial support to new ideas.
- Reduction of illiteracy rate as there is increased investment in formal education.
- Industrialization begins to take root
- Increase in saving constituting 5% of National income or Gross Domestic product.
- Increase in investment constituting 5% of National income or Gross Domestic Product.

Take-off stage

This is the 3rd stage of development according to Professor W.W. Rostow when a society becomes self-reliant or self-sustaining and therefore experiences a breakthrough in the vicious cycle of poverty.

It is characterized by:

- High level of employment
- High investment 10-15% of GDP or National income

- High savings 10-15% of GDP or National income
- Self-sustained growth or self-reliant economy
- Emergence of new political and economic institutions.
- High level of industrialization i.e. a leading sector appears.
- Emergence of new markets both domestic and foreign
- High level of urbanization
- High level of technology
- High literacy rates leading to social transformation
- High levels of infrastructural development.

Drive to maturity stage (pre-maturity stage)

This is the fourth stage of economic growth according to Rostow and is the stage between take off and maturity. It is basically a long period of continued progress. It is characterized by:

- Very high level of investment 15-20% of GPD
- Very high level of savings 15-20% of GPD
- Very high level of industrialization. This is reflected in the heavy manufacturing industries such as iron and steel, building of aircrafts and ships
- Very high level of employment
- Use of highly specialized or professional labour
- High level of bureaucracy or growth in administration
- High levels of technology
- Very high levels of urbanization
- Very high levels of infrastructural development
- High levels of monetization
- The economy is self-sustaining
- Production shifts from capital to durable consumer goods.

Age of high mass consumption

This is the fifth and last stage according to Rostow. It is the longest stage of economic growth and Rostow considers that it took the United States of America (USA) about 100 years to move from the fourth to the fifth stage. It is characterized by:

- Heavy industrialization
- Very high figures of Gross National product (GNP)
- An affluent population that is highly skilled and contented
- Massive mechanisation, that is, there is further expansion of modern technology in all activities.
- Mass production of sophiscated consumer goods.
- Resources become fully utilized and the economy becomes fully develop
- Hours of work are reduced and a high proportion of the labourforce is engaged in the service industry

N.B.Giving reasons, suggest the Rostowain stage at which Uganda's current level of development is.

Uganda is at the pre-conditions for take-off stage because of the following reasons.

- Growth of the manufacturing sector as a leading sector
- Rising rates of savings and investment
- Removal of institutional framework that hinders development such as conservatism and foreign exchange bottlenecks
- Steady growth process with the economic growth rate ranging between 5-7%
- Improvement in the development of infrastructure
- Mechanisation and modernization of the agricultural sector leading to increased productivity
- Development in foreign transactions
- General improvement in life life expectancy or living conditions
- Improved technology
- Improved entrepreneurial class
- Improved formal education such as universal primary and secondary education.

Limitation of the rotowian take-off theory

What are the limitations of the Rostowian take-off theory?

- It assumes that capital accumulation is the only engine of economic growth, which is not true since there are other factors such as skills, markets and technology
- It is difficult to demarcate one stage of growth from the other for example the 4th and 5th stages
- High level of savings may not necessary lead to economic growth as assumed by the take-off theory
- It does not consider the nature of distribution of income
- He assumed continuity in the road to development yet there could be discontinuity (delays o decline) in economic growth
- It does not consider external factors which affect economic performance for example foreign aid.
- Resources are not homogeneous in all countries or societies
- Some stages may not be necessary. Some economics skip some stages in their development process.

Sub-topic: economic development

Economic development

This is **the quantitative increase and qualitative improvement in the volume of goods and serviceproduced** in an economy **over a long period of time**. It is accompanied by **structural transformation** that leads to improvements in the variable that increase welfare for example increased freedoms of choice, increased self-esteem and increased political freedom.

For a country to attain economic development, it must attain economic growth which must be followed by improvement in the quality of goods and services.

Economic development is **a continuousprocess covering a long period of time and may bring about the following structural positive changes in the political, social and economic set up of a country:**

- Cultural changes that lead to new methods of production and bring about changes in the people's ways of life.
- Social changes that lead to better distribution of the country's wealth and facilitate a fairer distribution of essential goods and resources.

- Economic transformation that leads to the creation of policies and activities which generate higher incomes and improve people's standards of living.
- Educational reforms that lead to a shift in the occupational structure of the labour force.
- Political revolutions that often lead to radical changes in political institutions and the administrative structure with the aim of giving greater opportunities to the masses in the decision making process.

Features/characteristics of economic development

- Reduced economic dependence
- Political stability.
- High level of infrastructural development.
- Reduced level of illiteracy/ increased literacy levels.
- Improved technology.
- Reduced cultural rigidities (there is social transformation)
- Expansion of the manufacturing sector.
- Expansion of the monetary production /reduction in subsistence sector.
- Creation of more employment opportunities.

Objectives of economic development in Uganda:

In this case we consider the projected aims of the government as it strives to attain higher levels of economic development. We focus on how that objective is attained.

1. To reduce external dependence. This objective is attained through promoting local industries so that the country reduces dependence on imported goods.
2. To attain price stability. This objective is achieved by regulating money supply as well as increasing domestic production of goods and services in order to check inflation arising from scarcity of commodities.
3. To reduce unemployment in the economy. This objective is attained by putting in place measures to promote investment. Due the expansion in investment, more jobs are created for the people.
4. To attain a fairer distribution of income/ to check income inequality. The government strives to achieve this objective by implementing policies like progressive taxation, supporting projects for the disabled people and so on. The

aim of this is to reduce the income gap among the population.

5. To attain higher economic growth rate. This objective is achieved by promoting investment in the major sectors in the country so that more goods and services are produced. This helps to increase the rate of economic growth.
6. To improve the standard of living of the people. This is attained by encouraging people to engage in income generating projects like commercial fanning and small scale industries. Such projects enable people to earn income and they lead a better standard of living.
7. To improve the skills of Ugandans through training. To achieve this objective, government is carrying out educational reforms in secondary schools and tertiary institutions. Emphasis is being put on giving people practical skills that can enable them to create jobs in future.
8. To improve on the Balance of Payments position. This objective is attained by expanding the export sector to increase export earnings. At the same time, efforts are made to reduce expenditure on imports by supporting import-substitution industries.
9. To consolidate security of life and property. The government achieves this objective by strengthening security organs of the state (the army, Police e.t.c) so that a conducive environment for investment is created. By maintaining security, the government is able to improve the quality of life of the people.
10. To control the population growth rate to desirable levels. This objective can be achieved by encouraging the use of birth control methods. The aim is to reduce dependency burden in the country so that saving and investment is promoted.

A development goal:

A Development goal refers to those intended economic growth and development

targets which a country aims at achieving in a given period of time.

OrIs a preset target or objective of development that has to be achieved by an

economy during a given time.

OrTargets relating to improvements in citizens socio-economic welfare that an

economy aspires to achieve during a given time.

OrTargets or objectives social, economic or political to be achieved in a specific period of time.

These development goals are always stated in the major government policy statements such as Long term development plans, National Budgets, Ministerial

Policy statements and so on. The National development goals are closely linked or related to the Millennium Development Goals (MDGs).

The major development goals in Uganda are as follows:

- Reducing economic dependence.
- Reducing unemployment.
- Reducing income inequality.
- Attaining price stability.
- Attaining high rates of economic growth and development.
- Controlling population growth rate.
- Improving Balance of payments position.
- Eradicating illiteracy or improving labour skills.
- Providing security for life and property.
- Providing better health care services to the people.

Factors that influence the choice of development goals

Factors that Influence the choice of development goals in my country include;

- The natural resource(s) base.
- The political system / ideology of the ruling class.
- The price level / the rate of inflation.
- The level of development of infrastructures.
- The labour skills.
- The political atmosphere.
- The techniques of production.
- The size of the available funds.
- The level of dependence on external resources.

- The size of the subsistence sector.
- The entrepreneurial competence/ ability / skills.
- The balance of payments position.
- The population size, structure and growth rate.

Circumstances where economic growth is attained but it is not accompanied by a corresponding rate of economic development

It is possible for a country to economically grow without necessarily attaining economic development. This due to the following circumstances or conditions:

- When there is unequal distribution of income. More commodities may have been produced in a country but the majority of people are earning low. incomes and their quality of life is poor. This means that the aspect of economic development is lacking although there is economic growth reflected in more quantities of goods in a country.
- When the quality of goods and services is poor. A country may be producing more commodities whose quality is poor. It is true there is economic growth but the aspect of development is lacking.
- When there is high level of unemployment in an economy. Individuals who are jobless enjoy limited variety of commodities and they lead a poor standard of living despite the high economic growth rate reflected in more volumes of commodities produced.
- When there is political instability in the country. More goods and services may have been produced yet a country is experiencing political turmoil in some areas. The political instability lowers the quality of life of the people (e.g some people live if refugee camps). This makes a country to attain economic growth without achieving economic growth.
- When there is high rate of inflation in the country. More goods and services may have been produced yet the country is experiencing high inflation rate. High rate of inflation increases the cost of living leading to a low standard of living of the people. This makes a country to attain economic growth without attaining economic development.
- When people in an economy are being over-worked and they have little time for leisure. A country may be producing more commodities and it attains economic growth but the majority of the people are being over-worked and they have little time for leisure activities. As people forego leisure, their quality of life becomes poor despite the high economic growth rate.

- When there are social costs like pollution. Pollution of the environment due to industrial activities reduces the quality of life of the people much as more commodities are being produced. This makes a country to attain economic growth without achieving economic development.

- When heavy direct taxes are being levied by the government. Country may be producing more goods and services yet the government is levying heavy direct taxes on incomes of the people. This reduces disposable incomes of people and their quality of life is reduced (they lead a low standard of living). Economic growth is attained without economic development.

- When there are no improvements in the techniques of production used by producers. This causes production of low quality goods and services which results into low economic development despite the increase in the volume of commodities produced in the country (high Economic growth rate).

- When there is a considerable degree of conservatism among people. Economic growth may be attained but the majority of the people are not ready adopting new ways of doing things. Since people are not ready to change their cultural attitudes, their welfare remains poor despite the production of more goods and services.

- When the country is producing more capital goods than consumer goods. The production of more capital goods increases economic growth yet these goods do not directly improve people's standard of living as the case is for the consumer goods. Hence a country attains economic growth without achieving economic development.

Circumstances under which economic growth may lead to economic development

Question: Under what circumstances may economic growth lead to economic development?

- When incomes are evenly distributed.

- When there is a reduction in the social costs.

- When there is improvement in the quality of life of the people.

- When economic growth does not lead to excessive hard work and deprive people of leisure.

- When there is improvement in the quality of goods and services produced.

- When economic growth results from increased production of consumer goods and not capital goods.

- When there is increased expenditure on productive ventures or sectors.
- When there is security or stable political atmosphere in the country.
- When there is structural transformation of the society.
- When there is no inflation in the country.
- When there is a low rate of direct taxation.

Revision Questions

a. **Explain the contribution of private foreign investment in your country.**

b. **Examine the factors limiting the operations of private foreign investment in your country.**

a. **Explain the objectives of development.**

b. **Explain the factors responsible for the low level of development in your country.**

a. **Explain why education is regarded as an investment.**

b. **Examine therole of education in development of your country**.

Theories on sectoral priorities

These theories are about the choice of the sector to begin with if economic growth is to be achieved. These theories include:

1. **Balanced growth theory of economic growth**
2. **Unbalanced growth theories of economic growth**
3. **Big push theoryeconomic growth**

Balanced growth strategy (Propounded or advanced by Ragnar Nurkes)

Definition: This is a growth strategy (theory) which emphasises harmonious and simultaneous development of all sectors in an economy so that they complement each other and grow more or less at the same pace.

The strategy is aimed at creating inter-dependence among all sectors to ensure vibrant linkages. It also emphasises development of all the sectors at the same time. To achieve this strategy, there is need for an economy to have a critical minimum effort.

Meaning of Critical minimum effort.

This is the **minimum investment or sacrifice** which is required to attain or raise massive capital stock **necessary for an economy to take off.**

Advantages/merits of Balanced Growth Strategy (Positive implications)

- It results into increased National income figures and accelerated economic growth. The strategy increases the volume of goods and services provided in the various sectors. This increases the national income of a country leading to higher rates of economic growth and higher income per capita.

- Promotion of inter-sectoral linkages in an economy. Through this strategy, the sectors become interdependent. For example, linkages are developed between agriculture and industry. Agriculture provides raw materials to industries and at the same time, industries provide inputs for the agricultural sector. These linkages result into an integrated and self- sustaining economy.

- It encourages the training of various labour skills, which increases labour efficiency in the long run. Different sectors require different specialised workers who are trained in specific fields like engineering, accounting, business management etc. This specialised training of workers leads to greater efficiency of the labour force.

- It helps to widen the country's tax base. Sectors like agriculture, tourism, transport, communication, and manufacturing industry among others are being developed simultaneously. This results into a wide range of activities on which taxes are levied. This leads to greater tax revenue to the government. The tax revenue is channelled into financing development programmes.

- It reduces the problem of balance of payment deficit. This is achieved where the strategy leads to an increase in export earnings while at the same time there is a significant reduction in import expenditure especially when the strategy is combining development of export promotion industries and import substitution industries.

- More employment opportunities are created. Many jobs are created because many sectors are being development at the same time. Therefore, investment projects are set up. Such projects create more jobs which provide employment income to the people that is used to sustain their welfare.

- It promotes infrastructural development. Simultaneous investment in various sectors is always developed followed by a developed network of infrastructure in form of better roads, improved communication facilities, insurance services,

- banking services, etc. This developed infrastructure promotes further investment in the economy.

- It reduces dependence on other economies or dependence on one sector. The simultaneous investment in all sectors enables a country to reduce dependence on specific sectors. This is because different sectors are being development at the same time under the strategy. Therefore, a decline in one sector does not greatly affect the entire economy / sector.

- There is better utilisation of resources. When sectors are developed, the investors put to use many resources that would otherwise have remained idle. This reduces resource wastage in an economy. For example the industrial sector utilizes raw materials produced from the agricultural sector

- Promotes technological development. The strategy leads to the development of better methods of production to be used in the various sectors of the economy e.g. the use of machines in production greatly improves the quality of goods being produced, (such products /goods become more competitive in the market)

- A variety of goods is produced hence widening the choice of consumers. This exposure to a variety of goods and services is likely to improve people's standard of living. This leads to improved quality of life for the people in an economy.

- Regional balance in development is promoted. This is attained when the strategy focuses on the development of the urban sector and the rural sector. This ultimately leads to desired regional balance as far as distribution of economic benefits is concerned. It also checks rural - urban migration and its associated evils like open urban unemployment, increased crime rate in urban areas, emergence of slums and so on.

Demerits / disadvantages of Balanced Growth Strategy (negative implications)

It necessitates borrowing especially in developing countries, which results into external debtburden. The country may be forced to borrow from other countries to finance development of all sectors in an economy. However, this borrowing worsens the external debt burden and its associated problems. It also exposes an economy to external resource dependence.

- The strategy leads to resource depletion. This arises when there is over ambitious planning in all sectors. This results into over exploitation of the available resources in order to attain higher levels of economic growth in a short period of time. This gives rise to quick resource depletion.

- The strategy is expensive and costly to the economy. The government must meet massive expenditure to sustain the strategy. The government has to spend highly to develop all the sectors at once. The high expenditure leads to budgetary deficits in an economy.

- Wastage is likely to occur because of limited market. Investment in all sectors leads to massive production, which may not be followed up by an expansion in the market. The output is not taken up by the available market. There is wastage which even discourages further investment.

- Heavy losses occur because of project failure. The sectors are always inter¬dependent. Therefore, a failure in one sector leads to failure in other sectors as well. This results into losses to the government and the investors in an economy there by retarding the pace of economic growth.

- It results into inflationary situations in the short run. The strategy involves massive expenditure to develop all sectors of an economy. This increases money supply in an economy, which results into high prices. (This occurs where there is no substantial increase in the volume of goods and services, yet the volume of money in circulation is increased tremendously.)

- It strains Government planning machinery. The Government planning unit or department is burdened to plan for all sectors in the economy. This is not very easy in developing countries where statistical data about the economy is limited or inadequate. Planning for many sectors is made difficult and it strains the planners.

- It is likely to bring about dependence on the external economies. In some cases, the available local resources are not sufficient to develop / support development in all sectors of the economy. This forces the economy to depend on external resources like capital and technology in order to maintain the balanced growth strategy.

Limitations of the balanced growth strategy

N.B. We consider frictional factors / constraining factors/ hindrances to the strategy. We focus on those factors that **slow down** or **limit** the successful implementation of the strategy. Hence the limitations are different from the disadvantages. The limitations are as follows:

- Limited capital to invest in all sectors. The strategy requires massive investment in all economic sectors. However, this is limited by inadequate capital. Due to limited capital, the sectors are not fully financed to cater for their investment priorities. The sectors develop at a slow rate which limits the success of the strategy in developing countries.

- Limited entrepreneurship. In developing countries, there is limited supply of people with the necessary abilities to organise and co-ordinate factors of production. The shortage of vibrant entrepreneurs limits the adoption of the balanced growth strategy because there is inefficiency in the way factors of production are organised.

- Limited / inadequate market. A narrow market discourages further investment in an economy. Producers in the various sectors do not get the incentive to produce for a small market. Producers get frustrated hence limiting the success of the strategy.

- Poor infrastructure. Poor road network and communication facilities limit the growth of sectors. Where the road network is poor, it is difficult to transport the necessary inputs and finished goods from one place to another. This limits investment hence slowing down the implementation of the balanced growth strategy.

- Poor or uncoordinated planning. Balanced growth strategy calls for harmonious planning in all sectors. However, in developing countries, there is inadequate data on the economy. Therefore, co-ordination among the sectors of the economy becomes difficult hence limiting the strategy.

- Limited skilled labour. In developing countries, there is a shortage of highly trained labour to be used or employed in all sectors of the economy to make them develop at the same pace. Therefore where skilled labour is inadequate, the balanced growth strategy is slowed down.

- Weak inter-sectoral linkages. Linkages between the major sectors are always weak and under developed for example the agricultural sector may have weak linkages with the industrial sector. Hence development of one sector may not lead to the development of other sectors. This always slows down the balanced growth strategy because some sectors are lagging behind.

- Limited Government control over economy. Where the private sector is big, the government finds it difficult to have a direct control of all sectors of the economy. Therefore, implementing the balanced growth strategy becomes hard if the government controls only a small part of the national economy and hence cannot mobilise all the huge resources required..

- Poor investment climate. The high taxes levied on firms increase the cost of doing business in the country hence limiting the successive development of all sectors of the economy.

- Political instability. There is political instability/insecurity in some areas which makes investment risky and uncertain. Investors are discouraged from engaging in economic activities. Therefore, it becomes difficult to develop all the sectors at the same pace in a state of political instability.

Question

a. What are the basic requirements for a successful balanced growth strategy?

b. Assess the implications of the balanced growth strategy in developing countries.

c. What are the limitations of the balanced growth strategy?

Unbalanced growth strategy.

(Advanced by: **Professor Albert Hirschman)**

Meaning:

It is a strategy which advocates for the development of a few leading (strategic) sectors of the economy first and others develop later through linkages. Or

Unbalanced growth theory as propounded by Albert O. Hirschman advocates for investment in one or few key sectors of the economy that would ultimately lead to growth of other sectors through linkages.

Therefore, the key or leading sectors with strategic importance are selected and expanded so that they pull up or develop other sectors through linkages e.g by first investing in agriculture so that it becomes a base for producing the raw materials needed in the Agro- based industries.

Merits of the unbalanced growth strategy.

- It requires little resources to be developed. This means the meagre resources and be invested on the leading sectors first. It is also easier and cheaper to develop one or few sectors in case resources are limited.
- It is easier to co-ordinate, control and manage. Since one or a few sectors are handled at a time, it is easier for the economic planners to identify the investment needs of these sectors. Plan formulation and implementation is made easier.
- It promotes use of local resources. The strategy basically relies on the locally available resources unlike the balanced growth strategy that requires borrowing from abroad. Therefore, there is less dependence on foreign resources where the unbalanced strategy is being adopted.
- It encourages specialisation and its advantages. The key sectors are given priority and that is where there is greater specialisation. This increased specialisation enables producers to produce greater quantities of goods and services in the leading sectors and this leads to economic growth.
- It suits developing countries with limited market. Since developing countries have limited markets it is better to concentrate on the leading sectors first where market for such goods and services is available.
- It suits the limited technology of developing countries. Developing countries have limited technology and this can be adequately devoted to the key sectors other than catering for all sectors of the economy.
- It promotes back ward and forward linkages in the economy. Such linkages increase investment and more goods and services are produced.

- It suits developing countries with limited skilled labour. In this case, the limited skilled labour is only channeled and employed in strategic sectors, which can generate linkages with other sectors.

- It suits developing countries with poor infrastructures. In countries where infrastructure is not well developed to serve all sectors, it becomes better to embark on the unbalanced growth strategy instead of the balanced Growth strategy. The few sectors can still be sustained even with the underdeveloped infrastructure.

Arguments against the unbalanced growth strategy/ Negative impact/ demerits

- Some economists have advanced arguments against the unbalanced growth strategy and they include the following:

- It emphasizes specialization in key sectors but this is associated with some shortcomings like fluctuation of prices and unexpended fall in demand for products from the leading sectors.

- Under utilisation of resources is likely to occur since few sectors are being given priority. Resources are not channeled to the less priority sectors. This leads to excess capacity in the economy.

- The strategy leads to unbalanced regional development. This regional imbalance is associated with rural- urban migration which breeds social evils like high crime rate in the urban centres.

- It is likely to promote economic dualism i.e there is sectoral dualism where the developed and underdeveloped sectors exist in the economy. The under developed sectors are always undesirable in the economy.

- The strategy does not contribute significantly to employment creation in the economy. This is because few sectors are employing factors of production like labour. The few strategic sectors create less employment opportunities in an economy.

- The key / leading sectors may fail to stimulate forward and backward linkages in an economy. The strategic sector may develop but does not necessarily create the desired linkages to pull other sectors in an economy. This leads to economic stagnation.

- It is likely to cause income inequality in an economy. People employed or engaged in the leading sectors receive higher incomes than those working in the under -developed sectors.

- The strategy creates a narrow tax base within an economy. Few economic activities are being emphasized in the leading sectors and a narrow tax base is created.

- The strategy does not encourage the expansion of markets. Only the leading sectors are being encouraged and the markets are less likely to expand as compared to the balanced growth strategy.
- The leading sectors may produce less volume of goods and services. This leads to low levels of economic growth and low per capita income when the unbalanced growth strategy is implemented.

Qn**. Give and explain the reasons why the unbalanced growth strategy may not be appropriate for developing countries. Limitations of the unbalanced strategy**

- Political instability. The poor political climate scares away potential investors in the key sector for fear of losing their lives and property.
- Poor / weak planning machinery. There is failure to identify the strategic sectors.
- Limited supply of raw materials/ natural resources.
- Poor infrastructure to support the key sectors. The poor infrastructure hinders easy transportation of raw materials and finished products of the key sector.
- Limited forward and backward linkages in the economy, This makes it difficult to identify the key sector that can lead to the development of other sectors.
- Poor technology. The poor methods of production in developing countries discourage investors because of the high costs of production associated with it which prevents them from maximizing profits.
- Poor investment climate in form of absence of investment incentives in some sectors and heavy taxation among others discourages investors because of the high costs of production which prevent them from maximising profit.
- Limited capital stock. The limited capital in developing countries may not allow the creation of strategic imbalances in the economy which spurs economic growth.
- Poor land tenure system. The poor land tenure system hinders investors from accessing enough land required to establish the key sector.
- Limited skilled labour. Developing countries do not have the necessary skills to identify the leading sector, manage the leading sector and prompt the development of lagging sectors.

The big push theory. (Advanced by**: Paul Rodan Rosenstein)**

The theory states that, for a backward economy to take- off into self-sustained growth, a massive or heavy investment programme in industries and economic infrastructure is required.

Therefore, it is a strategy that calls for heavy investment in the industrial sector and economic infrastructure so as to attain self-sustained economic growth. This development theory also emphasizes having a critical minimum effort of the balanced growth strategy.

Advantages of the big push theory

- Acts as a wider source of government revenue through taxation of various industries.
- Creates more employment opportunities in the long run. This is because it encourages the setting up of labour intensive industries that are employment creating.
- Encourages diversification. The emphasis on setting up industries producing a variety of goods creates a diversified economic base necessary for the development of the country.
- Widens market due to linkages. The setting up of many industries creates market for the other sectors products in the economy for example agricultural raw materials.
- Encourages increased output. The massive investment in many industries leads to increased production of goods and services resulting in accelerated economic growth.
- Promotes the development of socio-economic infrastructure for example roads, power plants and banks. This is because of the need to set infrastructure to support the massive investment in many industries.
- Encourages the acquisition of skills through training. The heavy investment in many industries acts as a training ground for labour and helps in development.
- Reduces economic dependence. The development of many industries results into a self-sustaining national economy.
- Leads to increased foreign exchange earnings because of increased exportation of industrial output. This results into improved balance of payments position.
- Ensures economic stability. The high investment in industries ensures economic stability because the prices of industrial products are relatively stable.

Disadvantages of the big push theory

- The strategy is expensive because of the need to import capital goods and raw materials.
- Leads to high social costs for example pollution. There is noise pollution experienced by society due to the many industries set up.
- Big losses may result in case of uncertainties that befall the massive investment a industries.
- Worsen the problem of income inequality. This is because most of the industries ire foreign privately owned and urban based.
- Encourages rural - urban migration and its problems like congestion, slum development and open urban unemployment. This is because industries concentrate in urban areas.
- Leads to overexploitation of resources like fish, timber and minerals. This is "because of the need for raw materials to support industrial development.
- Encourages external economic dependence. This is mainly due to need for
- Imported intermediate products and foreign skills to facilitate massive industrial development.

Factors that limit the application of the big push theory in developing economies

- Limited basic infrastructure. The poor infrastructure in terms of poor roads can sustain big push theory due to the inability to transport finished products from and raw materials to the various industries.
- Political instability. The political unrest in some developing economies destroys industries and economic infrastructure and scares away potential investors from establishing them as they may be destroyed.
- Conservatism. The high affinity to traditional cultural values limits the generation of savings required for massive investment in industries.
- Poor land tenure system. The poor land tenure system in some parts of developing countries leads to poor performance of the agricultural sector yet it is supposed to be the main source of raw materials for industries. *
- Corruption. The increased corruption diverts the massive capital supposed to be invested in industries to personal interests. This results into limited funds for investment in industries.
- Weak policy implementation machinery. The administration or personnel in charge of implementation of the strategy is generally weak in terms of decision

making.

- Poor technology. The poor technology hinders investment in industry and economic infrastructure due to fear of high production costs.
- Limited capital. There is limited capital to buy machines, raw materials and land to be used in the establishment of industries and economic infrastructure.
- Limited skills. There is limited skilled manpower to be employed in industries as machine operators, mechanics e.t.c.
- Small markets. The small markets in developing countries discourage production on a large scale for fear of making losses.
- Limited entrepreneurial skills. There are limited entrepreneurial skills required in the establishment, running and managing of the industries and economic infrastructure. This limits the injection of capital in industrial projects.
- Poor investment climate, for example high taxes and limited subsidization act as a disincentive to promising industrialists..

Economic diversification as a development strategy

This is where a country limits dependence on one sector or a few products from a popular sector.

Forms of diversification

- Diversification within the agricultural sector: this involves production of a variety of food and cash crops as well as rearing of a variety livestock so that a fall in price in one area is counteracted by stable or increasing prices in other activities.
- Sectoral diversification: this involves development of a variety of sectors of the economy so as to reduce dependence on one sector or a few sectors.
- Regional diversification: this involves creation of many activities in a region.
- Intra-sectoral diversification: this involves creation of a variety of economic activities within a sector, for example, growing crops, rearing of a variety of animals e.t.c.
- Inter-sectoral diversification: this is the creation of multi-activities within a cross section of sectors hence linkages are emphasised.
- Market diversification: this involves acquiring a variety of markets for the existing products

Reasons for diversification of production reasons for diversification of production

include:

- To create more employment opportunities.
- To widen consumer's choice by providing a variety of goods and services.
- To widen the export base thus increase foreign exchange earnings.
- To increase the tax revenue of the country as many activities are undertaken. .
- To ensure balanced (equal) regional development and thus reduce rural-urban migration.
- To increase the country's Gross Domestic Product (GDP).
- To promote linkages between the different sectors of the economy.
- To ensure optimum exploitation and utilization of resources.
- To overcome problems of price fluctuations and its negative effects.
- To avoid the risks and uncertainties in some sectors especially agriculture.
- To ensure fair distribution of income.
- To control (structural) inflation.
- To encourage the development of infrastructure.
- To reduce the effects of dependence on a few products / activities.

Benefits of economic diversification

- It widens the export markets leading to increased foreign exchange earnings.
- This is achieved where a country is dealing in the export of many commodities id of a narrow range of goods being sold in the external markets.
- It enables developing countries to overcome problems of fluctuating prices especially with in the agricultural sector.
- It reduces economic dependence because the export market s and commodities are diversified and the economy no longer relies on one commodity.
- It increases employment opportunities in the many activities undertaken.
- It ensures that consumers are exposed to variety of commodities. This widens the consumers' choice leading to an improvement in the people's standard of living.

- Through regional diversification, a country attains equitable and fair income distribution. This helps to reduce rural-urban migration and its undesirable effects or consequences.

- It widens a country's tax base. This arises due to the existence of many activities undertaken through diversification. Government revenue is increased and a country is able to finance her capital and recurrent expenditure programmes.

N.B: Capital expenditure: This refers to spending by the government which is aimed at creating new capacities in the economy, for example, spending to construct a new power dam, a new high way, constructing new schools etc.

WHILE

Recurrent expenditure: This refers to spending aimed at maintaining the existing capacity in the economy, for example, paying government workers, repair of roads.

- It promotes resource utilisation in developing countries. Resources that would have remained idle are exploited. This is achieved through widening markets in the long run.

- It is an engine for technological development and transfers.

- It promotes the development of basic infrastructure in an economy especially where regional diversification is being emphasised. Better roads and communication facilities are developed in different regions of the country to ease investment activities.

- It checks or controls scarcity inflation as a result of availing more goods on the market. By controlling inflation, the cost of living falls and this improves people's welfare.

- It promotes entrepreneurship skills due to increase in the number of people willing to take on risks in the numerous activities.

- It creates linkages between different sectors in case inter-sectoral diversification is being emphasised e.g. the agricultural sector feeds the industrial sector with raw material while at the same time the industrial sector is also developed to supply inputs like fertilisers and machines to the agricultural sector. This promotes linkages between sectors of the economy

Merits of diversification of production

- Creates more employment opportunities

- Widens consumers' choices by providing a variety of goods and services.

- Widens the export base thus increase foreign exchange earnings. This reduces the balance of payments (B.O.P) problem.
- Increases the tax base of the country
- Ensures balanced regional development and thus reduces rural-urban migration.
- Increases the country's GDP/ economic growth due to increased output
- Promotes linkages between different sectors of the economy /market /raw materials.
- Leads to optimum exploitation and utilisation of resources.
- Helps to avoid the risks and certainties in some sectors e.g. agricultures.
- Overcomes problem of price fluctuation and its negative effects.
- Ensures fair distribution of income.
- Helps to solve structural inflation.
- Leads to development of infrastructure.
- Reduces the effects of dependence.

Factors limiting economic diversification

- Inadequate capital. There is inadequate capital for instance needed to buy land for growing a variety of crops and rearing a variety of livestock.
- Poor land tenure system. The poor organisation, distribution and ownership of land limits access to the productive resources that would promote growth of a variety of products.
- Poor infrastructure. The poor roads and rails limit the transportation of inputs and the marketing of products of many firms.
- Weak linkages among the sectors. This makes it difficult to have sustained development of many sectors and firms.
- Inadequate entrepreneurial skills. There are limited entrepreneurial skills to manage and run a variety of economic activities.
- Political instability which slows down regional diversification. Political unrest destroys firms and discourages investors for fear of losing their property and lives.
- The weak planning machinery of the government. This makes it difficult to

coordinate activities of many sectors.

- Economic instabilities like inflation, high interest rates which discourage investment by increasing the cost of production.
- Limited size of market/ narrow market. There is limited market for the variety of _ nets from different sectors which may lead to losses.
- Conservatism among people. Some of the farmers are not willing to engage in re production of more than one crop or a few animals.
- Limited skilled manpower due to abundant supply of un- skilled labour. There is limited skilled manpower to be employed in the different sectors of economy.
- Poor technology. There is poor technology that cannot be used in some of the sectors because of its inefficiency resulting in poor quality and low volumes of output.

Measures that can be taken to promote economic diversification in Uganda

- Undertake further liberalisation.
- Provide affordable credit.
- Reform the land tenure system.
- Improve labour skills through training.
- Improve infrastructure.
- Encourage entrepreneurial skills among people.
- Promote effective economic development planning.
- Ensure price stability or fight inflation.
- Widen size of market; by way of regional economic integration.
- Discourage conservatism or social prejudices among people.
- Improve methods of production or improve technology.
- Offer investment incentives such as tax holidays, subsidies to encourage investment in various sectors.
- Encourage savings to accumulate funds for further investment in different sectors.

- Encourage or promote inter-sectoral linkages.

QUESTIONS

1. (a) Distinguish between unbalanced growth and big push theory of economic growth.

(b) Examine the effects of the unbalanced growth strategies in an economy.

2. (a) Distinguish between balanced and unbalanced economic growth strategies.

(b) Examine the merits and demerits of unbalanced growth theory of economic growth.

3. (a) Distinguish between a loan and a grant.

(b) Assess the contribution of foreign aid to the economic development of your country.

4. Uganda being a developing country should seek assistance from developed countries so as to achieve economic development." Discuss.

5. (a) Distinguish between import substitution and export promotion strategies for industrial development.

(b) Explain the merits and demerits of the import substitution strategy in developing growth, developing countries

6. "**As a measure of accelerating economic growth, developing countries should adopt capital intensive technology." Discuss.**

7. (a) What are the reasons for encouraging export promotion industries in your country?

(**b) Explain the factors that limit the growth of the industrial sector in your country.**

Economic underdevelopment

Underdevelopment refers to the underutilization of resources in an economy

leading to low output and production of low quality goods and services.

OR

It refers to a situation in which the productive capacity (potential) of an economy is underutilised, that is , an economy has not yet fully utilised her productive resources and is characterised by low quality of output, limited labour skills, use of mainly poor techniques of production and high levels of price instability.

Traits of the Ugandan economy that are descriptive of underdevelopment are:

- Excess capacity in most firms.
- Low literacy rate.
- High population growth rates.
- Continued use of rudimentary technology.
- Low savings and investment rates.
- High unemployment levels.
- Low economic growth rates.
- Low life expectancy.
- Political immaturity.
- Predominance of subsistence production.

Features / traits / characteristics of under -development

- High rates of unemployment.
- Poor infrastructure.
- Weak industrial sector.
- High population growth rate.
- Low levels of income.
- High infant mortality rate / Poor health services.
- High illiteracy rates / Low levels of skills.
- High levels of economic dependence.
- A large subsistence sector / Predominance of subsistence agriculture.
- Unfavourable terms of trade.
- Existence of economic dualism.
- Low levels of entrepreneurship.
- Use of poor technology.
- Low Gross Domestic Product / Low economic growth rate.

- Political immaturity.

Social indicators of economic underdevelopment in Uganda

In this case focus is on those social aspects which tend to have an impact of -educing the quality of life of the people. Such social indicators of under development are:

- High illiteracy rates.
- Low life expectancy / High mortality rates / Poor health services.
- High levels of conservatism of the people.
- High population growth rate.
- Low self-esteem.
- Poor housing facilities.
- Preference of foreign values / cultures.
- Socially dualistic.
- High levels of malnutrition / low nutrition levels.

Economic indicators of underdevelopment in Uganda

In this case focus is on those economic aspects which tend to have an impact of reducing the quality of life of the people. Such economic indicators of under development are:

- Poor entrepreneurship.
- Low per capita income / low savings.
- Dualistic.
- Prevalence of excess capacity.
- Use of mainly poor technology.
- Widespread underemployment and unemployment.
- Small markets both at home and abroad.
- Mainly agricultural / subsistent.
- High levels of price instability (inflation).
- Persistent / chronic Balance of payments problems.

- Dependent on other countries.

Causes of underdevelopment in the developing nations

An account for the low level of economic development in the developing countries:

N.B: Students need to bring out any of the following aspects in the explanation of points;

Low investment / low output / resource underutilization / production of low quantity and low quality goods and services.

- Poor state of technology. The use of poor methods of production makes resources to be underutilized. This causes low output of goods and services hence leading to underdevelopment.

- Limited capital stock. This arises from inadequate machines and limited money capital therefore, investment cannot be expanded which leads to low volumes of output and this causes underdevelopment.

- Unfavourable terms of trade. Developing countries export primary products at low prices and import expensive manufactured goods. This creates shortage of foreign exchange earnings and developing countries are not able to exploit fully all the resources thereby causing underdevelopment.

- Limited labour skills / Brain drain / High illiteracy rates. There is a limited number of people with technical skills necessary to exploit and use the available resources. Resources are not fully exploited and therefore, there is excess capacity that leads to low production of goods and services and this causes underdevelopment.

- Corruption / low levels of accountability. Money that would have been used to finance development projects so as to produce more goods and services is embezzled by some government officials. As a result, there is low output of goods and services and this causes underdevelopment.

- Political unrest. This scares away potential investors making resources to be underutilised. This causes low output of goods and services hence leading to underdevelopment.

- High rates of capital outflow in form of profit repatriation. This is because of increased foreign investment in the developing countries. The foreign investors repatriate their profits leading to low levels of investment in the country. This causes production of low output of goods and services thereby leading to underdevelopment.

- Poor attitude towards work / conservatism of the people. Many people are not ready and willing to adopt modern ways or method of production. This makes output to remain low and underdevelopment arises.

- Limited market for the products both at home and abroad. Producers are not encouraged to produce in large quantities since the market is small and this makes resources to be underutilised, output becomes low and finally there is underdevelopment.

- Poor infrastructure. For example poor road network discourages investors form setting up investment projects. This results into low levels of resource utilisation and low output of goods and services which causes underdevelopment.

- Dominance of the subsistence sector. The subsistence sector is large and characterised by low output of goods and services. This makes resources to be underutilised thereby causing underdevelopment.

- Dependence on agriculture. Agriculture is mainly carried out on small scale - by peasant farmers and this creates low output of agricultural productshereby causing underdevelopment.

- Low entrepreneurial skills. There is poor organisation of factors of auction which causes underutilisation of resources, output becomes low and hereby causing underdevelopment.

- High debt burden and problem of debt servicing. This reduces the money available for investment thereby causing low output of goods and services and finally underdevelopment.

- Limited quantity, quality and variety of strategic natural resources like iron ore and coal are in limited supply and yet they are important in developingheavy manufacturing industries. This results into low levels of industrialisation and low production of capital goods thereby leading to underdevelopment.

- Dependence on foreign aid which kills initiatives at home. This is because .reign assistance bogs creativity and encourages laziness. This results into lowoutput of goods and services and finally underdevelopment.

- High population growth rates. This results into a high dependency burden Leading to low savings and low investment. This causes production of low outputof goods and services thereby leading to underdevelopment.

- Poor land tenure system. This makes large scale (commercial) agriculture difficult to carry out and therefore there is low output in the agricultural sector causing underdevelopment.

- Price and exchange rate instabilities. This increases the cost of production, discourages investors which leads to resource underutilisation. This leads to low output and finally underdevelopment.

- Poor investment climate /poor government policy of investment, for example, heavy taxation. This brings about low levels of industrialisation and resources needed in the industries remain unutilised which causes underdevelopment.
- Unfortunate structural adjustment programmes (SAPs). SAPs of the International Monetary Fund (IMF) and World Bank for example privatization and retrenchment forces the government to divert some of the money from certain sectors to implement some of these programmes. This causes low output of goods and services in those sectors and finally results into underdevelopment.

Measures that could be taken to accelerate the development process in Uganda

- Lay down strong infrastructure.
- Modernise agriculture since it is the backbone of the economy.
- Encourage development of human resources through intensive training.
- Attain political stability in all parts of the country.
- Undertake further expansion of the market to facilitate the process of commercialisation.
- Provision of capital to local investors.
- Develop appropriate technology through technological transfer and development.
- Control the high population growth rates through family planning.
- Promote the industrial sector.
- Provision of desired investment incentives.

N.B. Vicious circle refers to a situation that tends to precipitate certain undesirable phenomena or ends. It describes a series of unfortunate circumstances that intensify one another by feeding each other.

Least developed country is one which is stagnant with low levels of income and persistent unemployment characterised by constant poverty, very low living conditions and far below the international poverty line.

Underdeveloped country is one which is developing although living conditions are still low. It is one which is above the least developed characterised by less than full employment level, slow growth of Gross Domestic Output (GDP), economic vulnerability with the majority of its people just affording the bare minimum of life.

Poverty

This refers to a situation where a proportion or section of the population is able to meet only its bare subsistence essentials of food, clothing and shelter in order to maintain the minimum level of living.

Forms of poverty

a. **Absolute poverty** refers to a situation where a population or section of the population is at most able to meet only its bare subsistence essentials of food, clothing and shelter and no more.

b. **Relative poverty** is a situation whereby a section of the population is able to meet the bare minimum necessities of life and a bit of luxuries.

Causes of poverty in Uganda

- Limited basic raw materials.
- Limited committed leadership.
- Incompetent and over-ambitious economic policies.
- Political instability. This leads to destruction of property and lives which discourages the setting up of firms leading to low output hence generation of low incomes.
- Inappropriate education system.
- Hostile climate.
- Poor performance of the agricultural sector.
- Existence of social strata and class exploitation in the society.
- Inconsistent inflow of foreign aid.
- Inappropriate technology.
- High population growth rate. This leads to a high dependence burden which discourages savings and investment leading to low output hence generation of low incomes.

Measures aimed at reducing poverty in Uganda

- Developing infrastructures.
- Providing labour with skills through training.

- Encouraging savings.
- Improving techniques of production.
- Improving land tenure system.
- Controlling population growth rates.
- Providing affordable credit for investment.
- Widening markets for example joining regional co-operation.
- Providing entrepreneurship skills.
- Improving political climate.
- Encouraging modernization or commercialisation of agriculture.
- Fighting conservatism.
- Diversifying the economy.

TOPIC 3: THE DEVELOPMENT PROCESS AND CHOICE OF A DEVELOPMENT STRATEGY

Development process

Development is a multi-dimensional process characterized by the increase in real capital income of a country over a long period of time. The economy is transformed from a backward economy to a modern advanced industrial economy.

Development strategy refers to the policy measures taken by a planning authority aimed at the achievement of given development goals/ aims/objectives during a given time.

OR It is a broad policy guideline initiated and followed by a country in formulation and executing long term economic policies for the development of the nation.

NB: Economic policy refers to a statement of objectives and methods of achieving those objectives by the government, political party and business community

Choice of development strategy

This is defined as a search or an appraisal of an alternative course of action which leads to the development of the economy.

Development strategies for developing countries

Export promotion industrial development strategy

(Outward looking industrial development strategy)

Export promotion industrial development strategy: refers to an industrial strategy of promoting the domestic manufacturing sector with the view to increasing the export of manufactured goods.

Or

Is the policy of establishing industries to produce goods for the export market

Reasons for the adoption of the export promotion strategy of industries development

- To increase the country's foreign exchange earnings and this build up the reserves. This is due to the increased exportation manufactured products
- To improve on the country's balance of payments position. This is mainly due to the increased foreign exchange earnings from the increased export.
- To diversify the economy. This is due to the promotion of the industrial sector which increase the variety of goods produced and exported.
- To facilitate the use of idle potentials (domestic resources) of the country. This is because of the utilization of local resources as inputs in the manufacturing

industries that are set up.

- To create more employment. This is due to the setting up of many manufacturing industries that employ many people as machine operators and managers leading to increase in incomes.
- To promote commercialization of the economy. This is because of the encouragement of production for sale.
- To redistribute income in the economy. This is due to the numerous employment opportunities that are a source of income to many people.
- To develop the agricultural sector, Uganda being an agro-based economy. This is due to the linkages created by the development of the manufacturing sector that utilizes inputs from the agricultural sector.
- To diversify foreign markets. This is due to the expansion of exports necessitating the acquisition of a variety of markets for the existing products.
- To encourage development of technology. This is because most of the manufacturing industries are owned by foreigners who bring with them modern efficient production techniques leading to high quality and quantity output.
- To accelerate economic growth. This is because most of the establishment of many industries that results into increased output hence economic growth.
- To facilitate the development of infrastructure. This is due to the setting up of roads and energy facilities. The roads are set up ease transportation of raw materials and finished products.

Requirements for export promotion strategy.

- Skilled manpower.
- Adequate raw materials.
- Extensive advertisement abroad.
- Transport and energy facilities.
- Trade agreements to create guaranteed markets.
- Export promotion institution.
- Extensive research to identify products needed in external markets.
- Fiscal incentives to the export sector like tax holidays and subsidies.
- Large entrepreneurial class to undertake risks in the development of the

export promotion industries.

Questions

a. **Explain the objectives for export promotion in your country.**

b. **What are the limitations to export promotion as a development strategy?**

a. **Distinguish between export promotion and import substitution industrial development strategies.**

b. **Explain the merits of adopting the export promotion strategy of industrialization**.

Limitations to export promotion as a development strategy

Factors that limit adoption of export promotion strategy in my country are:

- Poor infrastructure like poor roads discourages potential investors from establishing industries for fear of high production costs involved.
- Limited skills. There is limited skilled manpower like machine operators (technicians) to be employed in the industries.
- Limited foreign market due to low quality products that cannot compete favourably in foreign markets. This discourages producers for fear of making
- High level of corruption. This results into misuse of the funds that would have been used for the expansion of the manufacturing industries.
- Political instabilities scare away potential investors from establishing industries and the existing ones from expanding theirs for fear of destroying them and losing their lives.
- Inadequate capital to buy land, machinery and inputs to be used in the establishment and running of the industries.
- Poor land tenure system limits accessibility to land to many potential investors thus discouraging them from establishing industries and also discouraging the existing investors from expanding theirs.
- Protectionist policies of the developed countries. They put restrictions on the exports from developing countries thereby limiting the amount exported hence discouraging them from exporting for fear of making losses.
- Limited local natural resources. There are limited raw materials which discourage potential investors to establish industries and existing ones to expand theirs for fear of producing at excess capacity and failing to earn high profits.

- Poor technology in the developing countries discourages potential investors from establishing industries for fear of producing low quality products which cannot compete in foreign markets.

- Limited entrepreneurial skills hinder the would be investors to establish industries because they do not have the necessary skills to run and manage them. This results in poor organization of other factors of production hence limited development of export-related industries.

- Firms are Usually high cost producers hence their products are relatively expensive. The strategy is limited by the expensive exports due to the high costs of production which make the exports uncompetitive in foreign markets and this discourages investors from producing for export for fear of making losses.

- Production of similar products hence cannot utilise developing countries" markets. There are limited markets for the exports of developing countries because they produce similar products which cannot be absorbed.

- High costs of advertising, market research and research into better products and processes scare off the potential investors.

Measures being taken to improve the performance of the export promotion strategy

- Giving fiscal incentives to exporters like tax relief and refund (customs drawback).

- Sending delegations of trade researchers to foreign markets or countries.

- Giving credit facilities to investors.

- Improvement of infrastructure.

- Setting up export promotion institutions.

- Joining regional co-operations.

- Encouraging diversification of exports.

- Carrying out extensive sales promotion campaigns in foreign markets.

Import substitution industrial development strategy

(Inward looking development strategy)

Import substitution industrial development strategy: refers to a strategy of producing internally the formerly imported industrial goods to reduce outflow of foreign exchange

Or

Refers to measures aimed at establishing industries to produce locally, goods that were formerly imported.

N.B. The inward looking development strategy calls for policies that stress economic self-reliance on the part of developing countries. These include development of indigenous appropriate technology and imposition of substantial protective tariff barriers in order to promote import substitution.

Requirements of the import substitution strategy

- Raw materials.
- Skilled manpower.
- Adequate market.
- Developed transport facilities.
- Adequate power / energy to run the industries.
- Incentives like tax holidays, credit facilities, tax rebates etc.
- Protectionism of the import substitution industries by imposing high tariffs on imported manufactured goods.
- Reduction of taxes on imported raw materials.

Reasons for the adoption of the import substitution strategy of industrial development.

- To reduce economic dependence. Import substitution industrialisation aims at reducing the reliance on imported manufactured goods.
- To save foreign exchange that would be used to import goods. Import substitution industrialisation aims at reducing foreign exchange expenditure on imported manufactured goods.
- To facilitate increased resource utilisation. Import substitution industrialisation aims at facilitating resource utilisation. This is due to increased production in the industries and high demand for raw materials by the industries.
- To develop the local skills. Import substitution industrialisation aims at promoting the development of local labour skills. This is through training facilities provided by the industries to enable labour handle modern physical capital.
- To create more employment opportunities. Import substitution industrialisation aims at providing gainful employment opportunities to an ever increasing larourforce. This is due to increased investment and production in the industries.

- To improve the Balance of Payment position. Import substitution industrialization aims at correcting the BOP position. This is done through reduction in the volume of imported manufactured goods and increase in foreign exchange earnings from exports in the long-run.

- To facilitate technological transfer. Import substitution industrialisation aims at enabling the shifting of new and better techniques of production by the foreign investors. This is due to the high use of efficient capital intensive technology in the import substitution industries.

- To accelerate economic growth. Import substitution industrialisation aims at stimulating investment. The increased investment leads to increased output production in the industries hence economic growth.

- To stimulate expansion of infrastructure. Import substitution aims at encouraging the development of infrastructure like energy plants to avail power and the road network to increase access to raw materials and areas of market for finished goods.

- To encourage capital inflow as foreign investors are attracted to set up such industries. Import substitution industrialisation aims at attracting foreign investors' to take on the large industries.

- To increase government revenue by way of taxation. Import substitution industrialisation aims at increasing sources of public income through payment of taxes and license payments.

- To control / check imported inflation. Import substitution industrialisation aims at ensuring stable prices in the economy by increasing production of formerly imported products from inflationary prone economies.

- To earn foreign exchange as some of these industries grow and begin to export some of the goods they produce.

Merits of import substitution

- Helps in saving scarce foreign exchange. The strategy saves scarce foreign exchange resources available by restricting expenditure on imported products.

- Reduces economic dependence. The strategy leads to production of goods that were formerly imported which results in reduced importation of manufactured goods hence reducing external dependence.

- Encourages exploitation of idle resources. More domestic resources are exploited as some of the industries use the locally available raw materials in the production process.

- Provides greater employment opportunities in the long run. This is because the strategy has more forward and backward linkages and facilitates the use of labour intensive techniques of production.

- Improves balance of payments (B.O.P) position. The strategy facilitates the setting up of industries that produce many goods that were formerly imported thus reducing importation and expenditure abroad.

- Facilitates technological transfer from More Developed Countries (MDCs).efficient modern technology is imported which leads to the improvement of the local technology leading to increased productivity.

- Stimulates growth of the industrial / manufacturing sector. This is because of the increased backward and forward linkages which enable the setting up of many industries.

- Promotes development of local skills through training. The strategy enables the organisation of workshops and seminars for the training of workers to operate and repair machines which results in improvement of skills.

- Promotes infrastructural development. The strategy encourages the construction of roads and rails to ease the transportation of raw materials and finished products.

- Controls imported inflation / reduces imported inflation. The strategy helps to control imported inflation by reducing the volume of imports from inflation prone economies.

- Encourages entrepreneurial development. The strategy facilitates the development of local entrepreneurs who undertake to bear risks and uncertainties through organisation of other factors of production.

- Encourages capital inflow in form of foreign private investments. The strategy facilitates the transfer of productive resources by foreign investors into the economies of developing countries leading to increased foreign exchange.

- Leads to foreign exchange earnings in the long run. In the long run, the strategy is outward paying and source of foreign exchange through exportation of the surplus products.

- Acts as a wider source of government revenue because it has more linkages and hence more economic activities which are taxed to raise income for recurrent and development expenditure.

- Promotes economic growth. The strategy fosters internal growth of the economy through increasing the quantity of consumer goods available.

Demerits of import substitution

- Encourages capital flight through profit and income repatriation .The strategy promotes excessive capital outflow since most of the industries are owned by foreigners.
- Subjects nationals to highly priced goods due to high costs of production. The strategy leads to high domestic prices due to high production costs leading to low standards of living.
- Limited variety of goods hence falling standards of living. There is limited variety of goods on the market because of protectionism which limits entry of imports.
- Consumption of poor quality goods/inferior substitutes due to continued government's protection which limits competition.
- Encourages high use of imported capital and intermediate goods causing balance of payments (B.O.P.) problems as a result of increased import expenditure.
- Tends to encourage capital intensive techniques resulting into technological unemployment whereby people are replaced by machines in the production process.
- Promotes monopoly tendencies with all the negative effects due to protectionism that limits competition from imported goods.
- Increased wastage of resources due to limited market. These industries produce r. excess capacity due to limited market resulting in wastage of resources.
- Over protectionism may lead to retaliation which reduces the volume of trade.
- Increased rural-urban migration with its evils since many of the industries are urban based. Many people move to urban areas to look for jobs leading to high crime rates, congestion, prostitution and development of slums.
- Results in a decline in government revenue due to a fall in import duty resulting from reduced importation.
- Increased government expenditure on subsidising the industries to encourage them to grow.
- High social costs like pollution because of many industries that are established eve off gases and release industrial wastes which pollute the environment.
- Management contracts are usually expensive to maintain for example tax holidays and concessions given. This reduces the net benefits of the investments

in import substitution industries especially by foreigners.

Limitations to import substitution as a development strategy

- Small domestic markets hinder the expansion and growth of import substitution industries due to poor quality goods and the final product being more expensive than the imported goods. The investors are thus discouraged from establishing and expanding industries for fear of making losses.
- high cost industries because of protectionism. The industries put a lot of pressure on the government to protect them from foreign competition through government providing subsidies and tax holidays.
- Shortage of inputs or raw materials hence the need for imported intermediate products. The limited supply of basic raw materials leads to production at excess capacity. This discourages investors to establish the industries and existing ones to expand because of getting low profits.
- Limited capital for establishing the industries. There is limited capital to buy raw materials and install new machinery thus making it difficult to set up industries.
- Limited technology. Developing countries have poor technology which limits the establishment of efficient import substitution industries.
- Limited skills to manage these industries. There is limited skilled manpower in developing countries which results in inefficiency in the operation of import substitution industries.
- Political instability. Political unrest in some parts of developing countries has hampered successful operation of import substitution industries by scaring the investors from injecting capital for fear of their lives and property.
- Setting up of wrong industries due to poor choice of priorities. The
- industries set up are inefficient and cannot be maintained, for example, the foreign investors set up assembling plants for final stages of production, which industries are not a priority for the developing countries.
- Dependency on unreliable sources of foreign aid to finance the establishment and maintenance of the import substitution industries. This strategy requires high capital investment that may necessitate foreign aid which in most cases is unreliable.
- Demonstration effect in consumption which is reflected in high marginal propensity to import. Consumers in developing countries prefer imported goods to those locally produced goods which further limits the market.

Review questions

1. **"To what extent is the inward-looking industrial development strategy ideal for your country?"**

2.(a) Explain the rationale of setting up import substitution industries in your country.

b. What are the limitationsto import substitution as a development strategy?

Choice of technique of production in industry

1. **Labour intensive techniques of production (1 pound technology).**
2. **Capital intensive techiniques of production (1000 pound technology).**
3. **Intermediate technology.**
4. **Appropriatetechnology.**

N.B: Technology basically refers to the ways or methods of carrying out production in an industry.

Developing countries need to make a wise choice between capital intensive and labour intensive techniques of production. **The choice of technique to be used depends on the following factors:**

- The degree of availability of the technique.
- The size of market to be served by the technique of production.
- The amount of output required.
- The benefits from the technique.
- The efficiency of the technique.
- The dangers associated with the technique.
- The cost of the technique in relation to the prices of the final output.
- The degree of substitutability of the method of production.

Labour intensive techniques of production(1 pound technology)

These are production methods that employ relatively more labour than other rectors, especially capital.

This production technique uses proportionately more labour than capital. It is referred to as a 1 pound technology or a capital saving technology. It is called a capital saving technology because it saves capital but it uses more units of labour, it is also called a one pound technology because it is cheaper and associated with low skills.

Merits of labour intensive techniques of production in developing countries.

- It is a source of employment in developing countries which experience high rates of unemployment. It creates more jobs in developing countries where there is redundant labour force. For example labour intensve methods help to create more jobs for people in the agricultural sector.

- It is cheap and easily affordable. It is cheaper to obtain and maintain when compared to the capital intensive techniques which are expensive to acquire. This is a bigger advantage in developing countries which have limited capital resources.

- It saves foreign exchange which would otherwise be used to import capital machines. This is because there is use of locally made simple tools hence there is no need of spending foreign currency to buy capital machines from other countries.

- It requires limited skills. The technique does not require complex skills because many people learn on the job. This fits well in developing countries where there is shortage of highly trained manpower.

- It facilitates the exploitation of vast rural potentials since the techniques are mainly rural - based. These techniques promote resource utilization in the rural areas through activities like farming, brick laying, making mats, carpentry e.t.c. This reduces excess capacity in the rural areas.

- Facilitates fair income distribution. More people are employed when labour intensive techniques of production are used. Income is earned by the employed people and this helps to re-distribute income.

- It is needed in agriculture where human judgment is paramount. Activities like harvesting ripe coffee beans, weeding of crops such as beans, maize, millet e.t.c) call for human judgment. Therefore, such activities require manual workers i.e labour intensive techniques of production.

- It reduces social costs in form of pollution. This method of production is not associated with activities that easily pollute the environment, that is, it is environmentally friendly unlike the use of capital intensive methods in industries that give rise to negative externalities like air and water pollution.

- Controls over- exploitation of resources. It does not result into excessive use of resources especially in the short - run. Irrational use of resources is avoided. As more people are employed, incomes and aggregate demand rise hence encouraging further investment.

- It can easily be spread all over the country and this helps to increase output. As output rises, higher rates of economic growth / GDP are attained. As more people are employed, incomes and aggregate demand rise hence encouraging further investment.

Demerits of labour intensive techniques of production

- It results into low output levels (low productivity). Due to use of rudimentary tools and limited skills in production, there is low output per un: of labour. This low productivity leads to slow growth of firms.
- It gives rise to low quality output. Production units that use labour intensive techniques produce low quality products. Such low quality products are less competitive and they are sold at low prices on the market. This causes losses to producers.
- It is associated with labour unrest. Trade unions can mobilize the dissatisfied workers to go on strike. The employers have no alternative since they depend on this labour. Strikes lead to loss of production time hence causing losses to producers.
- It is costly in the long-run. In the long run, it becomes costly to maintain a big number of workers (labourers) in terms of paying wages, catering for their accommodation, medical care, feeding, transport allowances e.t.c.
- It calls for a lot of supervision of workers at their work place. These results into heavy supervision costs because there is need to employ supervisors to be in charge of the workers.
- It does not encourage skills development. Since there is use of rudimentary tools in production, workers may not undergo training to acquire skills of using them. This kills the drive to acquire better skills in production.
- It does not encourage technological development. It is associated with limited innovations and creativity. The methods of production are not improved upon and remain more or less the same over time. This limits technological development.
- It results into under- utilization of resources. Due to its low productivity, some resources remain un exploited. Excess capacity arises and this causes low rates of economic growth. / low GDP.
- It is slow and time consuming. This arises from use of manual labourers who take more time to accomplish tasks. Therefore, more time is taken before goods

are put on the market. A producer may miss some immediate opportunity to sell goods to those who need them yet they are not available on the market.

- It is hard to produce standardised output using this technique of production. It is hard to have products of uniform size, appearance and quality when producers use labour intensive techniques of production.

Capital intensive techniques of production (£ 1000 technology or labour saving techniques of production)

Capital intensive technology is a production method which employs relatively proportionately) more capital than other factors of production, especially labour.

This production technique employs a big proportion of capital relative to labour ice other factors. It is alternatively termed as **a labour savingtechnique of production**. The term is used because it uses less units of labour and more units of capital. Since the technique is expensive and it involves hiring highly trained manpower, it is referred to as **the £1000 technology.**

Advantages of capital intensive techniques of production;

- Leads to high quality of output. As firms use capital intensive methods, the quality of products improves. Such high quality commodities command a wider market. Producers are able to earn higher profits which are an incentive for increased production.

- It saves time and it is less tiresome. The use of machines reduces on loss of reduction time in industrial firms. Machines simplify work and this reduces fatigue.

- Economies of scale are enjoyed due to large scale production (it leads to mass production/ it increases output). The level of productivity increases when capital intensive techniques of production are employed. More output is generated hence a higher level of economic growth/ GDP is attained

- It minimises the size of the wage bill paid to labour. It uses fewer labourers and consequently there is a reduction in the amount of money paid to workers in form of wages.

- It improves the skills of workers hence increased labour efficiency. Workers who handle machines are able to acquire skills from time to time, for example, some technicians learn skills of handling machines via on-job-training. Improvement in skills creates efficiency at work.

- It results into technological development and transfer. As a result of innovations and inventions, firms that are capital intensive gradually improve on local methods of production. At the same time there is technological transfer in form of imported machines like tractors and other industrial implements.

- It minimises or reduces on labour unrest. Less manual workers are employed in capital intensive production units. Therefore, the possibility of labour unrest in form of strikes is reduced.
- It facilitates better (optimum) and increased exploitation of resources. Capital intensive machines are applied in farming and in extracting minerals from their natural state (endowment). This enhances use of resources and excess capacity is avoided.
- It facilitates development of infrastructure. Capital intensive machines such as heavy tractors are used in road construction thereby helping in setting up basic infrastructure that supports further production.
- Leads to standardisation of output. By using machines during production, it is possible to make products of standard/same size, quality shape e.t.c E.g if a Bakery uses machines to cut dough into uniform sizes, loaves of bread of standard size are produced.
- It may promote employment in the long-run. Many capital intensive industries are set up and they provide jobs to machine operators or technicians and professional engineers. As these firms expand, investment levels rise thereby creating more jobs in the long- run.

Demerits / negative implications of capital intensive techniques of production

- It is associated with technological unemployment. The use of machines in production units reduces the size of the manual workers. Tasks which could have been handled by manual labourers are executed by machines. This causes technological unemployment.
- It worsens income inequality. It creates an income gap between those employed in the labour intensive firms (these earn low incomes) and those employed in capital intensive firms, like engineers who earn higher incomes due their professional skills.
- It is associated with mass production which may lead to wastage especially where the market is small. This results into losses to the producers thereby limiting further investment.
- It requires complex skills which may not be readily available in developing

countries. Many developing countries experience shortages of trained engineers and technicians who can competently handle machines in production firms. These countries resort to use of expatriates who are expensive to maintain and at the same time external resource dependence is worsened.

- It is mostly afforded by foreign firms whose owners repatriate profits to their mother countries. This causes a small multiplier effect in developing countries.

- It is associated with high costs. Heavy costs are incurred on purchase machines and related spare parts, repair and maintenance, salaries to machine operators e.t.c These heavy costs reduce the profits of producers.

- Over exploitation of natural resources which leads to resource depletion is bound to occur. By employing machines in the harvesting of timber from forests, there is a danger of depleting forests as a resource (there is reforestation).

- It generates social costs/ negative externalities to the public or society. Machines used in industries cause noise pollution. Dangerous gases are also emitted from industrial machines thereby causing air pollution. These social zests reduce peoples' welfare.

- Machines are not applicable in certain tasks or activities where human judgment is required /vital. A task such as marking handwritten examinations calls for personal human judgment of the examiner and a line is not applicable. Harvesting of ripe coffee beans and vanilla also - for human judgment hence rendering machines irrelevant.

Limitations of adopting capital intensive technology

- Limited funds / stock of capital to purchase machines repair them and maintain them.

- Limited labour skills to operate and repair the machinery.

- Small / limited markets for the technology and products i.e. the small markets cannot support mass production.

- Inappropriate where human judgement is required.

- Underdeveloped / poor conditions of infrastructure like poor roads to transport the machines.

- Political instability whereby investors are not willing to install their machines for fear of being destroyed.

- Conservatism / cultural rigidities whereby people are not willing to use machines and prefer to use their traditional production techniques.
- Poor land tenure system that cannot support production on a large scale.
- Low level of inventions and innovations due to limited research capacity.
- Limited entrepreneurial ability whereby there are few people with ability and skills to use and manage the modern technology.
- Poor topography, for example, hilly areas or rugged terrain that does not allow use of machines in production.
- Poor accountability or corruption leading to misuse of funds meant for the purchase of the technology.

Circumstances where capital intensive techniques can be applied in spite of abundant labour

The abundancy of labour does not mean that labour should always be used. There are situations that necessitate the use of capital intensive techniques. These include:

- Where capital intensive equipment is given to developing countries as a donation or grant, the abundant labour will not be utilised.
- Where labour is abundant but lacks the necessary skills, capital intensive techniques will be used.
- Where there is need to produce high quality products required in international markets, capital intensive techniques are preferred. Where the entrepreneur wants to acquire high levels of efficiency and productivity, capital intensive techniques are preferred to labour intensive. Where there is need for continuity in production process, capital intensive techniques will be used since the abundant labour may disrupt production through strikes.
- Where labour is abundant but expensive in the long run in terms of feeding, accommodation etc yet capital is artificially cheap due to lowering of taxes or. the equipment by the government. This encourages the entrepreneur to use capital intensive techniques rather than labour which is abundant. Where there is need to encourage technological development and transfer, capital intensive techniques are preferred, for example, foreign investors are more used to capital than labour.
- Where there is need to save time and produce output at a faster rate, capital intensive techniques are preferred compared to the abundant labour that is slow and time consuming.

- Where there is need to produce standardized output in order to promote economic growth, capital intensive techniques will be applied leaving the abundant labour unemployed.
- Where there is need to maximumly utilise the local resources, capital intensive techniques are preferred compared to the abundant labour which may result into excess capacity if applied.

A summary of the impact of labour intensive and capital intensive techniques

Labour intensive technology is the method of production which uses more labour relative to other factors of production especially capital.

Impact of using labour intensive techniques

Positive impact

- Provision of employment opportunities
- Facilitated fairer income distribution
- Encouraged use of locally available resources
- Widened tax base
- Controlled social costs like noise and pollution
- Helped to control excessive resource exploitation
- Saved foreign exchange that would be paid to expatriates.
- Helped to spread development because can be adopted in all regions of the country
- Encouraged investment due to increased demand
- Easily adapted since there are limited skills and requires low skills

Negative impact

- Constrained productivity in the economy
- Low quality output produced
- Resulted into resource under utilisation S low in producing goods
- Hard to standardize output
- High costs of providing amenities and wages

- Stifled skills development
- Labour unrest in for of strikes
- Stunted technological development
- Limited infrastructural development
- Hampered firms enjoying economies of scale due to low output levels.

Capital intensive technology are production methods that employ relatively - :re capital than other factors especially labour.

Impact of capital intensive technology

Positive impact:

- Facilitated optimal resource utilization, this is because the exploitation of available potentials is made possible as marginal land is put to use.
- Led to production of better quality goods.
- Led to production of higher output hence economic growth.
- Reduced labour unrest.
- Enhanced labour efficiency through training.
- Encouraged technological transfer and development through encouraging research and innovations.
- Led to the development of infrastructure. This is by facilitating and initiating mad construction to increase access.
- It is time saving in that it has promoted efficiency in production as it is faster than labour using techniques.
- Acts as a basis for industrial development.
- Diversification of production is made possible.
- Led to reduced/ lower costs in the long run because of low wage bill.
- Led to development of labour skills.
- Led to standardisation of output.
- In the long run offers employment.

Negative impact:

- Led to technological unemployment.
- Worsened the problem of income inequality.
- Resulted into over exploitation or resources thus quick resource exhaustion or depletion.
- Requires a lot of capital to purchase and maintain.
- May not apply in all areas or sectors for example it cannot be used in production of goods that require human judgements like tea and coffee.
- Led to high social costs like pollution and environmental degradation.
- Led to rural-urban migration and its negative effects.
- Resulted in problems of profit repatriation because of foreign ownership.
- It is costly in the short run.
- Led to mass production and thus wastage where market is small.

Technology

Technology refers to the knowledge of how to produce goods.

Technology development

Technology Development is a process of introducing, initiating and improving of the indigenous techniques of production.

Technology transfer

Technology Transfer is the shifting or movement of new and efficient production techniques from one economy to another mainly form developed economies to less developed economies.

Merits of Technology Transfer

- Leads to increased productivity of labour leading to greater output.
- Facilitates exploitation of resources. The introduction of better machines helps to exploit resources that would have remained idle.
- Leads to new and better quality products leading to high standards of living.
- Leads to development of labour skills. Labour acquires skills through training to use the new efficient machines.
- Leads to increased growth of the industrial sector. The new and efficient

production techniques lead to establishment of more and more industries leading to the growth of the industrial sector.

- Facilitates infrastructural development. There is increased construction of roads which enables easy transportation of finished products and raw materials leading to increased output.
- Leads to reduced wage bill in those affected firms as less labour is used.
- Leads to social and cultural transformation leading to economic growth and development.
- Promotes improved relations between countries hence increasing the volume of trade.
- Leads to production of standard output because goods pass through the same production process.

Demerits of Technology Transfer

- Leads to technology dependence and its associated negative effects like importation of capital intensive technology which is not appropriate to the economy.
- Leads to mass production which is not suitable for the small markets hence wastage of resources.
- It is expensive or costly to employ for it requires highly skilled manpower which is expensive and the process requires a lot of money to purchase and repair
- Leads to increased outflow of foreign exchange to import spare parts hence worsening balance of payments position.
- Leads to technological unemployment whereby machines replace labour.
- Leads to regional imbalance since it is mainly applied in urban areas neglecting rural areas.
- Leads to over exploitation of resources leading to quick depletion of resources.
- Promotes income inequality since it is owned by a few people.
- Leads to moral decay, for example, through internet on computers where people Jewess pornography.

Limitations (obstacles) to technology transfer

Major obstacles/ constraints to technology transfer from Developed to developed

countries include:

- Political instability. This scares away potential investors discouraging them team installing their machinery and does not provide a conducive environment for technological development.
- Inadequate funds in the developing (recipient) countries. There are limited funds to purchase and maintain the technology since it requires a lot of money to buy spare parts. This limits technological capacity building.
- Inappropriateness of the technology being transferred. Most times the technology transferred is irrelevant and unsuitable to conditions prevailing in the developing countries.
- Prohibition by patent laws in the developed countries. Intellectual property rights in form of patent laws have limited the developing countries from using their technology.
- Inadequate scientific skills for manning the technology. There is limited skilled manpower to operate and repair the new technology.
- Conservativeness. Some people are not willing to embrace the new technology (ideas) due to strong religious, cultural and traditional attachment, hence they prefer to stick to their technology they are used to.
- Poor infrastructure like poor roads which discourage movement of machines.
- Limited absorptive capacity. When the new technology is introduced it operates at excess capacity leading to wastage.
- Foreign sabotage. The rich technologically developed countries have sabotaged technological development in developing countries which would subject them to stiff competition and probably make the developed countries lose their market in the developing countries.
- Protective policies of recipient (developing) countries whereby they restrict importation of technology by imposing high tariffs on capital goods.
- Limited entrepreneurship skills whereby there are few people with ability and necessary skills to use and manage the modern efficient technology
- Ideological differences. This makes difficult to access better technology from some developed countries.
- The poor education system which is theoretical in nature and inappropriate does not facilitate technological capacity building but instead promotes capacity to consume foreign technologies and their products through the foreign

sophiscated tastes it creates.

Intermediate technology

Intermediate technology is the method of production that is neither tool backward nor too advanced.

Or a method of production that is between capital intensive and labour intensive technology. It thus uses labour and capital in a fair proportion.

It is a production technique which lies between the advanced capital intensive technology and the labour intensive technology. Therefore, this production technique is mid-way the capital intensive and labour intensive methods of production. For example the use of ox-ploughs in cultivation in some parts of Uganda is an example of intermediate technology.

Characteristics of intermediate technology.

- It mainly uses locally available resources / raw materials.
- Production is largely based on the local market, that is, producers sell output the local market.
- It can easily be adopted to local conditions like the use of Ox-ploughs in an area, takes into account the existing climatic conditions in that area.
- It is cheaper than capital intensive technology and can be afforded by a fairly big number of producers.
- It is basically a rural - based technology.

The impact of intermediate technology

Positive impact (merits)

- Created more employment opportunities to the people.
- Reduced rural urban migration and its negative evils.
- Facilitated rural development since it is a rural -based technology.
- Promoted local skills and expertise.
- Produces according to the local needs of the people and therefore reduce wastage.
- Re-distributed income thereby creating a fairer income distribution.
- Facilitated exploitation of resources.

- Increased the level of output.
- Saves the scarce foreign exchange since it uses limited imported inputs.
- Led to improved quality of output.
- Led to the development of local technology.
- Cheaper and easy to adopt.

Negative impact (demerits)

- Involves high costs since some machines are bought to be combined with manual labour that is being hired in a production unit.
- Gives rise to depletion of resources in the long - run.
- Results into lower productivity / lower output levels than that generated in capital intensive using production firms.
- There is a high wage bill incurred by producers. This arises because wages are 3£id to manual workers and the professional experts in charge of operating and repairing machines.

Role of intermediate technology in development

Role of intermediate technology in development include the following:

- Creates employment opportunities by making use of locally available labourforce in most segments of production.
- Helps in fair income distribution as it employs more and is used widely.
- Encourages exploitation of local resources or raw materials.
- Reduces foreign dependence on imported inputs and consumer products.
- Increases productivity of local resources leading to high output thus economic growth.
- Encourages rural development and transformation as it is mainly rural based. This controls rural-urban migration.
- Saves scarce foreign exchanges as limited inputs are imported.
- Promotes forward and backward linkages with other sectors of the economy hence limited wastage of resources.
- Promotes local research, innovativeness and creativity.

- Promotes local entrepreneurship by encouraging risk taking in the economy and organization of other factors of production.
- Promotes economic indigenisation as it mainly uses local resources.
- Promotes balanced regional development as it is geographically widespread.
- Promotes development of local skills most especially where it involves -rgrading of labour intensive methods.

Limitations of intermediate technology in developing countries

- Narrow markets for the locally produced goods.
- Inadequate supply of skilled manpower.
- Limited capital to finance research.
- Foreign sabotage by More Developed Countries.
- Conservatism.
- Limited government support and encouragement.

Appropriate technology

An appropriate technology is a production method which is **socially and economically suitable** for a given economy (society).

OrA production method which is in line with development objectives and suits the development level of an economy.

N.B The emphasis is on the suitability of the technology e.g the use of energy saving cooking stoves , use of solar energy equipment, use of gas for lighting arc cooking can be appropriate in one society while in another society it is Hydro -electric power which is appropriate as a source of energy.

Conditions under which a technology may be regarded as Appropriate

In developing countries, technology is said to be appropriate if it satisfies the following conditions:

- When it suits the social conditions of the economy /area.
- When it is economically suitable for the society using it.
- When it is affordable and readily available to the people who want to use it.
- When it is suitable for the local surroundings and friendly to the environment in

which it is being used.

- When it leads to employment of the locally available labour.
- If it uses locally available resources or raw materials.
- When it is rural based thus facilitating the establishment of industries in rural areas.
- When it is suitable for the market it is intended to serve.
- When its components and maintenance are made and done locally.
- When it does not require advanced skills that are not available but uses locally available skills.

Factors that influence/affect/determine the development of appropriate technology

- Availability of funds/ capital
- Level of skills / education.
- Level of entrepreneurship.
- Level of innovations and inventions.
- Degree of external / foreign influence.
- Government influence on technological development.
- Market for technology and products made using that technology. A wider market for goods produced using appropriate technology, increases the use of that technology while a small market for goods leads to a reduction in the use of the technology.
- Cultural factors. Where cultural beliefs favour appropriate technology, it becomes more developed. However, where cultural beliefs are not in line with this technology, it becomes less developed.
- Natural factors, for example, topography, soils and drainage. Unfavourable natural factors limit the development of appropriate technology while favourable natural factors stimulate the development of appropriate. Technology for example, the use of ox-ploughs as an appropriate technology in some areas is influenced by natural factors.

Factors that limit the development of appropriate technology

- Limited capital.

- Unfavourable cultural factors,
- Negative external influence.
- Limited skills.
- Limited government support on technological development,
- Low level of entrepreneurship.
- Low level of innovations and inventions
- Unfavourable natural factors like poor soils, por drainage etc.
- Narrow market for the technology and its products.

Questions

a) “Distinguish between **Labour saving** and **Capital saving** techniques of

b) “Uganda needs to adopt capital intensive techniques of production as a way of attaining higher rates of economic growth. “Discuss”.

a)Distinguish between **technological development** and **technological transfer.**

b)Explain the factors that limit technological transfer in developing countries.

a) Differentiate between Labour intensive technology and Intermediate technology.

b) Assess the implications of using labour intensive techniques of production in ml economy.

Foreign direct investment in uganda

Foreign direct investment or direct foreign investment is the transfer of productive resources or capital by foreign individuals, companies, and multinational corporations inform of business operations.

Key terms to note

i. Investment is the process of creating capital stock or process of devoting part of a person's / nation's income to create capital stock /capital goods.

ii. A Multinational corporation. This is an international company which has its headquartersin one country but it has a number of affiliate branches and areas of operation in other countries; in both developed and developing countries. Examples are: Coca-cola, Caltex, Shell, MTN: Sony, Panasonic, Toyota among others.

iii. Foreign private investment refers to the process of devoting part of income to the increasing of capital stock in the country by individuals and firs from other countries.

iv. Foreign capital investment refers to investment by foreigners as individuals, companies and multi-national corporations involving the transfer of productive resources in form of business operations.

v. Foreign capital refers to producer goods in the country which are owned by outsiders/foreigners and it is mainly manifested in investment undertaken by MNCs.

vi. Private foreign investment is the shifting of producer goods from one country to another, mainly form developed to developing countries, by firms and or individuals.

Factors that have influenced the level of foreign direct investment in uganda

- The availability of investment incentives (tax incentives). The provision economic incentives such as land allocation in Namanve and tax holidays (relief) leads to high levels of foreign direct investment because it reduces production costs and increases profits which encourages the foreign investors to invest more but high taxes lead to low levels of foreign direct investment because it leads to high production costs and low profits thereby discouraging foreign investors.

- The level of infrastructural development. High level of infrastructural development leads to high level of foreign direct investment because it enables the transportation of inputs to production sites as well as transportation of finished products to markets which encourages foreign investors but poor infrastructure in form of poor roads hinder access to inputs and market for finished products which discourages foreign investors hence low foreign direct investment.

- The political climate /atmosphere. Favourable political climate leads to high levels of foreign direct investment because foreign investors are confident of the security of their lives and property which encourages them to establish production plants but political unrest leads to low levels of foreign direct investment because it destroys production plants and infrastructure resulting in heavy losses hence scaring foreign investors from investing in such areas.

- The availability of raw materials (the natural resource base). Greater and better exploitation of available natural resources leads to large scale production which encourages high levels of foreign direct investment but limited basic raw materials limits the production capacity of firms that are set up which results into low levels of foreign direct investment.

- The availability of capita/ (the existing stock of capita). Big size of the existing capital leads to high level of foreign direct investment because it increases the capacity of investors to hire factors of production to be used for the establishment of foreign investments and expansion of the existing ones while small size of the existing stock of capital leads to low levels of foreign direct investment because it limits the capacity of investors to hire factors of production to be used for the establishment of new firms and expansion of existing ones.

- The entrepreneurial ability. High level of entrepreneurial ability leads to high levels of foreign direct investment because investors have sufficient skulls to organise factors of production to yield maximum output and to exchange the products to maximise profits but low levels of entrepreneurial ability leads to low levels of foreign direct investment because investors are unable to effectively mobilise factors of production which limits establishment of new foreign investments.

- The labour skills. A big size of highly skilled workers is able to promote foreign direct investment due to its high level of efficiency and productivity but limited labour skills result into low labour productivity and efficiency thereby discouraging foreign direct investment.

- The techniques of production. The use of better, advanced technology encourages greater levels of production which promotes high levels of foreign direct investment but the use of poor technology in production does not lead to increase in output thereby discouraging foreign direct investment.

- The land tenure system. A better land tenure system which allows individual ownership of land increases access to land for investment purposes hence high levels of foreign direct investment but a poor land tenure system limits access to land resources for investment purposes which discourages foreign direct investment.

- The degree of conservatism. Increased levels of conservatism where people have a negative cultural attitude limits production due to the traditional way of doing things thereby discouraging foreign direct investment but an increase in the number of people with a positive cultural attitude are willing to take on modern methods of production and are able to produce more goods and services leading to high levels of foreign direct investment.

- The market size. The expansion of market for the products of foreign investors through, for example, joining regional co-operation such as East African Community leads to high levels of foreign direct investment because there is an increase in the amount of profits enjoyed and limited wastage of resources but a small size of the market leads to low levels of foreign direct investment because investors are discouraged to invest due to fear of excess output that leads to wastage of resources and heavy losses.

- The level of accountability (corruption). High level of accountability and financial discipline increases the funds meant for investment thus promoting high levels of foreign direct investment but poor accountability or1 of corruption leads to misuse of funds that would facilitate investment to personal interests hence limiting foreign direct investment.

- The price stability (the rate of inflation). Low inflation rates lead to low costs of production and increased profitability which encourages the expansion of foreign direct investment but high rates of inflation increases the cost of production and reduces profit levels thereby discouraging foreign direct investment.

- The degree of liberalisation of the economy. The liberalisation of the economy allows foreign investors to participate in production for exchange which results in the growth of foreign direct investment but increased unnecessary government controls on trade limits the freedom of individuals to set up investments thereby discouraging the growth of foreign direct investment.

- The level (degree) of bureaucracy. High level of bureaucracy makes it difficult to acquire clearance, work permits and licences thereby discouraging foreign direct investment but low level of bureaucracy makes it easy to get work permits, clearance, licences and access to utilities thereby promoting high levels of foreign direct investment.

- The level of (external) publicity of investment opportunities in the country. Increased international campaigns on possible investment opportunities in the country encourages more foreign investors to come and set up investments hence increase in foreign direct investment but the inability to carry out international campaigns to convince investors to come and set up investments in an economy limits the level of foreign direct investment because there is limited awareness of investment opportunities.

Merits (benefits) of foreign direct investment in Uganda

- Closes the foreign exchange gap/ leads to increased inflow of foreign exchange. Foreign investors bring in foreign exchange in order to finance then-activities. They exchange it for the local currency and this help to close the foreign exchange gap in Uganda.

- Leads to increased output hence economic growth. Foreign investors increase the volume of goods and services produced in Uganda thereby contributing to economic growth and increased Gross Domestic Product (GDP).

- Creates more employment opportunities. Business firms and enterprises set up by foreign private investors provide more jobs to the local people (both skilled and semi-skilled people). Those who are employed earn income in order to sustain their lives by buying the basic necessities.

- Source of revenue to government through taxation. The government taxes the profits of multinational corporations (corporate tax) or charges PAYE (Pay As You Earn) from the salaries of workers in Multinational corporations. This enables government to raise revenue to provide public goods which are necessary for development.

- Means of technological transfer/ fills the technological gap. Foreign direct bring better and more efficient techniques of production from their countries. This leads to production of high quality products.

- Promotes the development of local labour skills/ leads to increased supply of labour. Foreign investors train the local people through on - job training programmes and this enables them to acquire the basic skills needed in that is, they train technicians, production supervisors, book keepers among others.

- Promotes use of local resources which would have remained idle hence of resource wastage. Multinational corporations produce final products by making use of raw materials and other resources that would otherwise lay idle for example, oil companies from other countries are exploiting oil wells in Uganda; which have remained un- tapped.

- Widens consumer choice due to production of a variety of goods. Since consumers are able to select what to buy from a wide range of inter-related goods and services, this enables them to improve their standard of living.

- Promotes the development of basic infrastructure. Foreign investors are investing in the provision of infrastructure like electricity, communication facilities, banking infrastructure among others. This has promoted the development of basic infrastructure in Uganda. Although the infrastructure are for their benefit, members of the general public also benefit by accessing the infrastructure.

- Promotes efficiency of local firms due to competition. The local firms also strive to improve quality of their products so that they are not outcompeted by the foreign investors. This results into increased efficiency of local domestic firms.

- Accelerated industrial growth in Uganda/ led to the development of the industrial sector. Some foreign investors set up industrial firms for example manufacturing and agro - based processing industries and this increases the pace : f industrial development in Uganda.

- Promotes international co-operation (friendly relations with other countries) and therefore increases international peace and the volume of goods traded. By hosting foreign investors, Uganda is able to maintain stronger political ties with mother countries of those foreign investors. This has an advantage of promoting trade links with other countries hence getting other associated benefits.

- Encourages inventions and innovations, hence technological development. Foreign investors carry out research and try to develop better production techniques and marketing strategies. This consequently improves the quality of goods and services produced in Uganda.

- Improves the Balance of payments position. Some of the foreign investors produce goods which would have been imported from other countries and paid for in hard currency. This enables the country to reduce her foreign exchange expenditure and this slowly improves the Balance of payments position.

- Leads to production of quality goods and services. Due to use of better methods of production and competition between private investors, quality of products increases thus enabling consumers to consume better quality products.

Demerits or costs of foreign direct investment in uganda

- Accelerates capital out flows in form of profit repatriation and this causes Balance of Payments (B.O.P) problems.

- Worsens income disparities. The foreign private investment contributes to the widening of the income gap by providing more incomes to the foreign owners compared to indigenous entrepreneurs.

- Promotes external dependence of the economy. Uganda relies on foreign investors to bring in foreign capital, technology and skills which worsens external dependency problem.

- Local firms may be out competed by the big foreign investors.

- Gives rise to technological unemployment which arises from the use of advanced capital intensive machines / technology. Human labour is replaced with machines hence unemployment is created.

- There is irrational use of resources which leads to quick depletion of some of the resources. Private foreign investors lead to exhaustion of resources due to overexploitation since the objective of production is profit maximization no: resource conservation.

- Breeds foreign domination of the economy. These foreign investors always demand for excess concessions from government in form of tax holidays, free land for location of projects etc. These excessive concessions given to foreign investors by government finally reduce the net benefits from such foreign investors.

- Results into environmental hazards like air and water pollution where foreign investors are investing in industrial projects or establishments. The foreign investors degrade the environment by dumping of industrial wastes on the environment.

- Breeds regional / sectoral imbalances in development. This arises because foreign investors prefer to locate their industries or business projects in urban areas and this leaves out the rural areas.

- Promotes rural - urban migration and its associated problems. This is due to concentration of their activities and investments in urban areas thereby promoting rural exodus in search of better income earning opportunities.

- Erosion of cultural and moral values. This is due to the transfer of western-values by the owners and foreign workers in these investments thereby eroding the traditional African culture.

Impact of relying on foreign investments- a summary

Positive impact

- Helped in closing the savings-investment gap
- Source of government revenue
- Created employment opportunities
- Promoted technological progress and transfer
- Helped in skills development through training
- Encouraged infrastructural development
- Promoted international co-operation
- Helped to fill the skilled manpower gap
- Improvement in resource utilisation
- Innovations are encouraged
- Widened consumer choices because of variety
- Encouraged efficiency in firms
- Helped in accelerating economic growth

- Facilitated industrialization process
- Closed the foreign exchange gap
- Led to production of quality products

Negative impact

- Accelerated profit repatriation or capital flight
- Worsened economic dependence
- Led to irrational exploitation of resources
- Led to regional imbalances
- Interference in government decisions
- Promoted rural-urban migration
- Led to unemployment due to use of capital intensive techniques
- Worsened income inequalities
- Local firms are sometimes outcompeted
- Excessive concession which reduces net gains
- Erosion of cultural / moral values
- Caused substantial social costs for example pollution

Problems facing the private foreign investment in Uganda

- Limited capital. There is limited capital due to low profits and limited access 3 loans from financial institutions as a result of problems of collateral security, untrustworthiness of the borrowers and discouraging interest on the loans.
- Limited skilled labour. The efficiency of the investments set up by foreigners is limited by the use of mainly unskilled and semi-skilled labour due to :he poor system of education.
- Inadequate market. There are limited markets for products of the foreign private investments both at home and abroad. Internally the markets are limited by the general low incomes of consumers and competition by superior imports. Externally, the markets are limited by the poor quality of the products which cannot therefore, compete abroad and by protectionism in the external markets.
- Poor infrastructure. Infrastructures such as roads, rails and power are in a poor

state and impede (hinder) the transportation of inputs to production sites as well as transportation of finished products to markets.

- Political instability in some areas. There is political unrest in some areas of me country which has resulted in the destruction of production units of the foreigners hence discouraging private foreign investment in such areas.

- Poor investment climate for example high tax regimes. Taxes imposed on private foreign investments sometimes are too high to enable firms meet costs of production from the sale of final products. This has resulted in the closure of enterprises and stagnation in the growth of others.

- Poor land tenure system. This limits access to land resources for investment purposes as most of the land is in the hands of absentee landlords and communal ownership.

- Poor technology. The techniques used in production are mainly labour intensive which does not lead to rapid increase in output. The available techniques are poor due to limited innovations and inventions and importation of main unsuitable technology for production.

- High level of corruption / poor accountability. This leads to misuse c funds that would facilitate investment to personal aggrandizement (interests).

- Limited natural resources / limited basic raw materials. This limits the production capacity of the firms that are set up by the investors.

- High inflation rate. The high rates of inflation increase the costs < production making it difficult to undertake investments in the country.

- Natural hazards. These mainly affect investments in the agricultural sector thereby limiting the supply of raw materials needed for the agro-based industries

- Limited entrepreneurial ability. Some of the foreign business people do no: have sufficient skills to organise factors of production to yield maximum outpx and to exchange the products to maximise profits.

Measures that have been taken to promote the operations of the private foreign capital

- Improvement of infrastructure. The government has facilitated the building of strong and sound infrastructural facilities, for example, banks, power plans and the road network. The improved road network has enabled the investors access areas of market for their final products and raw materials needed in the production units.

- Maintenance of political stability. The government has tried to create ar enabling environment in order to give confidence to the foreign investors I undertake greater production.

- Expansion of market through economic integration. The government has taken measures to expand markets for products of the foreign investors througn for example, joining regional co-operation such as the East African Community.
- Improvement in technology. There has been encouragement of technologies development and transfer through research and enabling policies which has enabled setting up of many investments in the country.
- Liberalisation of the economy. The economy has been liberalized to allow every individual to participate in production for exchange. This has resulted in the growth of the private foreign investments.
- Improvement in labour skills through training. The government has encouraged the setting up of many vocational institutions and universities to offer training to labour. This has resulted in improvement of labour skills.
- Provision of favourable investment climate through offering investment incentives to foreign investors such as land allocation, tax holidays and tax rebates. Private foreign investment has been encouraged by provision economic or tax incentives to investors. This has encouraged the foreign investors to invest in the economy since they are guaranteed tax relief till their investments been profitable.
- Undertake land reforms. The government has enacted land laws (the Land Act) to ease access to the land resources for investment purposes.
- Maintenance of price stability (fight against high inflation rates) through macro-economic stability policies. Inflation has been controlled and price stability maintained through using sound macro-economic policies such as contractionary restrictive) monetary and fiscal policies. This has discouraged speculation in the my and encouraged production for exchange.
- Privatisation of public enterprises. Most enterprises which were previously state owned have been sold off to private foreign entrepreneurs as a way of increased efficiency in the enterprises.
- Improvement in entrepreneurial skills. This has been done through training r me proper management of business operations by way of seminars and workshops for entrepreneurs. This has the potential of providing skills into better organisation of other factors of production through increased taking on of risks.
- Provision of credit facilities. There has been encouragement to financial institutions to avail credit at low interest rates to the foreign investors to enable them acquire capital necessary for business operations.

- Attempts at fighting corruption to ease investment. There has been effort - stumping out corruption through the use of the institution of the Inspector General of Government (IGG) and the Anti-Corruption court so as to reduce the rest of doing business in the country.

- Establishment of specialised institutions to promote investment like Uganda Investment Authority (U.I.A.) which is a one-stop centre for all information on investment related activities.

- International campaigns to convince investors to come into the country. The government has undertaken measures to carry out international campaigns on possible areas of investment through strengthening bi-lateral ties with countries like China, Germany, Japan among others. This has encouraged more foreign Investors to come and set up investment ventures.

Steps which are being taken to attract foreign investors in Uganda

- Offering of investment incentives for example tax holidays being offered to foreign investors, gazetting land for the foreign investors at Namanve industrial park e.t.c. Private foreign investment is being encouraged by provision of economic or tax incentives to investors. This is encouraging the foreign investors to invest in the economy since they are guaranteed tax relief till their investments become profitable.

- Building of strong and sound infrastructural facilities/ improving basic infrastructure by constructing better roads. The government is facilitating the building of strong and sound infrastructural facilities, for example, banks, power plants and the road network. The improvement of the road network is enabling the investors to access areas of market for their final products and raw materials needed in the production units.

- Attaining political stability in the country. The government is trying to create an enabling environment in order to give confidence to the foreign investors to undertake greater production since there is assured safety of life and property.

- Fighting inflation or achieving macro- economic stability, for example, ensuring stability in prices, stability in exchange rates and so on. Inflation is being controlled and price stability maintained through using sound macro-economic policies such as contractionary (restrictive) monetary and fiscal policies. This is discouraging speculation in the economy and encouraging production for exchange.

- Undertaking further privatization of public (state) enterprises. Most enterprises which were previously state owned are being sold off to private foreign entrepreneurs as a way of increasing efficiency in the enterprises.

- Undertaking further liberalization of the economy. The economy is being liberalized through removal of unnecessary government controls on trade. This is to allow every individual to participate in production for exchange. This has resulted in the growth of the private foreign investments.

- Intensifying international publicity of investment opportunities available in Uganda. The government is undertaking measures to carry out international campaigns on possible areas of investment through strengthening bi-lateral ties with countries like China, Germany, Japan among others. This is encouraging more foreign investors to come and set up investment ventures.

- Training people and equipping them with skills required by foreign investors/ Undertaking appropriate manpower training in Uganda. This is through offering training to labour in form of organizing seminars, workshops and on-job training so as to increase efficiency and productivity in the firms established by foreign investors.

- Reforming the land tenure system. The government is trying to enact appropriate land laws (the Land Act) to ease access to the land resources for investment purposes.

- Encouraging acquisition of entrepreneurship skills. This is being done through training in the proper management of business operations by way of seminars and workshops for entrepreneurs. This is being done as a potential way of providing skills into better organisation of other factors of production through increased taking on of risks.

- Fighting corruption to ease investment. There is effort being made in stumping out corruption through the use of the institution of the Inspector General of Government (IGG) and the Anti-Corruption court so as to reduce the cost of doing business in the country.

- Expanding of market through joining economic integration. The government is taking measures to expand markets for products of the foreign investors through, for example, joining regional co-operation such as the East African Community.

Review questions and answers

(i) what is Meant by **'private foreign investment'?**

Private foreign investment is the shifting of producer goods from one country to airily form developed to developing countries, by firms and or

(ii) Mention three limitations to **foreign private investment** in your country.

- Poor infrastructures

- Conservation of the people
- High levels of corruption
- Limited labour skills
- Poor political atmosphere
- Poor land tenure system
- Limited supply of raw materials
- Insufficient tax incentives
- High levels of inflation
- Bureaucracy in obtaining permits,
- Limited market.

I. **Define the term direct foreign investment.**

(ii) Give any three demerits of direct foreign investment in your country.

Direct Foreign Investment is the transfer of productive resources / capital by individuals, companies and multi-national corporations in form of business operations.

Demerits of Foreign Direct Investment thus;

- BOP problems rise
- Unemployment due to use of capital intensive technology and R-U-M.
- Over exploitation of resources
- Capital flight
- Excessive concessions given to them reduce the net or real benefits
- Worsens economic dependence
- Sectoral and regional imbalances are perpetuated
- Subduing or suffocating local firms
- Interference in political decisions
- Erosion of cultural / moral values
- Have worsened income inequalities.

a) **Explain the role of multinational corporations in the development of Uganda**.

- Source of government revenue.
- Encourage the development of infrastructure.
- Creation of employment opportunities.
- Promotion of international friendly relations.
- Promotion of labour skills.
- Close the savings-investment gap.
- Production of variety of goods and services.
- Close technological gap.
- Facilitate industrial development
- Promote high quality goods and services.
- Help in closing the manpower gap.
- Promote high quality goods and services.
- Promote efficiency in the firms.
- Encourage utilisation of the available resources.
- Promote economic growth.

(b**) Examine the factors that affect the operations of multinational corporations in your country.**

- Government policy of taxation and subsidisation.
- Political climate.
- Level of infrastructural development.
- Labour skills.
- Entrepreneurial skills.
- State of technology.
- Level of accountability or degree of corruption.
- External publicity.

- Land tenure system.
- Market size.
- Availability of raw materials.
- Degree of conservatism.
- State of inflation or price fluctuations.
- Degree of bureaucracy, for example, in clearance, acquiring licences among others.

Questions:

1. (a) Define the term **Foreign direct investment.**

   (b) Assess the implications of foreign direct investment in an economy.

2. (a) Explain the role of the private sector in the development of your country,

   (b) What are the challenges faced by the private sector in your country?

3 (a) What is meant by **Multi- national corporations?**

   (b) Assess the impact of multi-national corporations in your country.

4. (a) What are the objectives of promoting foreign direct investment in your country?

   (b) Why may foreign direct investment be undesirable in your country?

5. (a) Explain the factors that influence foreign investment in your country.

   (b) Suggest measures that should be taken to encourage foreign investment in your country.

6. (a) What are the benefits of direct foreign investment in your country?

   b) plain the measures that are being taken to promote foreign investment in

Sub- topic: education and development

Meaning of education

Education refers to the acquisition of knowledge and skills both formally and

Informally. It is an ingredient in the process of human capital formation.

Education is regarded as a consumer good, an economic good and a capital good therefore, it is an investment.

Education as a consumer good

The following qualify education to be a consumer good;

- The recipient derives utility of having an education.
- Society derives utility by living with an educated person,
- Education raises the quality of life and enables one to appreciate life more fully.

Education as an economic good

The following characteristics or traits qualify education to be an economic good;

- Has a money value or a price to be paid.
- Provides utility.
- Has opportunity cost.
- It is scarce
- It is marketable and transferable.

Education as an investment

The following features qualify education to be an investment;

- Has opportunity cost because it requires sacrifice,
- Cost money and has a price to be paid.
- Involves risks and uncertainties, for example, failing to move from one level / class to another
- Involves time preference.
- Produces high quality services in the long run since it raises the quality of xanpower and its productivity.
- Has returns in the long run, for example, generates future streams of income.

Reasons for investment in education

- To provide skills to labour.
- To reduce income inequality.
- To promote national integration.
- To solve the unemployment problem.

- To reduce dependence on foreign skills/ to save foreign exchange for paying expatriates.
- To increase the rate of natural resource utilisation and avoid wastes.
- To increase output hence economic growth / to accelerate economic growth.
- To create a productive labourforce .
- To fight conservatism / to act as a vanguard for introducing new ideas in the country. Education is used to eradicate backward attitudes, beliefs, cultural values and superstitions.
- To promote acceptable values and attitudes / to facilitate change in the attitudes of people.
- To control population growth rate / to control fertility in women.
- To spearhead political, social and economic changes.

The role of education in the development process

Benefits of education in the development process

- Provides skills to labour. Education equips labour with the necessary skills to utilise and maintain modern physical capital.
- Reduces income inequality. Education acts as a means of effecting fairness in income distribution especially if it is accessible to all school going children like Universal Primary Education and Universal Secondary Education.
- Promotes national integration. Education is a means of facilitating national integration / unity through promoting national consciousness that is necessary as a precondition for all progress.
- Solves the unemployment problem. Education creates employment to the teachers, the industrialists producing scholastic materials etc and thus it is a source of income.
- Reduces dependence on foreign skills/ saves foreign exchange for paying expatriates. Education raises the quality of local labour, its efficiency and productivity thereby reducing the over reliance on foreign skills.
- Increases the rate of natural resource utilisation and avoid wastes. This i because of the increased market for manufactured and agricultural products.
- Increases output hence economic growth / accelerates economic growth. The increase in labour skills enables the production of high volumes of output due to

efficiency of labour.

- Creates a productive labourforce. Education raises the quality of labour, its efficiency and productivity.

- Fights conservatism / acts as a vanguard for introducing new ideas in the country. Education helps to eradicate backward attitudes, beliefs, cultural values and superstitions. Thus it promotes acceptable values and attitudes / facilitates change in the attitudes of people.

- Controls population growth rate / controls fertility in women. Increased education level encourages use of family planning methods and forces women to postpone chances of child birth at an early age.

- Spearheads political, social and economic changes. Education acts as a means to social, political and economic change.

- Education leads to innovations and inventions through research thus technological progress.

Challenges associated with education

- High dropout rates due to the increased expenses need to attain better education

- Low returns to investment, that is, low cost-benefit ratios. The returns of education are in the long run but may not be fully achieved if the educated fails to get a job.

- Accelerates unemployment. Education brings about school leavers' unemployment because the present education system is more theoretical than Tracheal.

- Worsened income inequalities. This is because it is mainly accessible to those with a rich family background. This increases their income earning chances unlike those with a poor family background.

- Principal cause of rural urban migration and associated problems.

- Leads to brain drain. The present education system enables people acquire high skills yet highly skilled labour may prefer moving for greener pastures upon filling to get a job in Uganda.

- Not aligned to the needs of developing economies.

- Creates educated people with no skills. This is because of the theoretical nature of the system.

- Discourages people from joining rural agricultural sector. The present education system does not prepare one to take up a living in the rural areas.

- Replica of colonial masters thus creates people with inappropriate attitudes. The present education system from the productive traditional cultural background by way of promoting western values.
- Heavily exam oriented. This is because the current education system is geared towards getting good grades with no sense of social responsibility.

Possible solutions to changing the present education system in Uganda

- Encourage free and compulsory primary education to reduce the illiteracy level and increase the enrollment ratio. This can promote equity in income distribution.
- Vocationalisation of education through promotion of practical subjects like woodwork, tailoring and agriculture. This can impart technical and practical skills to the youth for job creation.
- Encourage free female education in order to overcome the sex inequalities in the education sector.
- Encourage cost-sharing for post-secondary education for those who are able to pay. This can be done through extending loans and scholarships to students.
- Encourage private investment in education especially technical institutes, polytechnics, universities etc to increase on the literacy rate.
- Design a flexible school programme to fit the interest of the community in order to reduce the dropout rate.
- Integration of education in the community setting through community service oriented skills like extension services in agriculture, adult literacy programmes.

Sub-topic: foreign aid

This is the **international transfer of public funds in form of loans or grants or technical assistance** either directly **from one government to another (**that I bilateral aid)or indirectly through the **vehicle of a multi-lateral assistanceagency** / organization like the World Bank and International Monetary Fund (IMF) (that is multi-lateral aid).

OrIs the transfer of resources from one country to another usually from the developed countries to the developing countries; either directly or through international agencies. It could be bilateral aid or multilateral aid.

OrIs the transfer of resources, mainly funds, from one country to another by government, organisations, firms and individuals in order to help the recipient country.

Forms of foreign aid

Grants refer to the transfer of resources without any requirements for repayment.

Loans refer to the transfer of resources which must be repaid back with interest or without interest in a given period of time thus there are loans with interest and interest free loans.

The loans may be short-term, medium-term or long-term. They may also be soft loans or hard loans.

N.B.

i. **A soft loan** is financial assistance provided at very low or no interest and with long repayment periods. It is usually provided by one government to another.

OrIs the transfer of funds from one economic entity to another which must be paid with interest over a long period of time at concessionary or low interest rates.

OrRefers to funds lent out (financial advance) at concessionary (low) interest rates or no interest yet it provides other concessions to borrowers for example, long repayment periods, interest holidays, extended grace periods etc. .

ii. A hard loan is financial assistance with a high interest rate and a very short repayment period.

OrIs one with high interest rate yet with very short repayment periods. It is mainly paid in currency of a nation that has economic stability and a sound reputation abroad.

Reasons why Uganda continues to rely on loans

- Due to low tax revenue.
- To finance long term development projects.
- To fill the persistent budgetary deficits of government
- Due to low domestic savings.
- Low export earnings yet there is rising need for imports.
- Technical assistance: this is the transfer of resources in form of high level manpower like doctors, engineers, economists, nurses among others and the provision of scholarships.
- Direct Foreign Investment is the transfer of productive resources / capital by foreign individuals, companies and multi-national corporations in form of business operations.
- Relief items in form of medicine, food, clothes etc.

- Military assistance in form of training the army and the police.
- Technological transfer in form of machinery and equipment, for example, computers.

Some key terms

Project tied aid (use-tying) refers to assistance from an economic entity to another with (specific) conditions on profits / economic activities to be financed /

developed.

Or

Refers to assistance given to support a specific project hence resources given be diverted for any other purpose.

Merit of Project tied aid

- Promotes proper project planning
- Promotes proper accountability
- Creates market for the products of the donor country ?
- Avoids diversion of funds by the recipient country,
- Fills the budgetary gap by providing revenue for government projects. .
- Fills the manpower gap
- Fills the technological gap
- Fills the savings-investment gap.
- Strengthens international relations .
- Accelerates industrial growth
- Increases employment opportunities.

Tied aid refers to foreign aid in the form of bilateral loan or grants that require the recipient country to use the funds either to purchase goods from the donor or to use it to finance a specific project named in the aid.

OR

Disbursement of the aid is dependent on the recipient country implementing socioeconomic and political conditions set by the donor.

Examples of tied aid

- Tied aid which requires the recipient to abide by conditions set by the donors for example the recipient country is required to purchase goods from the donor country using the grant / funds **i.e. aid tied to source orpurchase (procurement tying).**
- Aid given to finance a specific project named by the donor. The recipient country's is required to implement socio- economic and political conditions dictated by the donor before the aid can be given i.e. project tied aid.

Reasons for the existence of tied aid in my country include;

- To promote proper project planning
- To increase control of the recipient country by the donor.
- To ensure proper accountability by both the recipient and donor.
- To create market for the products of the donor country.
- To alleviate the effects of natural disasters.
- To fill the manpower gap
- To fill the savings-investment gap
- To fill the technology gap
- To fill the government revenue-expenditure gap
- Due to the inability of the recipient country to identify cheaper and unconditional sources of aid.

Untied aid is one that the donor allows the recipient country to spend it on a wide variety of items (justified in terms of the total needs and development plan of the country rather than any particular project).

A Donor is a country or agency that gives aid or assistance. Donors can be multi¬lateral or bi-lateral.

Multi -lateral aid is assistance offered through international aid agencies like the World Bank and IMF and with no direct link between the donor and recipient countries.

While

Bilateral aid is assistance that is offered directly from one government/country another without going through an aid agency.

Benefits of relying on foreign aid in developing countries

- Closes the foreign exchange gap or trade gap. Foreign aid is to finance import surplus like fuel, drugs and manufactured goods which cannot be paid for from our exports.
- Closes government revenue-expenditure (budgetary) gap. Foreign aid gives budgetary support to the country. It is used by the government to cover recurrent a development expenditure that cannot be financed by the country's revenue sources like taxation, that is, it is a source of income to the government that is used to finance he-expenditure shortfalls.
- Fills the savings-investment gap. In developing countries like Uganda, the required investment which could be generated from the local or domestic savings always exceed? the available domestic savings. Thus the need for foreign aid to supplement domestic savings in order to meet the investment requirements.
- Fills the skilled manpower gap. The available manpower usually falls below the required personnel, thus, foreign aid supplements skilled manpower in form of technical
- Facilitates the development of infrastructure. Foreign aid has financed the development of supporting modern infrastructure such as roads, power dams, schools and hospitals which form the framework for economic development.
- Provision of employment opportunities. Foreign aid has created employment opportunities through being channeled into financing government projects and expanding the industrial sector. This expands the employment opportunities for the local people.
- Closes the technological gap. Foreign aid in form of capital goods or machinery has enabled the country to improve on its level of technology through encouraging logical transfer.
- Alleviates (solves) the effects of catastrophies. Foreign aid especially relief assistance has been useful in offsetting the effects of natural calamities like famine, drought, wars, feces, earthquakes and so on by meeting the needs of the suffering people.
- Where it is well utilised, it improves productivity, skills and wages. Foreign aid channeled to institutions of higher learning improves on the skills of local labourforce resulting in increased productivity.

- Facilitates the utilisation of idle resources. Foreign aid enables the recipient country ■ 32 to use the formerly idle resources and this leads to increase in output of goods and
- Strengthens international relations. Foreign aid has promoted international co-:n and international understanding between donors and recipients. This has increase the volume of international trade.
- Foreign aid in form of capital investments accelerates the pace of industrial growth. Foreign aid has been utilised to promote the development of the industrial sector through renovating old industries and setting up new ones.

Problems of relying on foreign aid in developing countries

- Leads to balance of payments problems due to repayment obligations especially when the aid is tied. Foreign aid accelerates capital outflow in form of loan repayment and interest thus affecting the capital account of the balance of payment
- Leads to unemployment. Sometimes technological aid is inappropriate causing dislocation of local labourforce due to introduction of machines like computers in banking industry. This causes technological unemployment.
- Promotes brain drain. Foreign aid in form of technical assistance demoralizes local manpower forcing many of the highly skilled individuals to seek employment in other countries.
- Kills local initiatives, that is, promotes/ encourages laziness. Foreign aid discourages local initiative as recipients constantly expect assistance instead of working hard.
- Leads to domination of the economy by foreigners, that is, the preconditions set are sometimes disastrous. Foreign aid has promoted the external dependence of the developing countries on the donors through interference in the economic decision making process.
- Leads to cultural erosion. Foreign aid erodes the socio-cultural values of the recipients and instead has promoted western values that are not in the best interests of the borrowers.
- Political domination by foreigners. Foreign aid has enabled the donors to interfere in the political decision making process of the developing countries, thus undermining their sovereignty. This is because aid at times has political strings attached with the objective of promotion of foreign political ideologies.
- Accelerates capital outflow due to debt servicing. The costs of contract finance

are high in form of high interests and short repayment periods. This results into excessive capital outflow.

- Distorts planning since sometimes aid is inadequate, uncertain inconsistent, tied etc. In most cases, the aid is inadequate, inconsistent and may be withdrawn before completion of a project. This may distort the planning process or development programmes of the recipients as most of the projects may remain incomplete.
- It is costly, for example, to maintain expatriates and due to the aid being tied to source / purchase. Aid in form of technical assistance and tied aid is expensive. For example, aid tied to source or purchase prevents the recipient from buying from the cheapest sources elsewhere in the world.
- Leads to under-utilisation of local resources. The technological aid provides to the developing countries kills local production as the aid cannot be sufficiently used to exploit the local resources. Also, food relief reduces domestic production of some consumer goods leading to operation at excess capacity.
- Sometimes preset conditions are disastrous. Foreign aid may have politic, strings attached to it thus undermining the political sovereignty of the country as it promotes foreign political ideologies.
- Undermines capital formation due to debt servicing and payment.
- payment of the principal and interest on the foreign loans reduces the available in the domestic economy for investment purposes hence limited c formation.
- Debt servicing sometimes denies nationals essential goods and services
- Foreign aid in form of contract finance leads to high costs due to high interest and short periods of repayment. The increased debt service burden sometime denies the national of essential goods and services.

Question

Examine the impact of relying on foreign aid in your country.

A summary

Impact of relying on foreign aid in Uganda- a summary

Positive impact

- Helped to fill the savings - investment gap
- Helped to fill the foreign exchange gap

- Helped to fill the government revenue-expenditure gap
- Helped to fill the skilled manpower gap
- Helped to fill the technological gap
- Helped in provision of more employment opportunities
- Helped to develop infrastructure
- Accelerated industrial growth
- Strengthened international relations
- Helped to raise level of economic growth
- Helped to alleviate suffering of the people due to catastrophies / disasters

Negative impact

- Led to balance of payment problems,
- Led to unemployment.
- Promoted brain drain.
- Killed local initiatives /promoted laziness.
- Led to domination of the economy by foreigners / Preconditions set are sometimes disastrous.
- Led to cultural erosion.
- Led to political interference/domination by donors or foreigners
- Accelerated economic dependence
- Accelerated capital outflow due to heavy debt servicing requirements,
- It is costly for example to maintain expatriates.
- Disorted planning since sometimes aid given is inadequate, uncertain and tied. .
- Led to under utilisation of local resources
- Inappropriate technology transferred
- Stifled and development due to pay back burden

Importance of aid to donor countries

The motives of giving foreign aid by the donors include:

- Creating employment for surplus labour. Aid increases employment to the donor countries. The increased output required to satisfy both the domestic and foreign remand leads to employment of more labour.

- Commercial reasons through creating market for surplus output. Aid enables enable countries to dispose off their surplus output that would have killed the local production in their economies.

- Ideological / social / cultural dominance. Aid is used by the donor countries for ideological reasons and to persuade the recipient countries into a similar line of development.

- Extending military influence. Aid is used by donor countries for strategic reasons. It is used to maintain spheres of influence in the developing economies especially aid in form of military assistance.

- Economic dominance. Aid increases the exports of the donor country and its Gross National Product (GNP) through encouraging the recipient countries to import from the donor countries.

- Humanitarian reasons. Aid is given for humanitarian reasons to offset the effects of calamities in the developing economies, for example, famine, drought, floods and so on.

- Political dominance. Aid can be used to serve foreign diplomacy through enhancing the culture and political influence of the donor country in the recipient country.

TOPIC 4: AGRICULTURE AND INDUSTRY

Agricultural development

Agricultural development refers to the transformation or changing of agriculture from traditional small scale peasant agriculture to large scale modern agriculture.

OR It refers to the changing of the agricultural sector form subsistence production to high output commercial production.

Requirements of agricultural development in less developed countries

- Undertaking modernisation of agriculture.
- Extension of agricultural knowledge and pass on the information to the farmers through \ extension services.
- Undertaking commercialization of agriculture to reduce on the subsistence sector in the economy.
- Improving on agricultural diversification.
- Breaking the social and cultural institutions that affect the land tenure system.

Way in which agriculture is dominant in Uganda's economy

- Major source of food. Both subsistence and commercial agriculture to feed theurban population.
- Great contribution to Gross Domestic Product (GDP). About 60-65% of the value goods and services produced in Uganda is from agriculture.
- Major source of exports. About 80-90% of Uganda's exports are derived from agriculture for example coffee, cotton, tea, tobacco and horticultural products.
- Major source of employment. About 80% of Uganda's population is engaged in agriculture either directly or indirectly.
- Major land use. About 60% of Uganda's land use is put under agriculture.
- Major source of raw materials for agro based industries. Many industries in Uganda use agricultural raw materials for example the textile industry.

Account for the dominance of the agricultural sector in your country.

Explain the factors that limit large scale agricultural production in your country.

Explain the structure of the Agricultural sector in your country.

(d) Describe the features of the agricultural sector in your country.

(e) What are the implications of such structure of agricultural sector to your country?

(f) Why is necessary to change the structure of the agricultural sector in your country

The role of agriculture in development

The role of agriculture in the development of an economy:

- Provides employment opportunities to the people. Agriculture provides employment to the majority of people either directly or indirectly because it is labour intensive.

- Ensures equitable income distribution since it is basically labour intensive with majority of the people employed.

- Provides revenue to the government through taxation. Government gets revenue by taxing the farmers through licences and market dues which enables it to finance her development programmes.

- Releases labour to other sectors of the economy. As agriculture productivity increases, the surplus labour moves to other sectors.

- Provides market to the industrial sector. As agricultural productivity increase? people's incomes increase which increases their purchasing power and demand for industrial goods. Also, with agricultural modernization practices the demand for industrial products in form of farm equipment, fertilizers among others increases.

- Generates foreign exchange to the country. Developing countries earn foreign exchange from exporting mainly agricultural products. Therefore, by developing agriculture they are able to increase on their foreign exchange earnings to facilitate importation of capital goods needed for industrial development.

- Supplies raw materials to the industrial sector. Agriculture provides raw materials to the agro-based industries which helps to develop the industrial sector

- Contributes towards the Gross Domestic Product (GDP) of the country Agriculture leads to increase in output of goods especially large scale product! units, thereby facilitating economic growth.

- Encourages rapid development of infrastructure. As agriculture productive increases, it encourages the construction of better roads to transport products to the market and storage facilities to store perishable products to avoid wastage.

- Promotes balanced regional development since it is carried out in all region of the country.

- A source of food for the people both in rural and urban areas. Agriculture is a :' food to feed the increasing population in the country. Food is needed to feed people employed in the industrial sector, schools, hospitals and prisons. Increases food production saves foreign exchange that would be used to import

Problems that result from over relying/ over dependence on agriculture:

- Leads to low output levels due to natural hazards like bad weather,
- Leads to low government revenue from taxes,
- Leads to limited level of industrialisation.
- Results into unfavourable terms of trade.
- Leads to unfavourable balance of payments.
- Does not encourage the development of skills.
- Leads to low levels of development due to low incomes / vicious circle of poverty.
- Prone to price fluctuations due to changes in output levels.
- Encourage seasonal unemployment. –
- Leads to diminishing returns which further reduces output.
- Promote dualism due to existence of subsistence and monetary sectors.
- Results into undiversified economy thus limited export sector.

Factors that affect performance of agricultural sector in my country include;

- Level of capital.
- Political climate.
- Size of the market,
- Level of infrastructural development.
- The nature of the land tenure system, el of research and development.
- Government policy towards agriculture.
- Level of skills of farmers
- Level of accountability within the sector.

Challenges / obstacles to agricultural development in a market economy

- Difficulty in marketing output due to small or limited markets.
- Problem of transportation of the inputs and final products due to poor infrastructures.
- Difficulty in raising the quantity of output using poor techniques production.
- Difficulty in improving skills or finding skilled labour due to high levels of illiteracy.
- Poor political climate making it difficult to attract people to the sector and causing difficulty in remaining in production.
- Poor land tenure system hence difficulty in expanding the scale of production.
- Low prices.
- Unfavourable natural factors making it difficult to realize targeted quantity anc quality of output.
- Poor entrepreneurship.
- Limited government commitment.
- Conservatism hence difficulty in making some farmers to accept modem] techniques of production.
- Poor attitude to agriculture.

Measures that are being adopted to improve the performance of agriculture in Uganda

- Undertaking land reform policies to make land more accessible.
- Providing credit facilities to farmers to increase their capacity to exploit land.
- Carrying out research in all fields.
- Improving infrastructure.
- Providing extension services to the farmers.
- Putting emphasis on agricultural diversification.
- Encouraging mechanization of the agricultural sector.
- Encouraging industrialisation within agriculture.
- Encouraging the training of labour.

- Promoting the development and or revival of co-operatives.
- Ensuring political stability.
- Providing subsidised inputs to farmers.
- Promoting market expansion for example through regional integration.
- Improving pricing policies for example through strengthening commodity agreements.

Review Questions

1. (a) Explain the obstacles to agricultural development in your country,

   (b) Explain the obstacles to agricultural development in your country.

2 (a) Differentiate between development objectives and development strategies

(b) Explain the merits and demerits of the agricultural development strategy in your country.

Commercial agriculture

What is meant by "commercial agriculture?"

Commercial agriculture is the deliberate act of encouraging large scale production mainly for exchange thereby reducing the level of subsistence production.

Explain the factors that have retarded the growth of Uganda's commercial sector

- Limited market,
- Inadequate capital.
- Conservative nature of most of our producers.
- Underdevelopment of financial institutions
- Political instability. :
- Poor technology.
- Limited entrepreneurial skills.
- Poor land tenure system.
- High taxation of large scale businesses.

Merits of diversification of agriculture

Diversification of agriculture is the creation of several activities in the agricultural sector in order to reduce dependence on one or few activities.

The creation of multi-activities within the sector include rearing of animals alongside growing of crops or introduction of new crops under crop husbandry.

It also involves setting up of processing plants in the agricultural sector.

Reasons for diversification of agriculture in Uganda

Reasons for diversification of agriculture in my country include:

- To reduce seasonal unemployment thereby create more employment opportunities from the numerous economic activities.
- To reduce the effects of price fluctuations and thus stabilise prices of the agricultural products.
- To increase agricultural output hence accelerate the process of economic growth.
- To increase revenue to the government by producing a variety of taxable products thus widening the tax base.
- To increase and stabilise primary producer's incomes / earnings.
- To increase foreign exchange earnings through increased agricultural exports.
- To increase utilisation of the land resources thus promoting the exploitation of idle resources in the economy.
- To reduce income inequality hence facilitate fair income distribution in the economy.
- To promote infrastructural development so as to ease access to the market for the final products and inputs for the agricultural firms.
- To promote commercialization and hence reduce incidences of subsistence production.
- To fight / control structural inflation by reducing supply rigidities through production of a variety of products.
- To promote linkage with other sectors so as to promote industrial development in the economy.
- To ensure food security and guard against importation of food supplies.

- To improve the balance of payments position since more foreign exchange is earned.

Merits of diversification of agricultural production

Merits of diversification of agricultural production include:

- Creates employment opportunities.
- Widens consumer's choice by providing a variety of goods and services.
- Widens the export base thus increases foreign exchange earnings.
- Increases the tax revenue of the country as many activities are undertaken.
- Ensures equal regional development and thus reduces rural-urban migration.
- Increases the country's Gross Domestic Product (GDP).
- Promotes linkages between the different sectors of the economy.
- Leads to optimum exploitation and utilisation of resources.
- Overcomes problems of price fluctuations and its negative effects.
- Avoids the risks and uncertainties in some sectors especially agriculture.
- Ensures fair distribution of income.
- Solves or controls inflation.
- Leads to the development of infrastructure.
- Reduces the effects of dependence on a few products / activities.

Land tenure system

This is a system of ownership, transfer of ownership and utilisation of land in an economy during a given period of time.

Reasons for changing the land tenure system in Uganda

- To ensure stability of the land tenure, that is, minimise conflicts over land.
- To make long term planning for land use possible.
- To ensure better utilisation of land so as to increase output hence economic growth.

- To increase the monetary value of land.
- To reduce income inequalities.
- To reduce unemployment.

Agricultural development

Most developing countries emphasise investment in agriculture to attain higher rates of economic growth.

Merits/ positive impact arising from the agricultural development strategy

- More employment opportunities are created since it is labour intensive. Most farming activities are labour intensive. This results into creation of more job opportunities. Workers earn income which is used to buy the basic necessities of life hence improving their standard of living.
- The sector is the source of food for the rising population. Agriculture provides food like rice, potatoes, maize, cassava etc. This improves the nutrition levels of people as starvation and hunger are avoided. Dependence on imported food hems is also reduced. By having adequate food supply, a country is able to feed its people.
- It is a major foreign exchange earner. Through exporting agricultural products like coffee, cotton fibre, vanilla e.t.c. a country is able to earn foreign exchange. This improves a country's foreign exchange reserves. At the same lime, the foreign exchange can be used to finance a country's development programmes as well as paying off the external debt.
- It reduces income inequality. Through developing agriculture, balanced regional development is attained where farmers in different areas are able to earn incomes from agricultural activities. This reduces the gap between the agricultural farmers and industrial workers thereby reducing income disparity among people.
- It is relatively cheaper to undertake. The agricultural sector is basically labour intensive. This makes it a cheaper strategy to adopt in developing countries, which have shortages of capital.
- It is a source of raw materials to the industrial sector. The agricultural sector provides vital inputs for use in the agro- based industries e.g providing cotton acre in the textile industry and sugar canes for the sugar processing industries. The development of agriculture is important since it helps to feed the industries with raw materials hence creating back-ward linkages. .
- It has quicker returns. Agriculture involves the growing of some crops with

maturity period. For example, farmers can grow crops like beans and -ne and then harvest them for sell within a short period. This brings in quicker monetary/financial returns compared to the long-run benefits in the industrial sector.

- It stimulates rapid infrastructural development. As agriculture is being developed, there is need to put in place production supporting infrastructure like better road network. The infrastructure put in place eases / facilitates the transportation of agricultural products from one place to another, as well as supporting other investment activities.

- Agriculture provides a high potential source of revenue to government. This is attained through taxing agricultural exports, levying taxes on imported rural inputs like tractors, taxing incomes of workers in the sector like veterinary doctors.

Demerits/ positive impact arising from the agricultural development strategy

- Low tax returns. The sector may not provide a wider tax base for government. This arises when production in the sector is on subsistence basis and little output is sold by the farmers. There is limited income that can be taxed by the government.

- It is subject to diminishing returns. There is reduced soil fertility as a result of poor farming practices and continuous use of land by the farmers. In the long-run, agricultural output declines.

- It leads to seasonal and disguised unemployment. Farmers who concentrate on one or a few crops are likely to become idle, unemployed, and redundant after the harvest season. This creates seasonal unemployment which results into falling standard of living for the farmers.

- It leads to instability in prices and incomes. Agriculture products are prone to fluctuating price. The fluctuations in prices lead to unstable incomes from agriculture. This frustrates the farmers leading to neglect of farming.

- It increases external dependence. This occurs where a country relies on other countries to provide market for her agricultural products. This worsens foreign trade dependence.

- It may worsen the poor terms of trade. This arises where the prices of imported agricultural products are falling but the prices of imported manufacture,: goods are rising. This reduces the net benefits from international trade as a result of poor terms trade.

- It worsens (perpetuates) the unfavourable balance of payments for developing countries. Agricultural economies always earn less from agricultural export yet they incur high or heavy expenditure on imports from other countries. This leads to unfavourable balance of payment positions.

Strategies of the agriculture sector

Strategies in agriculture are used to change or transform the methods used in agriculture or to improve them. These strategies are as follows:

1. Improvement Approach.
2. Transformation Approach.
3. Mechanisation of Agriculture.
4. Modernisation of Agriculture.

Improvement approach

This approach aims at providing existing methods of agriculture rather than shifting away completely from local methods in practice.

It aims at encouraging agricultural development within existing peasant production units. This is done in ways such as;

- Farmers are advised and educated on how they can improve their farming system or methods
- Provision of certain necessary inputs such as fertilisers, better seed varieties, acaricides e.t.c to the farmers.
- Extending short term credit facilities to the farmers.

Advantage of the improvement approach

1. Great amounts of capital are not required,
2. Fundamental social changes are not demanded of the farmer.
3. It creates employment for the unskilled people who are likely to improve upon their skills.
4. It improves the quality of labour in rural areas thereby leading to better, quality products. The likely disadvantage is that it may not lead to greater levels of output as compared to the transformation approach.

Problems faced in implementing the Improvement approach.

- Agricultural assistants or extension workers are not well facilitated by the government . They are provided with bicycles and motor cycles to ease their transport to farming areas. So, these agricultural assistants fail to visit many farmers.
- The advice being offered may be either out dated or not applicable to the particular locality
- Poor infrastructure.
- High level of conservatism among the farmers.
- Limited capital.
- Poor land tenure system
- Adverse climatic conditions

Transformation approach

It refers to the changing of the existing methods of agriculture so as to move away from traditional farming systems. Some of the existing traditional methods are conservative and out - dated. Therefore, there is need to be replaced with modern techniques of agriculture for the purpose of increasing production.

It aims at a complete change of agricultural production,

Transformation approach is associated with the following advantages.

1. It makes use of the modern techniques of production.
2. It promotes mechanisation techniques in production. .
3. It encourages government participation through marketing boards and co¬operative.
4. It encourages collective farming where by many people work as group on large-scale units.

The major advantage of this approach is that greater quantities of output are achieved which implies more exports, more government, revenue and greater employment.

Demerits (disadvantages) of the transformation approach

1. It requires a lot of capital investment i.e. (tractors, irrigation equipment e.t.c which are in short supply in LDCs.
2. Consolidation of land for large-scale production is not an easy thing to do because it may create social political problems.

3. People may resist working in groups as it could be mis-interpreted to mean communism.

4. It may lead to unemployment since capital intensive technologies are employed.

5. It leads to transformation of cultural and traditional values.

6. It leads to changes in land ownership (land tenure system) which may be resisted by some people.

7. It gives rise to diseconomies of scale. Due to lack of management skills among the local entrepreneurs, an attempt to transform agriculture by introducing large scale farming methods at a certain level may lead to diseconomies of scale.

Agricultural mechanization strategy

It refers to the adoption and use of machines, tools and equipment in the production of agricultural products. Mechanisation therefore involves the use of tractors, combine harvesters, mechanical sprinklers etc. It is normally connected with large scale farming planning.

OrMechanisation of agriculture refers to the strategy or policy of using modern techniques in the agriculture sector to increase output and incomes.

OrIt refers to the use of modern techniques of production (machines) such as tractors, ploughs, sprayers, sprinklers and combine harvesters (instead of labour intensive techniques) so as to increase quality and quantity of agricultural output.

OrIs where machines are highly utilized in the farming of crops and animals.

Merits of agricultural mechanisation

- Leads to increased output hence economic growth / results into increased output in the agricultural sector. The application of machines enables farmers to cultivate more land and put it to use. This generates higher levels of output in the agricultural sector hence increasing the contribution of the sector to GDP.

- Leads to production of quality output / improves the quality of the produce. This is achieved through mechanised spraying and harvesting. The output is likely to be improved in terms of its quality. The high quality output is more competitive on the market and the farmers can afford to sell it better prices.

- Reduces expenditure on labour / saves on the cost of labour / reduces the average costs of agricultural production in the long run. The average cost of producing agricultural products reduces in the long run. This enables the farmers to earn higher profits.

- Saves time / simplifies farming activities. Mechanisation makes farming easier, faster and less tiresome. This encourages more production since the workers handling the machines, find the jobs attractive.

- Leads to increased utilisation of land resources / increases the size of land under agricultural activity. With the use of machines like tractors, more land can he under cultivation compared to the small pieces of land utilised by the farmers who use manual labour. This increases the level of land utilisation in the country hence reducing excess capacity in the agriculture sector.

- Reduces dependence on nature. This is due to the possibility of applying nation on farming activities which allows continuity in production.

- Reduces seasonal unemployment. This is due to continuity in the production process that allows labour to be employed throughout the year.

- Improves the skills of labour. This is due to the increased handling of modern machines in production which enables workers to acquire skills from time to time.

- Leads to increased incomes of the producers. This is due to the increased output that is harvested and exchanged for money hence more income to farmers.

- It is more appropriate in the dry areas where manual labour cannot easily be employed. Such dry areas can be put under agricultural use by applying machines like tractors, ox-ploughs and use of mechanical irrigation.

Demerits of agricultural mechanisation

- High rate of soil exhaustion which may lead to low output.

- Expensive in terms of spare parts, fuel, skills required and maintenance.

- Over production may result leading to storage and marketing problems.

- Causes technological unemployment.

Problems encountered in an attempt to embark on agricultural mechanisation Limitations or challenges to agricultural mechanisation in Uganda.)

- Limited capital. Since farmers have inadequate capital, they always fail or find it difficult to purchase the necessary agricultural machinery like tractors and other farm implements.

- Limited skilled labour (inadequate technical staff to handle the machines). There is shortage of skilled people trained in agricultural engineering. This makes it hard keep the machines in proper working condition and this limits effective use of machines of the farms.

- Conservatism of the farmers. The attitude towards agricultural mechanisation is still poor since many peasant farmers are still inclined to their traditional farming methods. Many farmers are not willing to use machines on their land. The poor land tenure system. In some areas of the country, land is highly fragmented yet agricultural mechanisation is possible and viable where large pieces of land exist without being fragmented. Therefore, with land fragmentation it becomes uneconomical to use machines.

- Limited market for surplus agricultural products. A narrow market for agricultural products discourages farmers from embarking on mechanisation. This small market leads to wastage of agricultural output, which arises from increased mechanisation of farming.

- Mechanisation is not applicable to all crops / unsuitable where human judgement is required. The nature of some crops requires human judgement for certain activities like harvesting and weeding e.g. the harvesting of ripe coffee beans requires human judgement which makes machines not be applicable in this case.

- Poor infrastructure. Poor roads network makes it hard to move agricultural machines to those areas where they are needed by the farmers e.g farm tractors may not easily access rural areas with poor road network.

- Unfavourable physical factors, for example relief / topography in some areas. Poor topography of some areas for example, the hilly and mountainous areas are not viable for agricultural mechanisation.

- Limited entrepreneurship skills. There are few farmers who have the ability and necessary skills to use and manage the modern agricultural machinery and organise other factors of production as well.

- Low and unstable prices for the agricultural products. This causes frustration among the farmers because the increased output arising from mechanisation is offered at low and fluctuating prices.

- Underdeveloped technology / poor production techniques. Sometimes the machinery bought for use in agricultural production is unsuitable to conditions prevailing in the country.

- Political instability. This scares away potential investors discouraging then from installing agricultural machinery.

- Low levels of accountability / corruption. This has resulted into the misuse of funds that are supposed to be used in mechanising agriculture at sub-county level.

Question

(a) Examine the merits and demerits of agricultural mechanisation in your country.

(b) How can agricultural mechanisation be improved in your country?

(c) Explain the factors which are frustrating government's effort to mechanise agriculture in your country.

Modernisation of agriculture

Meaning:

Agricultural modernisation refers to the changing of the agriculture sector from subsistence production to commercialised high yielding sector.

Or The policy of increasing the output and incomes of the agriculture sector through measure such as mechanisation or use of better production techniques, use of -roved breeds e.t.c.

OrIs the changing of farming from subsistence to commercialized high yielding agriculture using high yielding methods of production and improved breeds of crop and animals.

The policy of agricultural modernisation involves increasing output and incomes of the agriculture sector through measures such as mechanisation/use of better production techniques, use of improved breeds of animals.

The aim of PMA is to increase the income of (rural) farmers and reduce poverty on a sustainable basis. It is one of the components of the Prosperity. For All Programme highlighted in the budget for the financial year 2008/2009. (Refer to that budget speech in library)

Features of a modernised agricultural sector

- Increased use of fertilisers on the farm to increase agricultural yields.
- Use of modern methods of production or farming such as mulching crop rotation, reducing soil erosion etc.
- Use of tested seed varieties and better breeds of animals.
- Provision of better extension services to the farmers.
- Greater mechanisation on agricultural farms,
- Better marketing systems i.e. the farmers being assisted to identity foreign markets

- Better transport and storage facilities be in place.
- Credit availability and accessibility to the farmers.
- There should be increased processing of agricultural output with an element of value addition.

The major components / targets of PMA

- Supporting agricultural extension services, for example, supporting the work of NAADS (National Agricultural Advisory Services). The operation of NAADS is being co-ordinated at the district level and its work is to render advisory services to Be farmers at grass root level.
- Distribution of better seeds to the farmers, for example, distribution of cotton seeds, distribution of coffee seedlings through Uganda Coffee Development Authority.
- Improving the feeder road network to link rural areas to the market centres. The aim is to facilitate or ease transportation and marketing of farmers' produce.
- Funding research programmes in the agricultural sector in order to develop better-crop varieties and animal breeds. This is co-ordinated through NARO (Nations-Agricultural Research Organisation) and the various research institutes across the country.
- Providing affordable credit to the farmers. This is being done through mi finance institutions (savings co-operatives credit societies or SACCOs) arc the commercial banks.
- Improving the quality of agricultural produce in order to make it more competitive both on the domestic and foreign market. Emphasis is being put on adding value to agricultural exports through better storage facilities arc processing before export.

Methods of agricultural modernisation in developing countries

- Development of infrastructures.
- Land tenure reforms.
- Agriculture research.
- Diversification.
- Mechanisation.
- Provision of inputs to farmers.

- Industrialisation within agriculture.
- Development of co-operative societies.
- Maintaining political stability.
- Training of manpower.
- Irrigation.
- Provision of credit facilities.

Reasons for modernisation of agriculture

- To reduce dependence on nature.
- To increase output hence economic growth.
- To reduce seasonal unemployment.
- To increase foreign exchange earnings / to improve the Balance of Payment (BOP) position.
- To reduce income inequalities / to increase producer's monies.
- To develop roads.
- To release labour for other sectors.
- To provide more revenue to the government.
- To reduce regional imbalances.
- To promote growth of the industrial sector.
- To attain price stability / to avoid or control structural inflation / to control price fluctuations.
- To promote food security and ensure a healthy population.
- To improve terms of trade.
- To monetise the economy.
- To fight conservatism

Factor limiting agricultural modernisation in uganda

Factors agricultural modernisation in my country are:

- Supply of capital. This limits the farmers' ability to acquire machinery develop the agriculture sector.

- Limited supply of skilled labour due to the high levels of illiteracy. This leads to low agricultural productivity and poor quality agricultural products, Poor techniques of production. This leads to low quality agricultural products thus discouraging modernisation of agriculture.

- Limited market both at home and abroad. This leads to difficulty in marketing output hence wastage of agricultural products thereby limiting the modernization on of agriculture.

- Conservatism of the farmers hence difficulty in making some farmers to accept modern techniques of production. They tend to oppose changes in production and the use of scientific methods of production.

- Poor infrastructures, for example poor roads especially in rural areas. This discourage effective movement of inputs and final agricultural products from the s to the market bases.

- Natural hazards / unfavourable natural factors for example pests and diseases. These reduce or make it difficult to realise the targeted quality and cause of agricultural output.

- Unfavourable political atmosphere making it difficult to attract people to the sector or for them to remain in production. This reduces investment in agriculture sector and causes destruction of agricultural fields.

- Corruption / low levels of accountability. This is clearly shown by the mismanagement of NAADS funds due to the high levels of financial indiscipline.

- Poor land tenure system hence difficulty in expanding the scale of faction. The traditional ownership discourages land consolidation and large scale agriculture.

- Low prices of the products. This causes fluctuations in the farmer's incomes cry discouraging agricultural modernization as farmers incur losses and me frustrated.

- Poor entrepreneurship skills. This leads to poor management of the 1 sector leading to high level of inefficiency and limited modernization of agriculture.

- Unfavourable topography. The hilly, mountaneous and swampy nature of discourages the use of machines in agricultural production thereby limiting modernization of agriculture.

Steps being taken to promote the modernization of agriculture in Uganda

- Encouraging / facilitating provision of credit facilities to farmers
- Introduction of high yielding seeds and breeds (inputs) to the farmers
- Introduction of better production methods
- Availing training to farmers-NAADS
- Undertaking land reform policies
- Encouraging research in better breeds, seeds and production methods for le NARO.
- Improving (rehabilitation and extension of) infrastructure
- Maintaining political stability
- Expanding market through joining or encouraging regional co-operation
- Improving entrepreneurial skills
- Fighting corruption for example in NAADS

Ways in which the agriculture sector is being modernised

- Training labour or providing skills.
- Improving political climate.
- Developing infrastructure.
- Widening markets.
- Encouraging diversification of agriculture.
- Improving techniques of production.
- Encouraging use of modern or hybrid seeds.
- Liberalising agricultural marketing.
- Setting up institutions to promote the agricultural sector for example Coffee
- Development Authority.
- Encouraging extension services or education.
- Revitalising co-operative societies.
- Encouragement of research in agriculture.

Question:

1. (a) Outline the objectives of modernizing agriculture in your country.

(b) Explain the factors which are frustrating modernisation of agriculture in your country.

Measures /steps that should be taken to improve the agriculture sector in Uganda

- Land reforms policies to make land more accessible
- Provision of credit facilities to farmers to increase their capacity to exploit land.
- Carry out research in all fields/ new farming methods
- Provision of extension service to the farmers
- Put emphasis on agricultural sector's technology
- Improvement of infrastructure
- Industrialisation within agriculture
- Development and /or revival of co-operatives
- Provision of subsidised inputs to farmers /provide input
- Train labour to acquire the necessary skills.
- Ensure political stability
- Market expansion e.g. through regional integration
- Improve the pricing policies e.g. Through strengthening commodity agreement

Mention any four problems of over relying on agriculture in your country.

Define the term agricultural modernisation.

State any three factors limiting agricultural modernisation.

Sub topic: The Industrial Sector in Uganda

The industrial sector in Uganda is small but steadily growing and expanding. The percentage contribution of the industrial sector to Uganda's G.D.P according to the National Budget for the Financial year 2015/2016 is at

NB: Industry is a collection of firms that produce related products and are . re in constant competition with one another for the market and resources.

A firm is a unit of production under unified management or single control.

Forward linkages exist when setting up of an industry results into emergence of other industry or industries, with the newly established plants forming markets for products and by-products of already existing industry.

Examples of forward linkages in Uganda include:

Sugar industry leading to the sweets industry.

Grain processing industry leading to animal feeds industry,

Iron and steel industry leading to the construction industry.

Backward linkages is where existence of an industry leads to setting up of new industries to supply existing industry with inputs,

Examples of backward linkages in Uganda include:

- Food producers to the industrial sector.
- Print Pack making cardboards to Bread and cigarettes industries.
- Sugarcane out growers to sugar industries.
- Tea out growers to tea processors.

Role of the industrial (manufacturing) sector to the economic development of Uganda

Positive role of the industrial sector in Uganda

- Creation of more employment opportunities. This is due to increased investment and production in the industrial sector
- Facilitates infrastructural development. This is because the industries encourage the construction of better infrastructure like roads for the mobility : inputs and the final goods.
- Encourages technology transfer and technology development. This is due to nigh use of capital intensive technology in the industrial sector.
- Improvement in Balance of Payment position. This is due to increased production of industrial products for export which led to increased foreign exchange and reduction in the volume of imported manufactured goods due to setting up of import substitution industries hence saving scarce foreign exchange.
- Facilitates resource utilisation. This is due to increased production in the industries and high demand for raw materials by the industries which results in

utilisation of idle resources hence avoidance of wastage.

- Improvement in the terms of trade. This is due to the value added to products which increases the prices of export products relative to the prices of imports.
- Encourages production of high quality output through adding value through processing or manufacturing. This is due to competition amongst the industries, use of advanced technology and highly skilled labour in the industries.
- Promotes economic growth hence increased Gross Domestic Product (GDP). This is due to increased production in the industries.
- Reduces (economic) dependence on importation of consumer goods. This is due to increased volume of industrial products and hence reduced dependence on imported manufactured goods.
- Promotes the development of local labour skills. This is through training facilities provided by the industries.
- Promotes the development of entrepreneurial skills. This is through training facilities provided that enable individuals take on risks of organising other factors of production through injecting capital in setting up industries.
- Attracts foreign investment / capital inflow. This is because most of the large scale industries are owned by foreign investors.
- Promotes forward and backward linkages with other sectors. This is through provision of market to agricultural products and raw materials to subsidiary industries.
- Provides revenue to the government.
- Widened consumer choices through production of a variety.

Negative role of the industrial sector in Uganda

- Over-exploitation of non-renewable resources hence depletion. The industry sector leads to exhaustion of resources due to over exploitation since the objective of production is profit maximisation not resource exhaustion.
- Leads to pollution hence environmental degradation. The industrial sector degrades the environment by dumping of industrial wastes on the environment leading to low levels of economic development.
- Increased capital outflow. This arises from the dominance of foreign ownership of the large-scale firms and the reliance on imported capital and intermediate goods.

- Imbalance in regional development. Since majority of the industries are established in urban areas neglecting rural areas thus there are better infrastructural developments like roads and social amenities in urban areas compared to rural areas.

- Technological unemployment arises. This is because industrial development tends to be capital intensive thereby replacing human labour with machines.

- Dependence on imported inputs / external resource dependence. This is because there is need to import capital goods and spare parts to be used in the industries

- Leads to income inequality. The industrial sector contributes to the widening of the income gap by providing incomes to industries that are expanding and little or no incomes to industries which are contracting. Likewise, majority of industries are owned by a few who are able to earn high incomes at the expense of the majority who have no industries.

- Low revenue to the government due to concessions that are usually given to foreign investors setting up the large -scale industries.

- Imbalance in sectoral development. This is due to more emphasis being put on the development of the industrial sector at the expense of other sectors.

- Low quality of output. The industrial sector (especially small scale industries) process poor quality products mainly due to use of poor techniques of production.

- Exertion of pressure on government for concessions, for example, protection ports. This breeds inefficiency in industrial operations.

Benefits of industrialising the economy

- Industrial products have high and stable prices. This helps to stabilize producer's income. Thus industrial growth relieves a country of fluctuations in the prices of agricultural products.

- Provision of more employment opportunities in the long run. This is due to linkages with other sectors of the economy.

- Creation of forward and backward linkages. This is because industrialisation has more complementary features than investment in agriculture. Therefore, it provides market to other sectors like agriculture due to its linkages.

- Industries encourages structural changes in the economy. Industrial development is necessary for structural changes and for the diversification of the economy. This reduces dependence on a few agricultural exports which is most characteristic of most developing countries.

- Industries encourage specialization and trade. Expansoion of industries permits increasing specialization within the industry leading to increasing returns. This enhances the development of the country and improves the terms of trade.

- Industries promote skills development through training of labour. Increased industrial development leads to increased training facilities for skilled labour. Thus promotes skills development, increases the efficiency and productivity of labour.

- Creation of a positive attitude to development. Industrial development is a powerful tool of social transformation through reducing the size of the once sector in the economy.

- Encourages development of infrastructure in form of roads to ease the transportation of raw materials and finished products. Industrial development fads to the setting up of better social and economic infrastructure which form the framework for the eventual development of the country. Reduction in economic dependence due to increased domestic production of formerly imported products. Industrial development reduces external impendence by reducing importation and encouraging local production of manufactured goods.

- Improves the Balance of payments position due to reduction of import expenditure as most of the consumer goods are now domestically produced.

- Improved terms of trade. This is because industrial products command relatively high prices on the world market compared to agricultural exports.

- Industrial sector raises the level of government revenue through taxation of the industrial activities. Industrial development widens the source of government revenue in form of corporate taxes and taxes on exports or" manufactured goods.

- Encourages technological development due to improvement of local technology and importation of efficient modern technology thus leading t: increased productivity. Industrial development encourages inventions arc innovations that lead to technological progress in the country.

- Industrial development is an engine to rapid economic transformation. Industrialization increases production and offers a wider scope for development on modern commercial lines compared to agriculture whose level of productivity is extremely low.

Factors affecting / determining / influencing the growth of the industrial sector in Uganda

- Political climate; political unrest scares away investors thereby discouraging investment in the industrial sector while political stability builds confidence in the investors thereby attracting more investment in the in industrial sector thus promoting its growth.

- Size of capital / income; large capital encourages large scale industrialisation which promotes the growth of the industrial sector while limited capita- discourages large scale industrialisation thereby limiting the growth of the industrial sector.

- State of technology; use of better, advanced technology encourages production of high quality industrial products which promotes the growth of the industrial sector while use of poor technology encourages production of poor quality industrial products thereby limiting the growth of the industrial sector.

- Land tenure system; poor land tenure system limits access to land by the investors which discourages the growth of the industrial sector while a better land tenure system with individual ownership of land encourages access t: land by the investors which promotes the establishment and growth of the industrial sector.

- Labour skills; limited labour skills result into low labour productivity and low output of the industrial products thereby discouraging the growth of the industrial sector but high labour skills result into high labour productivity and large output of industrial products and hence high industrial growth.

- Size of market; small market size limits sales and profits and thus causes wastage of resources thereby discouraging producers in the industrial sector and hence low industrial growth while a large market size encourages high sales and high profits which limits wastage and this leads to high production and growth in the industrial sector.

- Entrepreneurial skills; limited entrepreneurial ability leads to poor organisation in the industrial sector thereby discouraging industrial growth while high entrepreneurial ability leads to proper organisation of factors of production and high level of industrial growth.

- Mate of infrastructure; better infrastructure in form of good roads promotes the mobility of inputs and final products thereby encouraging industrial growth but poor infrastructure in form of poor roads discourages the mobility of inputs and limits access to market for the final products thereby limiting industrial growth.

- Inflation rates; high inflation rate leads to high cost of production which discourages production in the industries hence limiting industrial growth but low inflation rates lead to low costs of production which encourages investment in the industrial sector thus promoting its growth.

- Level of corruption / degree of accountability; high corruption limits the amount of funds for industrial growth as most of the funds are channeled to individual interests while high level of accountability and financial discipline increases the amount of funds meant for industrial growth. Government policy of taxation and subsidisation; high taxes and limited subsidies increase the cost of production thereby discouraging investment in die industrial sector while low taxes and high subsidies reduce the cost of production and this encourages more production and increased growth in the industrial sector.

- Level of exploitation of the available natural resources / supply of raw materials; high supply of raw materials leads to large scale production which encourages industrial growth while limited supply of raw materials leads to low output and low industrial growth.

Limitations of industrialisation in uganda

The major challenges impeding industrial development in Uganda include:

- Limited capital. There is limited capital due to low incomes and profits and limited access to loans by industrialists. This discourages the buying of equipment and machinery for industrial development.

- Limited markets. There are limited markets for the products of the industrial at both at home due to low incomes and abroad due to their poor quality. This leads to low sales and thereby resulting into wastage of goods or resources and limits industrial development.

- Underdeveloped infrastructure. Infrastructures such as roads, rails and plants are in a poor state. This limits effective movement of raw materials and finished products from one place to another and this limits industrial .

- Limited skilled labour. The efficiency of industrial investments is limited by use of mainly unskilled and semi-skilled labour due to the poor education system. This limits labour productivity and labour efficiency which results into low quality and quantity of output produced hence limiting industrial development.

- Poor technology. This is mainly due to use of labour intensive techniques of production and importation of unsuitable technology for production which results production of poor quality industrial products thereby discouraging industrial development.

- Political turmoil. This scares away investors because of fear of losing their lives and property thereby discouraging industrial development.

- Limited entrepreneurial abilities. This leads to poor management / high level of inefficiency in the industrial sector thus limiting industrial development.

- Inadequate raw materials to be used for the production of industrial products because of poor performance of the agricultural sector that is the main source of raw materials for agro-based industries.
- Unfavourable tax levels. This leads to high costs of production in the industries and stagnation in growth of some firms, thereby limiting industrial development.
- Stiff competition from foreign goods. This further limits the market for local industrial products that cannot compete with the superior foreign products thereby limiting industrial development.
- High cost of doing business due to the high rates of inflation. This has resulted in the closure of some industrial firms and stagnation in the growth of others.
- Unfavourable land tenure system. This limits access to land resources for industrial development.

Measures being taken to improve the industrial sector in uganda

Measures being taken to improve the industrial sector in my country include:

- Widening markets for example by joining regional groupings. This is aimed at minimising wastage of resources thereby encouraging the potential investors to produce and existing investors to expand so as to increase output and earn more profits hence development of the industrial sector.
- Developing infrastructures by constructing better roads. This is to improve on the transportation of the raw materials and finished products of the industries which encourages investors to establish more industries and expand existing ones
- Stabilising the political atmosphere/ climate. This is to build confidence investors so as to attract local and foreign investors to develop and expand the industrial sector because they are assured of safety of their lives and property.
- Improving (changing) the land tenure system. This is through carrying out large reforms to enable potential investors have access to land for industrial development and the existing investors to get more land so as to expand their firms.
- Providing affordable capital for investment /industrialisation. This is through providing low cost credit facilities (loans) to increase capital for buying more land and more raw materials so as to expand the scale of industries.
- Fighting corruption (promoting proper accountability). This is aimed ensuring proper accountability and financial discipline thereby availing mo funds to

industrial investors to expand the scale of operation.

- Stabilising prices through use of various sound macro-economic policies like contractionary monetary and fiscal measures. The government aims controlling inflation and maintenance of price stability which discourages speculation in the economy and encourages industrial production for exchange.
- Vocationalising education / provision of labour with skills. This is through offering training to labour in form of organizing seminars, workshops and on-job.
- Training so as to increase efficiency and productivity that enables industries increase the quantity and quality of output.
- Providing tax incentives to firms in the industrial sector. This is aimed at improvement of investment climate by providing tax holidays and tax rebates. This is helping to reduce the cost of doing business in the country and is -raging investors to set up firms since they are guaranteed tax relief till their investments have become profitable.
- Liberalising the economy. This is through giving liberty to potential investors to establish industries and increase output by removing unnecessary government control on trade that tend to inhibit industrial expansion.
- Modernizing agriculture / developing cheaper and reliable sources for the supply of materials / creating linkages with other sectors. This is aimed at enabling the industrial sector to have continuous supply of raw materials hence enabling it to expand.
- Improving entrepreneurship skills to enable potential investors to acquire the required skills to organize other factors of production thereby facilitate them establish and manage the industries effectively
- Farther privatization of public assets/ enterprises is being carried out so as to encourage potential investors to buy state owned industries and establish new one hence expansion of the industrial sector,
- Improving techniques of production/ technological development and transfer. This is aimed at enabling investors to improve on the quality and increase on the volume of industrial output, International campaigns to attract investors to come in the country and establish industries to take advantage of the existing market potential in various - f investment.
- Strengthening / establishing specialised institutions for industrial
- development like Uganda Investment Authority, Export Promotion Institutions and Private Sector Foundation to improve performance of the sector. This is

because through these organizations government is able to determine ways of assisting the potential industrialists to set up firms in the country.

- Encouragement of savings. This is to build the stock of capital necessary for the purchase of machinery and inputs for industrial development and expansion.

Measures that should be taken to increase the growth of the industrial sector

- Develop infrastructures.
- Improve labour skills.
- Improve entrepreneurial ability.
- Provide affordable credit for investment.
- Stabilise the political atmosphere.
- Improve land tenure system.
- Stabilise prices / control inflation.
- Promote technological development through research.
- Fight corruption.
- Provide tax and other incentives to industrialists.

Scale of operation or size of industries. The industrial sector in Uganda is mainly dominated by small scale industries, with few medium scale plants and very few large scale establishments.

Small scale industries

Small scale industries are those whose firms operate with small sized plants, 1ow employment and hence small output capacity. They are basically production units engaged in processing, manufacturing, assembling and servicing activities. Examples of small scale industries are maize milling, bakeries, carpentry workshops, garages, brick laying etc.

Features of small scale industries

- Mostly use local inputs and raw materials.
- Mainly serve small markets.
- Mainly owned by the indigenous people /local citizens.
- Mainly engage in small capital investment.

- They are mainly labour intensive.
- Mainly produce at excess capacity.
- Mainly produce durable consumer goods.
- Mainly small sized plants with low output level.
- Mainly require little capital for establishment and maintenance.
- They are mainly geographically dispersed / scattered throughout the cour
- They mostly employ semi-skilled and unskilled labour.

Effects of small scale industries in developing countries

Positive Effects Of Small Scale Industries

- Lead to increased employment opportunities since they are labour intensive. As small scale industries develop, they create more jobs to both the trained and casual workers. Such people earn income which enables them to buy rk basic necessities of life and improve their standard of living.
- Promote fair distribution of income because they employ many people. Small scale industries widen economic activities from which people generate income. As people earn income, the extent of income inequality is reduced.
- To some extent, they promote self-sufficiency since they use local resources hence no need for importation of resources and also by producing a variety goods for the local markets, small scale industries help to reduce dependence on foreign economies.
- Lead to improvement in balance of payment position because they use local inputs hence a reduction in importation. They save foreign exchange which would have been spent on imports. This helps to reduce the B.O.P problem to some extent since expenditure on imports is reduced.
- Lead to exploitation of the would be idle resources leading to increased output. They lead to the utilisation of resources which would have remained idle 1 resources get utilised, wastage of such resources is avoided, for example, some small scale industries recycle scrap metals into useful products thereby avoiding wastage of that vital resource.
- Facilitate development of infrastructure, for example, roads are constructed to enable the movement of raw materials and final goods. The setting up of small scale industries in particular areas calls for the development of supporting infrastructure

in form of better road network, ware housing facilities and commercial banking facilities.

- Act as a source of government revenue through taxation in form of corporate taxes. Government generates substantial tax revenue and license fee from small scale industries. This revenue is used by government to finance her development programmes.
- Provide a wide variety of goods due to competition thus widening consumer choices. Since small scale industries produce a variety of products, consumers' choice is widened and this leads to improved standard of living for the local people.
- Promote acquisition of skills as people employed learn to use machines and repair them. They provide on the job training programmes for the workers. For example many local technicians are trained on the job in small scale industries where they acquired skills of working in even bigger industries.
- Leads to increased incomes due to the provision of employment to people.
- Provide cheap goods and services thus improving people's standard of relatively by using locally available materials inputs, small scale industries produce cheap commodities which can be afforded by the majority of the people. This helps to improve people's standard of living.
- Promote creation of forward and backward linkages leading to more investment and employment. When industries are set up in an area, they induce the setting up of new firms to provide raw materials to those already existing industries (back-ward linkage). At the same time, new firms also emerge such that they creating market for products and by-products of the industries (forward linkage).
- Act as grounds for technological development. They are grounds for development of local technology. Small scale industries produce small machines like coffee graining mills. Through research, these machines are improved upon.
- Promote further industrialisation of the economy as more industries are set up because of backward and forward linkages. Therefore, they enable a country to diversity from agricultural to industrial production.
- They serve as a training ground for entrepreneurs. Some entrepreneurs learn the skills managing industries from small scale industries. In the long-run, entrepreneurs acquire management skills which they can later use to manage medium and large scale industries.
- There is increased output / they increase levels of GDP. Small scale industries lead to production of more goods which results into higher National Income figure /GDP.

Negative Effects Of Small Scale Industries

- Lead to wastage of resources because of unnecessary competition and duplication of activities. Many small scale industries are competing for the same resources / inputs and this leads to irrational use of such resources in the long run.
- Lead to limited contribution to employment since they employ few people. During their infant stages, small scale industries do not employ many people and therefore they contribute less to reducing unemployment in the country.
- Lead to under utilisation of resources since they produce small output. This arises from poor methods of production. At the same time, small scale industries serve a small market which eventually makes them to produce at below their installed capacity making resources to be under-utilised.
- Lead to pollution of the environment because small scale industries emit fumes. Pollution of the environment as a result of poor disposal of industrial waste.
- Congestion in urban and semi urban areas. They are mainly concentrated in such areas and this causes regional imbalance in the distribution of economic activities.
- Promote growth of slums since they are mostly established in urban areas. Many people move from rural areas to go to urban areas to look for jobs leading to the development of slums. They lead to growth of slums in urban and semi - urban areas where they are mainly concentrated. This leads to social evils like high crime rate in urban areas where those industries are located.
- Production of low / poor quality goods. This arises from use of poor techniques of production, use of low quality inputs and failure to abide by quality specifications. This has reduced market for products of small scale industries.
- They contribute less or low revenue to government. Since they operate or. small scale, the government gets low tax revenue from them i.e. small scale industries are not major or significant sources of tax revenue to the government.

Reasons for continued existence of small scale firms

- Poor infrastructure like poor roads and poor energy facilities tend to increase the cost of production thus making it difficult for firms to transport materials. Therefore, they are not able to increase their output because of high costs of transporting raw materials.
- Limited capital for expansion. Some of the small firms do not have e capital to buy raw materials to increase their output hence they are forcer remain small.
- Fear of diseconomies of scale. Some firms remain small for fear of nr increased average costs of production associated with operation on a \irs. scale, for example,

failure to supervise and control workers by manager.er due to over-expansion.

- Limited skilled labour. Many of these firms employ unskilled labour leadrr_ to low levels of efficiency and productivity thereby discouraging firms trrrr expanding.
- Limited supply of raw materials because of unfavourable natural factors taxing these firms to remain small in case of agro-based industries.
- Limited markets. Due to the small size of the market, small firms are discouraged to increase their output for fear of making losses hence remaining
- Poor techniques of production. These increase the cost of production making it difficult for firms to expand because they fear to make losses
- Fear of high risks and uncertainties. Some firms remain small because of the increased risks associated with large scale production like fall in demand for the products, losses etc.
- Choice of the entrepreneur / objective of the firm. Many of the owners of small firms desire their independence. They have no ambitions to expand because they do not want to lose their control.
- Market requiring personal touch. Some of the services dealt in require the owners personal touch / contact, for example, hair salons, private medical clinic, law firms etc.
- Limited entrepreneurial ability. Some of the owners of these small firms do not have the skills to run and manage the large firms thus prefer to remain
- Poor political climate. Some firms remain small because of the political unrest m some parts of the country which dents the confidence of the investors. They are scared about their life and property and would prefer to operate on a small scale to avoid making big losses.
- Limited space for growth / poor land tenure system. Some firms remain small because they do not have enough land to enable them to expand. Fear of increasing corporation taxes makes the small firms remain small because they do not want to incur those taxes which increase the cost of production and reduce profits.
- Some firms remain small because they are in their early stages of development and they have not raised enough time to expand, for instance, they have not raised enough capital to buy more land so as to expand.
- Some of the small scale firms are used as pilot projects. So they tend to operate on a small scale so as to attain high levels of efficiency. Since they are on a small scale, they are easily supervised, monitored and evaluated.

Large scale industries

These include;

- Steel rolling mills
- Large scale breweries
- Large scale soft drink processing industries such as Coca-cola industry.
- Large scale textile firms
- Large scale cement making industries such as Hima Cement Industry Ltd and Tororo Cement industry Ltd.

Effects of large scale industries in developing countries

Positive effects of large scale industries

- Low prices of final output due t economies of scale.
- Provide employment opportunities to people. They operate distribution store (in different parts of the country and this enable more people to be employed by such large scale industries.
- They operate distribution stores in different parts of the country and this enable more people to be employed by such large scale industries.
- Lead to infrastructural development.
- Promote technological development / transfer.
- Contribute revenue to government through taxes.
- Lead to economic growth by producing more goods in the economy.
- Improve labour skills through training. They stimulate development of skills
- through on the job training programmes for the workers.
- Increased utilisation of idle resources hence avoiding wastes.
- Promote growth of entrepreneurial ability.
- Lead to urbanisation and its merits.
- Save foreign exchange.
- Increased foreign exchange earnings due to exportation hence improved BOP position.

- Production of quality output hence efficiency in production because they are capital intensive.
- Reduced dependence on imported consumer goods. They help to reduce
- dependence on imported manufactured goods.
- Promote linkages with other sectors.
- Production of variety of goods hence widening consumer choices. 4- High profit levels are enjoyed.

Negative effects of large scale industries

- Increase income inequality. They worsen income inequality in the economy
- Lead to imbalance in regional development / rural-urban migration and its evils. They lead to regional imbalance in development since they are mainly concentrated in urban areas.
- Environmental degradation through pollution. They create environmental degradation /pollution as, they are associated with social costs which inconvenience the public
- Increased dependence on imported inputs. They increase dependence on imported inputs and industrial spare parts. This creates external resource dependence.
- Low employment creation due to use of capital intensive techniques. They give rise to technological unemployment due to the use of capital intensive techniques of production
- Lead to over exploitation of resources hence depletion.
- Capital outflow due to wages and profit repatriation. Continuous capital out flows as a result of profit repatriation by foreign investors who own large scale industries.
- Balance of payment problems due to importation of inputs. It results into B.O.P problems due to massive importation of industrial machines through technological transfer.
- Political interference due to exertion of pressure on government for concessions. They exert pressure on government for protectionism and tax concessions. Large scale industrial investors always lobby government to be given supporting incentives like tax holidays. Through providing such subsidies, government expenditure increases in the long run and this lowers the net benefits from large

scale industries.

- Lead to monopoly tendencies and its demerits, for example, consumer exploitation and collapse of small scale firms. Some large scale industries have monopoly tendencies and they exploit the public or the consumers.
- Expensive to establish / set up.
- Heavy losses are incurred in case of breakdown / failure.
- Surplus production due to limited market hence wastage.
- Diseconomies of scale hence high prices for final products.
- Difficult to relocate / not flexible.
- Production at excess capacity hence wastage of resources.
- Consumer exploitation by way of charging high prices.

Questions:

1 a) Distinguish between a firm and an industry.

b) Assess the role of small scale industries in the development of your country.

2. a) Explain the contribution of the private sector to industrialization in your country.

b) What are the challenges faced by small scale industries in your country.

The contribution of the private sector to industrialisation in Uganda

N.B: We link the contribution of the private sector to the process of industrialisation. Therefore, we **do not** give the general merits of the private sector. We give those specific things which the private sector does in order to support the process of industrialisation in Uganda.

- The private sector trains labour which is employed and used in industries i.e. private institutions like universities train labour (managers, technicians etc). This trained labour is employed in the industrial sector to enable it operate more efficiently.
- It has extended loans to industrial investors. Private commercial banks and Other financial institutions provide or extend loans to industrial investors / firms. This enables industries to expand their activities using the capital which is borrowed from private financial institutions.
- Private firms create linkages with the industrial sector. For example some private firms supply industries with raw materials while others provide market for

industrial products.

- The private sector increases capital inflows by foreign private investors who set up industries.

- It has safe-guarded industries against business risks. Private insurance companies guarantee indemnity (compensation) to industrial investors in case of losses from insured risks. This inspires confidence among investors in the industrial sector thereby promoting industrialisation.

- It has promoted entrepreneurship skills in Uganda. The Uganda private sector foundation (UPSF) organises training workshops for industrial managers and entrepreneurs. This helps to promote / improve their managerial skills and they are enabled to effectively run industrial enterprises.

- It has put in place basic infrastructure which is used by the industries. For example, private communication companies in Uganda such as MTN and Airtel have set up communication infrastructure which is being used by industrial firms to promote trade.

- It has improved on business information. This includes information about potential markets (both within and abroad) and this has helped in promoting industries in Uganda.

- It has encouraged scientific innovations in industries. New techniques of production used in industries are developed by private firms through research.

- It has created competition thereby causing improvements in quality of commodities. This has helped in expanding the market for industrial goods due t: the improvement in their quality.

- It has encouraged technological transfers in industries. Modem machines used in industries are imported by the private sector. Such machines help to increase output in industries hence promoting the process of industrialisation in Uganda.

Questions:

1. a) Suggest measures that should be taken to promote industrialization in your country. (Refer to measures that should be taken to increase investment in Uganda)

b) "It is through industrialization that Uganda can attain higher rates of economic growth and development." Discuss

2. a) Describe the features of the industrial sector in your country.

b) Explain the measures being taken to improve the industrial sector in your country.

3. (a) Account for the low levels of industrialisation in your country.

(b) Explain the contribution of the private sector to the industrialization of your country.

4. "Uganda should adopt an agricultural rather than industrial development strategy if it is to attain a faster rate of economic growth". Discuss.

The approach to this question is:

i. Give merits of agriculture to be immediately followed by demerits of industry

ii. Give merits of industry to be immediately followed by demerits of Agriculture

In summary the approach is as follows in its systematic order:

1. merits of agriculture
2. demerits of industry
3. merits of industry
4. demerits of agriculture

Agriculture and industry as complementary strategies of development:

It should be noted that Agriculture and Industry complement each other in the development of an economy. They are NOT competing sectors. Agriculture has linkages with industry, hence the two sectors are inter-dependent.

In support of agriculture rather than industrialisation to attain faster rate of economic growth in Uganda, we look at merits of agriculture and demerits of industrialization.

Merits of agriculture:

More employment opportunities since it is labour intensive.

- Source of nutritive food for the population.
- Major foreign exchange earner
- Has quick returns.
- Source of raw materials for agro-based industries.
- Reduce income inequality since it employs a large number of labourforce and steadily leads to a rise in incomes of farmers.
- Relatively cheaper to undertake.

- Leads to balanced regional development because its development pulls up their rural areas.
- Calls for rapid infrastructural development.
- High potential source of tax revenue to the government for example through taxing imported farm inputs, incomes of veterinary doctors and extension workers.
- As it develops surplus labour is released to other sectors like industry.

Demerits of industrialisation:

- It is expensive to start and maintain.
- Encourages external economic dependence.
- Leads to high social costs like noise, pollution e.t.c.
- Worsens problem of income inequality.
- Encourages rural to urban migration and its negative consequences.
- Leads to depletion of resources due to overexploitation.
- Causes regional imbalance because they are mainly located in urban centres.
- Leads to low employment creation especially in the short run.
- The returns on industries are not immediate.

However, industrial development may be preferred to agricultural development because of its merits and the demerits of agriculture.

Merits of industrial development:

- Creates more employment in the long run.
- Provides a wider source of revenue.
- Promotes skills development through training.
- Improves terms of trade because their products' prices are higher.
- Encourages infrastructural development.
- Reduces external dependence by reducing importation.
- Improves the Balance of payments position because of high returns on them in foreign markets.

- Encourages technological development.
- Provides market to other sectors due to its forward and backward linkages
- Provides inputs to other sectors like agriculture for example tractors, fertilizers and chemicals,

Demerits of agricultural development

- Leads to low tax revenue due to their low value added.
- Leads to seasonal and disguised unemployment.
- Leads to instabilities in prices because of fluctuations in its supply.
- May perpetuate poor terms of trade due to falling prices of primary export like coffee.
- Leads to instabilities in incomes because of changes in its prices.
- It is subject to the law of diminishing returns for example loss of soil fertility.
- Leads to increased external dependence because the country cannot be self-sustaining by focusing on agriculture.
- Worsens the state of poor balance of payments position as a result of low earnings from export of agricultural products.
- Does not greatly promote skills development.

TOPIC 5: POPULATION AND LABOUR

Sub-topic: population

Population refers to the total number of people living in a specific area such as a particular country or town at a given time.

Some important concepts

Crude birth rate

This refers to the total number of children born alive per 1000 of a given population in a given year.

Determinants of birth rate

- Level of education
- Cultural status
- Food supply
- Level of technology for example family planning methods being used
- Natural female fertility rate.
- Government policy on population growth.

Death rate

This refers to the number of people who die in a year per 1000 of the total population.

Determinants of death rate

- Food supply.
- Political climate.
- Level of income of individuals.
- Level of medical care.
- Rate of natural hazards or epidemics for example Ebola, AIDS and cholera.

Population density: the number of people per unit area of land, for example, per square kilometre.

Population increase (rate of): rate at which a given population size grows over a given period of time, for example, one year.

Mortality rate: the number of people who die before their life expectancy is over.

In many developing countries the mortality rate has fallen because of improved economic and hygienic conditions, availability of modern medicine and better medical care and education which have been provided to the people by government.

Life expectancy: time period, normally in years, that a baby is expected to live after it has been born alive.

Fertility rate

This refers to yearly number of children born alive per thousand women within the child bearing age bracket, normally between the ages of 15 and 49 years.

Causes of high fertility rates in developing countries

- The economic value of children. Some communities attach great importance to the number of children in a family. This is because children are a source of labour and provide security to their parents later in old age.

- Customs and traditions. In some communities children are sources of pride, pleasure and respect to parents. A wife who bears many children is regarded as the ideal wife. Fertility rates are therefore, high in a community with such an attitude to children and women.

- Low cost of rearing children. The cost of rearing children in some societies is lower than benefits realised from them. Costs of rearing children in such societies is low because food is plentifully available free of charge and government mesas the cost of education and medical care. Thus the burden of having many children is not so much felt by parents thus encouraging them to produce more.

- Early marriage. Women in developing countries tend to marry when they air still young, usually at the age of fifteen or less. The child bearing period of up to 49 years of age is therefore very high.

- Limited access to education by women. The majority of women in developing countries have limited access to education thus limiting their role in society to provision of labour to family tasks and child bearing.

- Absence of government commitment to control fertility. Fertility rates are high due to failure by governments to punish families for having many children. This contrasts sharply with countries where governments use positive and negative sanctions to influence family size such as in China and India.

- Increased health and life expectancy of mothers. Education and health services have increased life expectancy of child bearing mothers through reduced maternal mortality rates thereby increasing fertility rates.

Population growth rate: refers to the rate at which a given population increases over a period of time, usually one year.

OrRefers to the rate / degree at which the population of a given area increases given time.

It shows the rate at which the population of a country is changing. This may natural population growth rate or artificial population growth rate.

Natural population growth rate is the rate of increase of the population over a given period due to inter play of birth rates and death rates.

OrThe rate at which a given population size grows over a given period due increase in the number of births and decrease in the number of deaths.

OrThe rate of change of population resulting from the interplay of birth rates and death rates.

It is established by expressing the difference between new births and deaths as - percentage of one thousand people.

Natural population growth rate = $\dfrac{\text{birth rate - death rate}}{1000} \times 100$

Artificial population growth rate: is the rate of change of population resulting from the inter play of immigration and emigration rates.

Artificial population growth rate: = $\dfrac{(\text{immigration rate – emigration rate})}{1000} \times 100$

Determinants of population growth rate

- Birth rate (fertility rate)
- Death rate (mortality rate)
- Emigration rate
- Immigration rate

Thus population growth depends on the relative increase in population size due to natural increase and net international migration.

Natural increase simply sires the excess of births over deaths or simply, the difference between dry and mortality rates.

Net International migration, is the difference between those leaving the country and those entering it during a given period time.

Population projection is an estimation of the future population size basing on the population size and population growth rate.

The population trap is a point in time, in the Malthusian population theory, at population size is equal to food supply or subsistence beyond which population is subject to starvation, death and misery.

Working population is the total number of people who are employed, self employed and unemployed in the economically active age bracket.

Fertility rate is the number of children a woman can bear in her reproductive ages/life, usually 15 to 45 years.

Hidden momentum of population growth is a situation where the greatest portion of the population is made up of the young implying a higher growth rate it future.

OrIs a dynamic latent process of population increase that continues even after a fall in birth rates because of a large youthful population that widens the population parent base.

Optimum population a population size that provides labourforce which is sufficient to exploit the available natural resources in order to yield maximum output per worker and per capita income is highest.

Overpopulation, a population size that provides labourforce which is in excess of ±e available resources leading to low output per capita.

Under population: a population size that provides labourforce which is insufficient to utilise the available resources fully and income per capita is less than optimum.

Population census

This is the physical counting of people living in an area or country every after years.

Reasons / rationale for carrying out a population census

- To enable the calculation of per capita income so as to indicate the standard of living. The per capita income is the ratio of the total income to the total population of the country.
- To establish the size of a country's population so as to facilitate planning, example planning for employment, housing and educational facilities requires accurate population figures.
- To establish the distribution of the population. This focuses on age, gen: (sex), level of education and spatial distribution. This enables the government to allocate resources appropriately in the country.

- To establish the quality of the country's population. This mainly focuses on a level of education and the healthy status of the people in the country. This aids manpower planning in the country.

- To establish the size of the labourforce. The government wishes to find out number of the people ready for employment such that it puts in place a conducive environment to ensure that the jobs are available.

- To determine or calculate the natural population growth rate. This is through computing the number of live births per 1000 population and the number of dealt per 1000 population so as to find out whether a population is increasing or not.

- To establish the rate of migration (to determine the artificial population growth rate). An increase in the number of immigrants with a fall in the number of emigrants represents an increase in the artificial population growth rate.

- To solicit for foreign aid. This is through presenting the population statistics international aid agencies or friendly countries. The aid agencies like USAID IMF, World Bank and IDA always request for population figures to determine the area/ sector and the amount of aid to be given.

- To establish the number of nationals and non-nationals in the country. This is to help the government design appropriate policies on ownership of property, work permits and immigration.

- To obtain population figures to demarcate political units like constituencies, town councils, municipal councils and town boards. The decision to accord any of the above statuses depends on the existing size of the population.

Importance of population census

- Determines the population growth rate.

- Determines the employment levels in the country.

- Determines the levels of education in the country.

- Determines the size of the country's potential labourforce.

- Determines the size of the population in relation to the available resources.

- Determines the age structure of the population in order to know the dependency ratio.

- Determines the population distribution in terms of rural and urban areas.

- Determines the rate of migration, that is, the number of emigrants an: immigrants.

Population pyramid

Population pyramid, also called age pyramid or age picture diagram is a graphical illustration of the age and sex structure of the population.

Or It is a graphical illustration that shows the distribution of various age groups in population (typically that of a country or region of the world), which forms the shape of a pyramid when the population is growing.

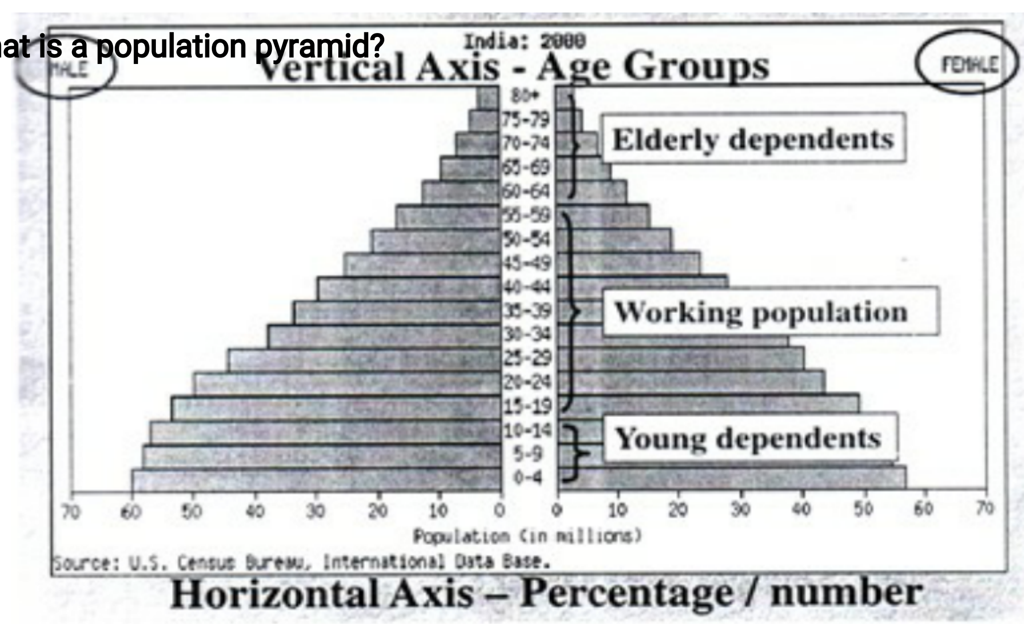
Population pyramids are often viewed as the most effective way to graphically depict the age and sex distribution of a population, partly because of the very clear image these pyramids present.

A great deal of information about the population broken down by age and sex can be read from a population pyramid, and this can shed light on the extent of development and other aspects of the population. A population pyramid also tells how many people of each age range live in the area. There tends to be more females than males in the older age groups, due to females' longer life expectancy.

Population pyramids are used by demographers as a tool for understanding the make-up of a given population, whether a city, country, region, or the world.

Population pyramids can be used to find the number of economic dependents being supported in a particular population. Economic dependents are defined as those under 15 (children who are in full- time education and therefore unable to work) and those over 65 (those who have the option of being retired). In many countries, the government plans the economy in such a way that the working population can support these dependents. This number can be further used to calculate the dependency ratio in that population.

What is a population pyramid?



Structure of Uganda's population

- The population of Uganda is characterized by the following:
- Dominated by the young age bracket constituting over 40% of the t population.
- There are more females than males. There is generally about 51% females and 49% males
- Mainly rural based. There is approximately 80% of the population living in rural areas.
- High illiteracy rates. About 32% of Ugandans do not know how to read and write.
- High population growth rates. The growth rate is as high approximately per annum.
- Most people (majority of the population) are semi-skilled and / or unskilled
- Mainly engaged in primary production. The productive force of the population are mainly engaged in primary production especially agriculture.
- There is uneven spatial distribution of population. Some areas or districts as highly populated for example Kampala with 7360 people per square kilorr.erc while other areas are sparsely populated like Moroto with 20 persons per squad kilometre.
- A big proportion of the population live below the international poverty line. About 35% of the Ugandans live below the international poverty line. Many people in Uganda live on less than one dollar (US$1) a day.

Economic implications of the population structure

Positive implications

- High market potential due to the high population growth rate. The steady growing population provides a large market potential.
- High potential for labourforce due to the high population growth rate. For example there is a possibility for the provision of cheap labour because many people are unskilled and semi-skilled.
- The high population growth rate provides a high potential for increased resource utilization leading to high economic growth rates.
- The dominant young population encourages effort to work hard so as to sustain the dependants.

- High potential for government tax revenue. This is due to the high population growth rate that provides labourforce to be taxed by the government.
- Acts as an incentive or potential for massive future investment because of the dominant young age brackets.
- The predominant young age group is usually innovative and creative. This g room for new discoveries leading to technological progress.
- The high population growth rate awakens the government to its responsibility: providing the necessary infrastructure which leads to increase in output.
- The high population growth rate reduces per capita social overhead costs for example reduction in the cost of providing infrastructure.
- Encourages labour mobility. The high population growth rate forces the skills: and unskilled labour to search for better opportunities either within the country: outside the country in order to earn a living.

Negative implications

- Results into unemployment and underemployment. This is because of the high population growth rate that results into excess labour supply compared to job openings.
- High rates of rural-urban migration and its negative effects like prostitution, high crime rates and congestion. This is due to the high population growth rates m rural areas that cause poor living conditions in such areas.
- High social costs in form of pollution, accidents, congestion and sanitary problems. This is due to the increasing population in the urban areas.
- Causes (perpetuates) increased income inequality between the employed and unemployed and between those above the poverty line and those below the poverty line.
- High government expenditure on provision of social services to the increasing regulation dominated by the young.
- High dependence burden thereby limiting savings. This is due to the dominance of the young age group that strains the working population.
- Worsens the balance of payments problems. This is because the high population growth rate leads to increase in import requirements to support the domestic
- Quick depletion of resources (overexploitation of the available resources). This b due to the increasing demand for resources like firewood by the increasing

regulation in the rural areas.

- Makes effective government planning for the population difficult. The steadily rising population makes it difficult for the government to make long term plans. This arises because economic planners fail to accurately predict the population size over the years to set realistic development objectives and targets.

- Increases external resource dependence especially on foreign manpower. The regulation of Uganda is mainly semi-skilled; therefore, Uganda relies on repatriates in different fields leading to higher foreign expenditure.

- Low effective demand / limited domestic market. This is because many people r. e on less than a dollar a day implying that they are very poor and are not able to buy many goods and services which scares away investors.

- Increases brain drain. The structure of Uganda's population reveals that a big size of the population is unemployed and this forces many skilled people to seek for alternative employment in other countries.

- Low labour productivity. This arises due to the fact that a big portion of the reputation is semi-skilled or unskilled which reduces the size of national income.

- Overstrains the available infrastructure like schools and hospitals. This is because the population is steadily increasing yet the infrastructure is not growing. Public utilities like hospitals, schools and roads are put under greater pressure by the growing population.

Theories of population

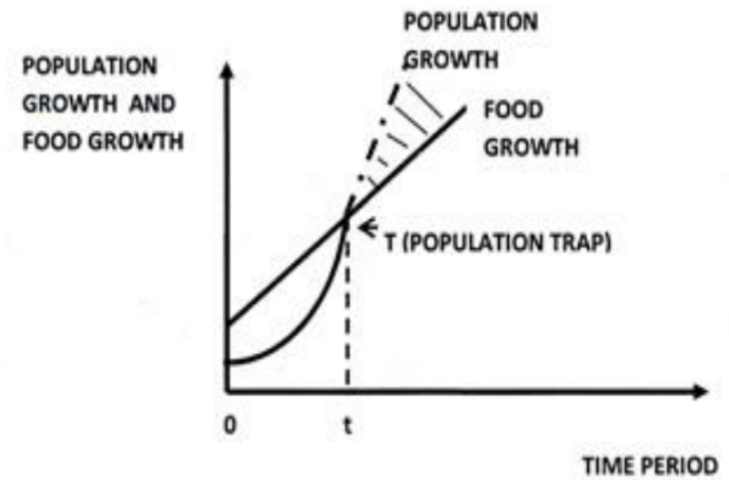
Malthusian population theory

Reverend Thomas Malthus' theory of population explains how population growth depends on food supply (resources available or means of subsistence), that is, shows the relationship between population growth and food supply. According to the theory, **population grows** at a **geometric rate** while food production tended to grow at an **arithmetic rate**. Therefore, the rate of increase in food production is slower than the rate at which population grows.

Malthus population trap or theory states that due to the above, there is a point when population growth equals food production (**population trap**); beyond which resources (food) would not be enough to sustain the population leading to vice, misery, sufferings, pestilence, death and other calamities (which tend to reduce population thereby bring a balance with food supply).

Therefore after the population trap, there was need to control (subject) the population through (to) preventive or **negative checks** like moral restrain (abstinence), celibacy, foresight and late marriages, otherwise **positive** or natural checks like famine, pestilence and diseases would serve to reduce population growth.

This situation can be illustrated as below:



At **point T**, the **population trap**, population growth equals means of subsistence (food production). Beyond point T (time period T), the shaded area, there if starvation, deaths, wars and diseases because population is more than food production.

Assumptions of the Malthusian theory of population

- Assumes a closed economy.
- Assumes constant technology applied to food production.
- Land is fixed in supply and subject to the law of diminishing returns.
- Food grows at an arithmetic rate.
- Population increases at a geometric rate.
- Population growth depends on only food supply.
- Assumes subsistence food production.

Applicability or relevance of the theory to developing countries

To a **smaller extent**, the Malthusian population theory is relevant to the developing countries in the following ways:

- Land supply being fixed and subject to the law of diminishing returns is what is being experienced in many developing countries and he envisaged this situation. In some countries there are diminishing returns to land due to overgrazing, over-cultivation, land fragmentation, soil erosion and desertification. This therefore, concurs with Malthus' assumption that the law of diminishing returns applies in production.

- To some extent population is still being checked by natural family planning methods. The natural family planning methods or control measures like celibacy, late marriages and abstinence from sex which are preventive or negative checks are being used; these control measures are his initiation.

- The positive checks on population exist in some developing countries. Therefore, population is being checked by wars and natural disasters such as floods, epidemics and earthquakes.

- Land problems or disputes are common issues in many parts of the developing countries, for example, Bunyoro in Uganda. This has led to land fragmentation and landlessness as population grows.

- Some areas of developing countries are facing food shortages (famine), for example, Karamoja in Uganda, Somalia etc. In some developing countries, peculation exceeds food supply and thus there is a problem of famine leading to deaths making the theory applicable.

Limitations or criticisms of Malthusian population theory

To a **greater extent,** the Malthusian population theory is of limited relevance or cable to developing countries in the following ways:

- It assumes constant technology which is unrealistic since technology is ever changing. The theory does not take into consideration the enormous impact of technological progress in off-setting the inhibiting forces of rapid population with. Malthus did not see the possibility of technological advancement which has made irrigation and large scale mechanised agriculture possible.

- It assumes a closed economy, yet economies of most developing countries are open economies. Malthus ignored the role of international trade in increasing food supply. International trade enables countries with food shortages to exchange t-food exports with food imports.

- Agricultural modernization is not foreseen by the theory yet this is taking place in most developing countries. This helps to increase food production and postpone the anticipated problem.

- Failure of the theory to visualise (foresee) the possibility of labour mobility from areas where opportunities are limited to areas where high wage employment opportunities exist.

- Population growth does not depend on food supply alone but also on other variables such as early marriages, fertility rates, net migration, improved nutrition and improved medical care. It is therefore, inaccurate to assert that population growth depends on food alone.

- The theory is based on the subsistence economy yet modern economies of developing countries are not predominantly subsistence any longer Commercialization of production leads to specialisation and increased output for exchange thus averting any possibility of shortages in food supply. This too was not envisaged by the theory.

- The theory did not foresee great improvement in transport that makes I possible to transfer food from areas of plenty to areas of scarcity hence developing countries can offset the problems of food shortages.

- It did not foresee the possibility of getting foreign aid/resources from other countries. Foreign food relief aid from countries with food surplus can offset the problems of food shortages in the developing countries.

- There is no mathematical relation as regards growth in food and population. There is no proof to show that population increases in a geometric progression and food production increase in an arithmetic progression.

- The theory ignored the deliberate and scientific methods of birth control. Malthus did not foresee the possibility of applying modern family planning methods like use of condoms, vasectomy and contraceptive pills to reduce on population increase.

- Malthus did not realise that rising living standards can cause a fall in birth rates and population growth. The theory assumes that national rates of population growth increase are positively related to the levels of national income. Therefore, as national income increases, population growth rates also increase yet in many countries as national income increases, birth rates have tended to fall.

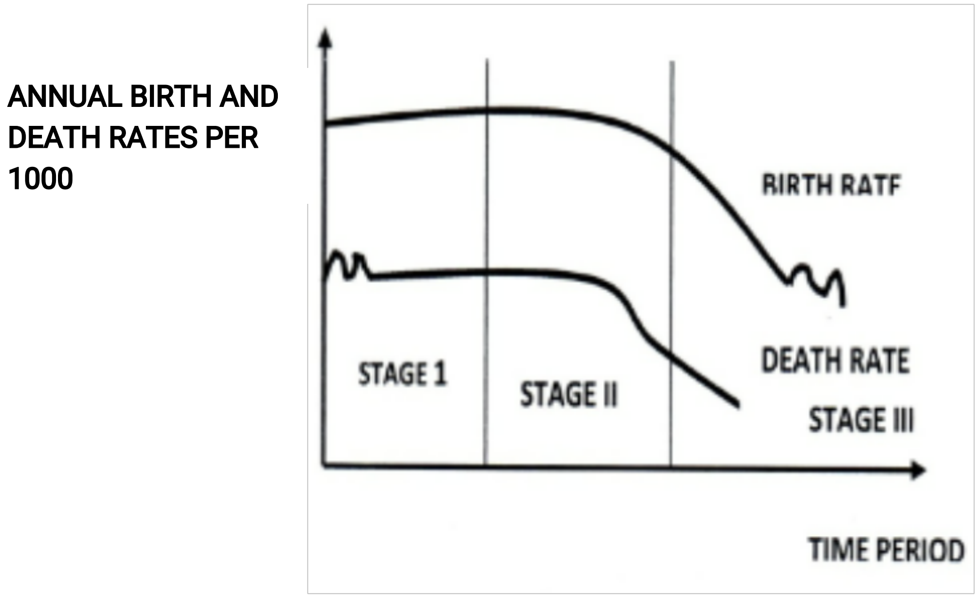
- It ignored the possibility emigration to ease press on resources. People emigrate from countries which are densely populated to countries which are less populated resulting into reduced pressure on resources in the overpopulated countries.

- Malthus was influenced by the law of diminishing returns which is not always true. At times increasing amount of a variable factor, labour, to a fixed factor, land, results in increasing and constant returns not diminishing returns as the theory assumed.

Theory of demographic transition

This refers to the phasing out process of population growth rate from virtually stagnant growth characterised by high birth rate and high death rates through a rapid growth stage characterised by high birth rates and low death rates to a stable - low growth stage where both birth and death rates are low.

Illustration



From the above figure the three stages can be explained as follows:

Stage I is characterised by high birth rates and high death rates due to poverty ignorance poor nutrition, poor medical care etc.

Stage II is characterised by declining death rates and high birth rates. The death rate is low due to introduction of modern drugs, improved medical and health vies, good quality food that is available etc. Most of the developing countries like Uganda depict some of the aspects of this stage.

Stage III is characterised by low and falling death and birth rates due to high levels of education, adoption of family planning methods, improvement in income level better standard of living and

reduced cultural tendencies. Many of the countries in the developed world especially Western Europe, Asia and North America depict some of the features of this stage.

The concept of under population, optimum population and over ovulation

Under population

Under population" refers to a population size that supplies insufficient labourforce relative to the existing co-operant factors leading to low average output

Or Is a situation where a country's resources exceed the existing population and some of the resources remain unutilized leading to low income per capita.

OrIs where the average output per head is below optimum because the pop insufficient to make use of all the resources.

Merits of under population in an economy

- It protects the country's resources from over exploitation.
- Reduces the level of inflation because there is reduced aggregate demand.
- Leads to creation of more employment opportunities for the avail labourforce.
- It may lead to equity in income distribution if majority of the people employed.

Demerits of under population in an economy

- Limited or small market size. The market for goods and services is small to the low number of consumers in the economy.
- Underutilisation of natural resources / Leads to wastage of resources as some will be idle. Resources especially land are underutilised due to inadequate labour to utilise them.
- Limited labour supply /Causes labour shortage. The supply of labour is due to existence of a few people in the economy.
- Low tax revenue.
- Low output hence low economic growth rate. The rate of economic grows" low due to low levels of economic activities.
- Low level of innovations and inventions. The level of innovation and invention tends to be low due to absence of competition in resource allocation and utilization because resources are in excess of the population.
- Leads to low levels of investment or discourages investment.
- High cost of social capital per capita /High average costs of providing social infrastructure. The cost of providing social capital, say infrastructure, per person is very high where population is scarce than where population is concentrated.
- Limited specialisation. The level of specialisation is low because ire available labourforce cannot afford to specialise in a particular activity and still be able to meet subsistence needs.
- Weak national defence. The national defence tends to be weak due to inadequate supply of manpower and other resources to facilitate the management of a

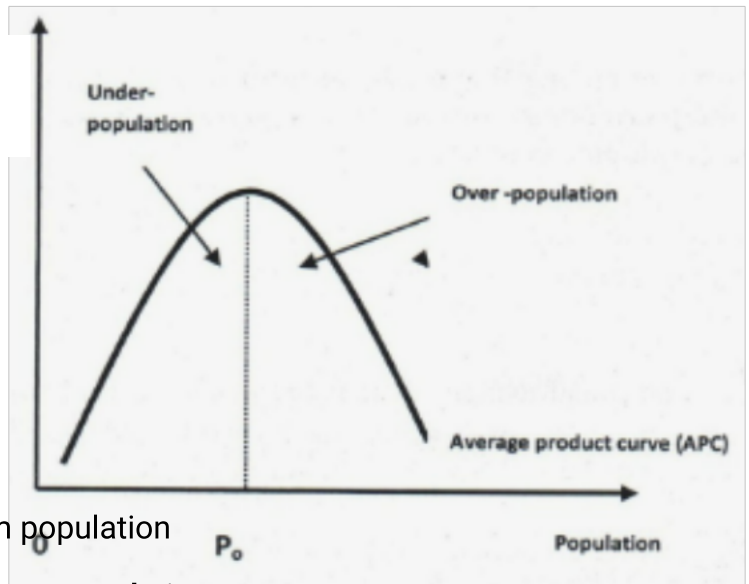
country's security needs.

Optimum population

This refers to the population size that provides labourforce that is sufficient to combine with co-operant factors (resources) leading to maximum output per worker (or highest per capita income per worker or highest average product per worker).

Hence a certain number of people is required to optimally utilise the available resources; below it (under-population) under utilisation of resources and above it (over population) resources are over-utilised, lustration

Illustration



Where OP0 is optimum population

Determinants of optimum population

- The level of savings.
- The level of technology.
- The level of natural resource base.
- The available stock of capital.
- The size of the population / amount of labour supply.

Indicators of optimum population

- Maximum utilisation of resources.
- High level of employment.
- More equitable distribution of incomes,
- Maximum output per worker.

- Limited dependence or expenditure on imports.

Over population

This refers to the size of the population that provides labourforce which when combined with the available resources, output per worker (income per capita per worker) reduces.

This is a population size where the output per person decreases as the population increase.

Causes of high population growth rates in developing countries

The rapid population growth rates in developing countries may be as a result the following factors:

- Early marriages among the youth. Many people marry and or produce cl¬early in life, say before the age of 21 years. This results in rapid population growth in developing countries.
- Reduced civil wars and natural calamities. This results in rapid population in developing countries as the relative calm forces people to procreate children.
- Cultural or traditional tendencies that encourage large families. In some cult children are regarded as sources of pleasure and pride to parents. Pan therefore; produce very many children in order to fulfill these traditional mores.
- High polygamy rate in society especially among Moslems. This results in population growth in developing countries among the polygamous communities.
- High poverty rate among the population. Many people produce children in or: to have old age social security later in life whereby children provide for the needs of their parents in old age.
- High level of prostitution. Many people have loose sex with several parties resulting in production of any, sometimes unwanted, children hence fast growth of population.
- Low level of literacy and inferiority complex of some women. Some woman believe that they are valuable only for their reproductive functions and that they can best retain their spouses by producing many children in polygamous familial for example, wives compete amongst themselves as to who would out-do the other in producing many children. This results in fast growth of the population.
- Limited family planning programmes in the rural areas. Many people are ignore of family planning methods; both their availability and benefits. Those that aware of their existence and benefits cannot afford to use them. This has result in limited use of contraceptives hence high birth rate and high population grow: rate.

- Decline in death rates due to improved health care. Improved medical care through effective public health programmes at all levels such as establishment medical facilities, vaccination and health awareness has reduced death rate-resulting in fast rate of population.

- High rate of immigration to developing countries due to insecurities in other countries. Due to political instabilities and limited economic opportunities.

- Some countries, many people emigrate to other countries leading to rapid population increase in the recipient countries.

- High rates of pregnancies among the unmarried due to rape and fornication. Due to the high level of adventurism among the unmarried, there is fornication suiting high rates of pregnancies hence high population growth rates.

- High infant mortality rates. Due to high infant mortality rates, many people produce very many children as security against child mortality so that as others die. Others remain. Sometimes all the children survive mortality resulting in high population growth rates.

- Low cost of raising children. The cost of raising children in some countries is low due to availability of food cheaply and state provision of merit goods like education and health at heavily subsidized rates. Since child upbringing is not very burdensome to parents, they do not see need to restrain their fertility.

Economic implications of a high population growth rate

positive implications

- High market potential. This is due to increase in effective demand by the growing population.

- High tax potential. This is due to increased investment, labourforce and consumer demand that provide more tax revenue to the government.

- High potential for labourforce. This is because of the increase in labour supply associated with the growing population.

- High potential for increased resource utilization. This is due to the high level of investment required to meet the increasing consumer demand hence increased use of idle resources.

- It is an incentive or potential for massive future investment. This is due to the increased consumer demand.

- Government is awakened to the responsibilities of providing the necessary infrastructure. This leads to increase in the level of output.

- The young population is usually innovative and creative. This is due to increase in the level of competition that results into more discoveries.
- It reduces per capita social overhead costs. This is because the infrastructure in form of schools, hospitals and roads is maximumly used.
- Initiates efforts to work harder to sustain the predominantly young population. This is because the working population strives to meet the demands of the dependants.
- High mobility of labour due to increased population pressure.

Negative implications

- Leads to unemployment and underemployment. This is due to the excess labour supply arising from the high population growth rate.
- Leads to high rates of rural-urban migration and its negative effects like prostitution, high crime rates and congestion. This is due to the poor working conditions in the rural areas.
- Leads to high rates of rural-urban migration and its negative effects like prostitution, high crime rates and congestion. This is due to the poor working conditions in the rural areas.
- Leads to high social costs in form of pollution, accidents, congestion and sanitary problems. This is due to the increase in the large number of people in the different areas. .
- Causes income inequality. This is due to the increase in poverty levels especially in rural areas.
- Leads to high government expenditure on provision of social services. This b due to the increasing demand for social facilities by the dependant population.
- Leads to high dependence burden. This is due to the large number of your, g people that depend on the working population.
- Worsens the balance of payments problems. This is due to the high level of importation to meet the demands of the population.
- Leads to quick depletion of resources due to overexploitation of the available resources to meet the rising demand of the population. It makes effective government planning for the population difficult. This is due to the high birth rates.
- It increases external resource dependence. This is due to increased reliance on

foreign aid, foreign manpower and foreign technology to meet the nee: of the high population increase.

- Leads to limited domestic market. This is due to the high level of poverty especially in the rural areas.
- It increases brain drain. This is due to the high levels of unemployment that forces highly skilled labour to look for better opportunities in other countries.
- It leads to low labour productivity. This is due to increase in the number of unskilled and semi-skilled labourforce.
- It over strains the available infrastructure like schools and hospitals. This because the increasing population demands for social services like education and health.
- Leads to low income per capita resulting in poor standards of living.
- Leads to low capital accumulation due to low savings.
- Leads to low investment due to the high level of consumption that limits funds set aside for accumulating savings.
- Leads to political unrest and social tension.
- It may lead to inflation due to high demand for goods and services.

Significance of an increasing population

Positive implications of an increasing population

The positive implications of an increasing population are:

- Increased labour supply. As population increases, labour supply also increases as more and more people become available for employment at the existing wage
- Wider market. As population increases, the number of consumers in an economy also increases. An increasing population therefore, provides a large and ready domestic market for goods produced both locally and imported.
- Increases the rate of natural resource utilisation. Resources, especially land, that were previously under and unutilised (idle) are brought to use by the existing circulation.
- Increased labour mobility. An increasing population prompts increased mobility of labour because of pressure on the existing resources in areas where population is increasing. Workers migrate from areas where there are shortages of factor inputs and wages are low to areas where co-operant factors are readily

available and wages high.

- Declining social per capita. The average cost of providing social infrastructures like roads, education and health per person falls as population size rises.
- Increased innovations. The population becomes more innovative and inventive as they look for ways of increasing output using the limited available resources.
- Strong national defence. An increasing population makes it possible for a sizeable proportion of the population to specialize in production and some labourers are committed to fulltime national defence.
- Government is prompted by the increasing population to adopt appropriate policies such as land reforms, manpower planning and family planning to solve the problem.

Negative implications (costs) of an increasing population

The negative implications of an increasing population are:

- Overutilisation of natural resources. An increasing population leads to overutilisation of resources and their exhaustion due to overstocking, overfishing and over farming by the large population.
- Widening income disparities. Income inequality increases because only a few people own means of production especially land and capital while the majority have very limited access to resources.
- Low savings and investment. The level of savings and investment decreases due to the high dependence burden. The large number of dependants on few workers leads to consumption of most of the incomes and low savings.
- land fragmentation and landlessness. Population increases more than the capacity of the available land to contain it leading to problems of landlessness and land fragmentation.
- Poor standards of living. The living conditions of the people become poorer because more and more people, especially children, share the limited resources. This results in malnutrition, congestion, poor medical care and education facilities.
- Increased government expenditure on provision of social services.
- Government expenditure increases due to the rising cost of provision of social services such as infrastructure, education and health for the large population.

- Balance of payment problems. A country faces balance of payment deficits because imports are increased to meet the ever increasing consumption needs of the population while exports do not increase at a fast rate because local output if mainly for domestic consumption.

- Increased levels of unemployment and underemployment. The level of unemployment and underemployment rises because there are more workers than can be employed by the available resources.

- Increased rates of rural-urban migration. Many people move from rural to urban centres in search of better opportunities such as social amenities and better paying jobs. This results in open urban unemployment and other evils.

- Low income per capita. Although national income increases due to increase in national output, it increases at a rate less than the rate of population growth. This leads to lower and declining per capita incomes.

- Increased social unrest. An increasing population leads to development of an idle and disorderly population because many people are unemployed, underemployed and poor and are therefore, easily convinced to cause social animosity in society, for example walk- to -work campaigns in Uganda.

Reasons for controlling population growth rates i> developing countries

- To control /reduce the dependence burden. This is because a high population growth rate leads to increased dependence burden on the small working population which leads to low level of savings, low level of capital formation and low level of investment.

- For purposes of reducing unemployment. This is because a high population growth rate leads to unemployment and underemployment as the public and private sectors are not in position to create enough employment opportunities to match with the high population growth rate.

- To reduce income inequalities / to promote equity in income distribution. This is because a high population growth rate leads high poverty levels especially in the rural areas.

- To control / reduce government expenditure on social amenities (services. This is because a high population growth rate leads to increased government expenditure on provision of social services like education and healthcare.

- As a way of improving on the Balance of payments position. This is because a high population growth rate leads to balance of payment problem due to increased import requirements to supplement domestic supply of goods.

- For controlling social costs like pollution / to minimise environmental degradation. This is because a high population growth rate leads high social costs in form of accidents, congestion, pollution and sanitary problems which are due to the increase in the large number of people in different areas.

- For purposes of increasing effective demand / market. This is because a high population growth rate leads to limited domestic market or low effective demand due to low income per capita.

- To ease planning for the population / for effective government planning. This is because due to a high population growth rate effective economic planning for the population becomes difficult due to limited resources / funds.

- To avoid overutilisation of the natural resources / to control or minimise depletion of natural resources. This is because a high population growth rate leads to quick depletion of resources due to over exploitation by the people.

- To reduce pressure on infrastructure / to minimise straining of the available infrastructure. This is because a high population growth rate leads to the available social and economic infrastructure in form of schools, hospitals and housing that ire overstrained.

- To control / fight rural-urban migration and its evils (negative effects). This is because a high population growth rate leads to increased rates of rural-urban migration and its related problems of rural stagnation, open urban unemployment and development of slums.

- As a means of reducing external resource dependence and economic dependence in general. This is because a high population growth rate leads to increased reliance on foreign aid, foreign manpower and foreign technology to meet the needs of the high population increase.

- To minimise brain drain. This is because a high population growth rate leads to brain drain which robs a country of her productive labour that tries to look for better opportunities in other countries.

- To improve labour productivity. This is because a high population growth rate leads low labour productivity especially in the agricultural sector due to the law of diminishing marginal returns.

- To fight crime and immorality. This is because a high population growth rate leads to development of an idle and disorderly population because many people are unemployed, underemployed and poor and are therefore, easily convinced to engage in crime and immorality.

- To fight / control inflation. This is because a high population growth rate may lead to inflation due to high demand for goods and services.

Population problems faced by developing countries

Population problems faced by developing countries are;

- High dependence burden.
- Unemployment and under employment.
- Balance of payment (B.O.P.) problems.
- Causes income inequality.
- Exerts pressure on land.
- Results into brain drain.
- High social costs for example pollution, congestion e.t.c.
- Pressure on existing infrastructure/ over-straining the infrastructure.
- High government expenditure on provision of social services.
- Effective planning for the population becomes difficult.
- Quick depletion of resources due to over-exploitation.
- Rural- urban migration (R-U-M) and its negative effects.

Population explosion

Population explosion is the sudden and rapid increase in population of an area or country relative to the existing available resources to sustain it.

Effects of population explosion include:

- Leads to over exploitation of resources.
- Leads to food shortages.
- Leads to land shortages.
- Leads to increased dependency ratio or burden.
- Leads to increased poverty.
- Leads to worsened balance of payments position.
- Leads to environmental degradation.
- Leads to increased income inequalities.
- Leads to rising demand pull inflation.
- Unemployment is increased.

- Distorts government projected planning.

Dependence burden

Dependence burden refers to the strain on the working population and government caused by expenditure on provision for the needs of infants, the young and the aged who are economically unproductive.

OrThe section of the population which is between the age of 0 and 15 years and 65years and above which is unproductive. Therefore reliant on the working population for survival.

Effects of dependence burden

The effects of dependence burden include:

- Leads to low labour supply.
- Leads to low savings and investment.
- Leads to high government expenditure / heavy burden on government provide social services.
- Leads to low quantity of output.
- Leads to under utilisation of existing natural resources.

Dependence ratio refers to the ratio of the number of dependants to the working population.

OrIs the proportion of the unproductive population to the economically active population.

OrIs the proportion of the number of dependants to the working population.

Therefore, **dependence ratio = Number of dependants: working population**

$$\textbf{Dependence ratio} = \frac{\textbf{Number of dependants}}{\textbf{Working population}} \times 100$$

Or

$$\textbf{Dependence ratio} = \frac{\textbf{Number of dependants}}{\textbf{Working population}}$$

$$\textbf{Dependence ratio} = \frac{\textbf{Unproductive population}}{\textbf{Economically active population}}$$

Examples

Given that the working population in a country is 12,000,000, the young population is 14,000,000 and the elderly population is 4,000,000, calculate the dependence ratio.

$$\text{Dependence ratio} = \frac{\text{Unproductive population}}{\text{Economically active population}}$$

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

$$= \frac{18.000.000}{12{,}000{,}000}$$

Dependence ratio =**3:2**

Or

$$\text{Dependence ratio} = \frac{\text{Unproductive population}}{\text{Economically active population}} * 100$$

$$= \frac{14.000.000 + 4.000.000}{12{,}000{,}000} * 100$$

$$= \frac{18{,}000{,}000}{12{,}000{,}000} * 100$$

= 150% or 150:100

Question: Supposing in a country of 28,000,000 people, the number of children are 14,000,000, the aged are 6,000,000 and the working population is 10,000,000; Determine the dependence burden.

Disadvantages of a high dependence ratio include:

- Leads to low savings and low investment.
- Leads to low productivity in the economy.
- Leads to heavy burden on government to provide essential services.
- Leads to underutilisation of resources.
- Leads to low tax revenue.

Declining population

This refers to a situation where population size is falling due to need to keep families small due to migration of population to other areas.

Effects of a declining population

- Decline in aggregate demand hence reduction in market size. The demand for goods and services decreases due to reduction in number of consumers.

- Reduced pressure on government to provide social services. There is reduced pressure on government to provide social infrastructures, education and health since the number of people requiring the services is falling.
- Decline in the level of investments. The level of investment falls due to inability of market to sustain productive industries. Some of the existing industries may collapse and close down.
- Attainment of optimum. Where the economy was over-populated, a decline in population size may enable it to attain the desirable optimum size.
- Reduced levels of unemployment. As population of an economy reduces, labour supply also falls. This leads to a reduction in the level of unemployment.
- Decline in labour supply. When population in an economy declines, labour supply also decreases. This may lead to a decline in output and increase in labour costs if the economy was not experiencing unemployment.

An ageing population

People within the age group of sixty years and above are referred to as the **aged population**.

Problems associated with an ageing population

- Declining output per capita. Output per person declines as people becomes older because peoples capacity to contribute to output declines with age.
- Declining labour supply. Labour supply in an ageing population declines as more and more people retire from work due to old age and poor health associated with old age.
- Limited mobility of labour. Labour mobility is low due to reluctance of the aged to move to new areas.
- Rising dependence burden. Where much of the population is made up of the elderly, the burden on the working population and the government to provide support to the aged is high.
- Low levels of innovations and inventions. The level of innovations and inventions declines largely because the aged are reluctant to accept new ideas nor are they willing to innovate new ideas of their own due to fear of uncertainties.
- Limited market due to declining demand for consumer goods and services.
- Low levels of investments. The level of investments becomes low because ire aged are reluctant to take risks of investments for fear of incurring losses that

may wipe out all the life savings.

Measures that are checking population growth rates h developing countries

A number of measures have been taken which may result into the lowering of fertility rates in developing countries. The measures include:

- Improving health facilities. Child health is being improved through establishment of medical facilities throughout the country and through mass immunisation against killer diseases and it is hoped it will reduce parents demand for many children for security purposes.

- Encouraging family planning. Efforts are being made through the mass media campaigns, to encourage family planning especially the use of contraceptives as to avoid unnecessary pregnancies. Encouraging women to participate in political and economic activities. This is done by giving women a head start in numerous political offices in the country and by extending loans to women. The economic empowerment of women is meant to enable women to make rational decisions concerning their bodies and to increase the opportunity cost of child bearing.

- Encouraging education for women. The education of the girl child and women in general is being encouraged, for example, through giving women additional 1.5 points when selection of students for entry into higher institutions of learning is being made. This is meant to keep students (women) longer in schools and reduce their bearing ages.

- Semsitising the population of the dangers of large families. People, through the mass media, are being sensitised of the dangers of having large families such as inadequate resources and time to look after children effectively. It is hoped that this will encourage parents to choose small families instead of large ones.

- Setting minimum marriage age and defilement laws. The minimum marriage age is being maintained at 18 years. Marriage of and/ or sexual relations with persons below that age is illegal and is subject to judicial penalties. This delay the age at which a person becomes a parent a first time and reduces the fertility period.

- Encouraging monetisation of the economy. The economy is being monetized and subsistence production is being discouraged through provision of markets for farm produce provision of loans to farmers. Monetisation of the economy shall increase costs of raising children and may discourage parents from having large families.

Factors limiting population growth rate control policies

- High levels of poverty/low income among Ugandans.

- Limited supply of skilled labour / family planning experts are few.

- Poor infrastructure limits information flow.
- Religious opposition, contradicting teachings (Islam and Christianity against family planning).
- Conservation due to rigidity in cultural norms.
- Over dependence on agriculture.
- Low cost of living in the country.
- High levels of corruption.
- Poor government policy on population control.
- Political unrest in some parts of the country.
- Early marriage.

Review questions

Question 1

(a). Explain the Malthusian theory of population.

(b). Account for the high population growth rates in your country.

Question 2

(a). Distinguish between under population and over population.

(b) Account for the control of population growth rate in your country.

Question 3

(a). Distinguish between picketing and collective bargaining.

(b). Account for the low bargaining power of trade unions in your country.

Question 4

(a). Examine the problems facing trade unions in your country.

(b). Explain the circumstances under which trade unions are justified to ask for higher wages?

Question 5

(a). Explain the objectives of trade unions.

(b). Why have trade unions failed to achieve their objectives?

Question 6

(a). What is meant by wage legislation?

(b). Examine the implications of minimum wage legislation in an economy.

Labour

Labour refers to any human effort, whether physical or mental that is utilised in the production process.

Significance of labour in the production process

- Labour creates capital or wealth from the reward it gets.
- Labour determines value. The value of a good depends on the amount of labour used to produce it.
- Labour utilises land and capital and without it, remain idle.
- The quality and quantity of labourforce, well motivated and having co- operant factors makes effective utilisation and exploitation of natural resources which raises output.
- Labour is the endfor which production is undertaken, that is, the need to satisfy human wants.

Productivity of labour

Productivity of labour is the amount of output produced per unit of labour employed (during a given period of time) i.e. it is the measure of output per unit: of labour employed.

Factors which determine the productivity of labour in Uganda

- Wages (motivation / remuneration / terms of service).
- Level of technology
- Level of skills / ability / education and training/ experience
- Availability and quality of co-operant factors;
- Quality of management / level of organisation of production process supervision
- Level of inventions and innovations
- Working conditions

- Attitude to work
- Natural ability / talent
- Political climate
- Physical ability / health conditions of workers

Factors which may lead to an increase in the productivity of labour

- Increase in the level of wages.
- Improvement in the technology / technological progress.
- Improvement in the quality of management.
- Increase in the level of skills.
- Improvement in the working conditions.
- Positive changes in attitude towards work.
- Improvement in political climate.
- Increase in the level of inventions and innovations.
- Increase in the level of specialization.
- Increase in the availability and quality of co-operant factors.
- Improvement in the health conditions of labour.
- Increase in experience.

Efficiency of labour

This is the measure of the quality and quantity of output that a unit of labour can produce in a given period of time.

Factors that influence or determine the level of efficiency of labour

- Natural ability or talent.
- Level of innovations and inventions.
- Physical ability or strength (health conditions of workers).
- Wages (motivation / remuneration / terms of service).
- Level of technology.
- Level of skills / ability / education and training/ experience.

- Availability and quality of co-operant factors.
- Quality of management / level of organisation of production process / supervision.
- Working conditions.
- Attitude towards work.
- Political climate;
- Level of specialisation or division of labour.

Labour supply

Labour supply is the number of hours of work labour is willing to work for at a given wage rate over a given period of time.

Factors that influence the supply of labour

- Health conditions of workers. When they are good, workers are active, they do not miss work leading to high supply of labour but when they are poor, workers are not active, they sometimes miss work leading to low supply of labour.
- Size of the population. When the size of the population is big, it means there are more people to work hence high supply of labour but when the size of the population is small, it means there are few people to work hence low supply of labour.
- The age composition of the population. When the majority of the population is a working population, then supply of labour is high but when few people are of working age, the supply of labour is low.
- Working conditions. When the working conditions are good, many people are encouraged to work leading to high supply of labour but when the working conditions are poor, many people are discouraged to work leading to low supply of labour.
- Political climate. When there is political stability, people feel secure to work hence high supply of labour but when there is political unrest, people are in fear for their lives hence low supply of labour.
- Trade unions' influence. Trade unions that have great influence, restrict labour supply so as to raise the members' wages but trade unions with less influence cannot restrict labour supply since there is minimal influence on employers leading to high supply of labour.

- The level of knowledge of job opportunities. When the level of knowledge is high, the supply of labour is high as more people get jobs but when the level of knowledge is low, the supply of labour is low as fewer people get jobs.

- The level of migrations. When the immigration rate is high, the level of supply of labour is high because there are more people to work but when emigration rate is high, the supply of labour is low because there are few people to work.

- Attitude of labour towards work. When the attitude is positive, people are willing to work hence supply of labour is high but when it is negative, people are not willing to work, hence low supply of labour.

- The level of mobility of labour. When the level of mobility of labour high, it means people are willing to move from one job or geographical area another hence high supply of labour but when the level of mobility of labour is low, it means few people are willing to move from one job or area another hence low supply of labour.

- The level of wages. When the level of wages is high, many people are motivated to work leading to high supply of labour but when the level of wages is low, many people are demotivated and discouraged to work leading to low supply of labour.

- The nature of the jobs. When a job is risky, people are discouraged to work for fear of contracting diseases or even losing their lives at work hence the supply of labour is low but when a job is non-risky, people are encourage to work because their lives are not in danger hence high supply of labour.

- The level of skills required in a particular job. When the level of skills required is high, the supply of labour is low because not so many people have these skills but when the level of skills required is low, the supply of labour is high because many people who have those skills.

Demand for labour

It refers to the number of workers or people employers are willing to offer jobs and retain in employment at a given wage rate.

OrIt is demand derived from demand for the products labour is required to produce.

Factors that determine the demand for labour

- The level of demand for a product that labour helps to produce.

- The level of wages or price of labour.

- The level of skills of labour.
- The availability of co-operant factors, for example, land, capital etc to complement labour.
- The proportion of the cost of labour to the total cost of production.
- The possibility of substituting labour for other factors of production.
- The amount of output of labour (the productivity of labour).

Marginal productivity of labour

Marginal productivity of labour refers to the quantity of output that can be produced or realised from the employment of one extra unit of labour.

Limitations to productivity of labour in developing countries include:

- Limited capital.
- Limited skills.
- Poor techniques of production
- L limited supply of raw materials.
- Poor attitude towards work.
- Poor working conditions.
- Poor entrepreneurial ability.
- Low wages.
- Poor land tenure system.
- Physical disability.
- Unfavourable political climate.

Labourforce is the proportion of the population that is made up of the working age group, excluding full-time students and housewives. It is the total number of people of the working age group that is available for employment at a given time.

Characteristics / features of Uganda's labourforce

- Mainly youthful.
- Slightly more females than males.
- Mainly employed in the primary sector.

- Mainly semi-skilled and unskilled.
- Mainly rural based.
- Many are employed in the public sector.
- Many are unemployed and underemployed.
- Majority of the labourforce is not unionised.
- Some are poorly deployed to occupations which do not match their skills.

Determinants of the size of labourforce

- Size of the population.
- Number of full time students / length of training period.
- Health status of the population.
- Government policy in terms of employment age / age structure.
- Social customs / number of full time housewives.

Wages

Meaning

A wage is a monetary reward or payment to labour for its contribution towards the production of goods and services.

Types of wages

1. **Nominal or money wage**. This is a wage expressed in monetary terms for example euro, shillings and dollars.
2. **Real wage**. This is the purchasing power of a nominal wage.

Or

The amount of goods and services a nominal wage can buy.

Determinants of the real wage

- Size of the nominal wage.
- Level of taxes.
- Amount of goods and services available.

- General Price level.
- Size of the monetary and subsistence sector.

1. **Basic wage**. This is a wage earned by a worker after removing all allowances and medical benefits.
2. **Minimum wage**. This is a wage set by the government above equilibrium and it is illegal to pay a worker below it.
3. Living wage. This is a payment to a worker sufficient to provide basic needs.
4. Or
5. It is a reward that is adequate for a worker and family to subsist comfortably.
6. **Subsistence wage**. This is a reward to labour that is just enough to enable him to meet the basic human needs. It is a minimum payment to a worker to induce him to hard work but not afford any luxury of life.

Methods of wage determination in developing economies

1. Time rate system. Wages are determined according to duration of work. The more the time spent on work, the higher the wages paid and the less the it spent on work, the lower the level of wages.
2. Piece rate system. Wages are determined by quantity of output produced. The more the work done by the worker, the higher the wages and a small amount work done leads to earning low wages.
3. Individual bargaining power of labour. Wages are determined by individual worker bargaining with his or her employer for an acceptable wage rate. A worker with strong bargaining power earns more wages than a worker with low bargaining power who is paid low wages.
4. Market forces of demand and supply for labour. The wage rate is determined through the interactive forces of demand for labour and supply of labour till equilibrium market wage is determined.
5. In a situation where the demand for labour is more than the labour supply, wages tend to be high and where labour supply is more than demand for labour, low wages are paid to workers.
6. Collective bargaining or trade union influence. Trade unions determine wages through round table negotiations for wages with employers. Strong trade unions are able to demand higher wages for their members compared to weak trade unions with a low bargaining power.
7. Government policy of wage legislation. Government determines wages through fixing of wages either at minimum below which it is illegal to pay or at a

maximum above which it is illegal to pay workers. The government sets wages of civil servants using a historical salary scale where they are graded such that top civil servants are paid high wages compared to the low cadre staff.

8. Employer's setting wages for the workers. The employer sets a wage at which to pay workers depending on his will and ability to pay the wage. Employers with a strong ability and willingness to pay, offer high wages to the workers while employers with a low ability and willingness to pay, offer low wages to the workers.

Some concepts under wages

- Wage freeze. This refers to the situation where wages are kept constant for a certain period of time by the government so as to check inflation.
- Wage drift. This is where piece rate earners negotiate with their employers for more allowances apart from the basic wage.
- Wage restraint. This is a voluntary restriction of wage increase where the government encourages trade unions not to increase wages so as to check inflation.
- Economy of high wages is the belief that high wages will increase the effort of the workers to an extent sufficient to compensate the employer for the greater cost of labour. Where workers have previously been insufficiently fed, ill clad and badly housed, an increase in wages would improve their efficiency.

OrIt refers to a situation where wages are increased with hope that the higher the wages, the higher the labour efficiency. When workers' wages are low, an increase in wages is expected to increase their welfare and efficiency making them devote more time to their jobs.

Methods / systems of wage payment in an economy

1. Sliding scale system. This is where wages are adjusted according to the changes in the cost of living such that an increase in the cost of living leads to high wages while a decrease in the cost of living leads to low wages.
2. Bonus payment system. This is a situation where a worker is given an extra amount of money for producing beyond the expected target or working beyond the recommended time.
3. Profit sharing system. This is a situation where workers are encouraged to buy shares in the business and on top of their wages; they are entitled to dividends (profits).

   Or

   A mode of wage payment in which after deduction of costs of output except labour costs, from selling price, the employer shares profits with the employee in terms agreed to by both parties to the contract.

4. Time rate system. This is a method of wage payment where workers are pair-according to the time they have worked for example per hour, day and month. The system involves clocking in and clocking out.

5. Piece rate system. This is a method of wage payment where workers are pair according to the amount of work done.

   The more amount of work done, the higher the wages and less amount of work done, the lower the wages.

Time rate system of wage payment

Time rate system is a method of wage payment where workers are paid according to the time they have worked for example per hour, day and month.

Merits of time rate system

- Encourages hard work in terms of working overtime. This is because workers put in more effort to earn more wages leading to high output produced.
- Better quality output is produced due to constant supervision of the work and absence of hurrying.
- Proper records of time are kept for easy or correct payment. Therefore, it becomes easy to calculate the wages given to the workers for example multiplying the wage rate by duration of work.
- Workers are encouraged to report in time for work. This implies that workers are self-driven.
- Workers are able to receive regular wage payments. Employees receive wages even during periods of temporary idleness.
- Less efficient / slower workers who take more time easily earn high wages as all workers are paid same wage.
- Minimizes conflicts between workers and employers thereby creating industry peace.
- In a situation where output cannot be measured for example health and education, it is difficult to apply piece rate.
- Minimizes destruction of delicate machinery due to absence of hurrying as is the case of piece rate.

Demerits of time rate system

- Encourages laziness by the workers.
- Leads to low production of goods and services.
- Slower and less efficient workers can easily be paid more than the faster and efficient workers.
- Poor quality output is produced where there is no supervision.
- Leads to high costs of supervision and time checking.

Circumstances in which time rate method is preferable to the piece rate method of wage payment

Time rates are more satisfactory than piece rates:

- When a high quality of output is essential for example as in computer programming.
- When the work cannot be speeded up, for example, in bus driving
- When there is no standard type of work, for example, in car repair
- When care has to be taken of delicate machines, for example, in medical tests
- When output cannot be easily measured, for example, in nursing and teaching.
- When working for long hours may undermine health, for example, in laundry
- When labour is by nature a fixed factor of production which must be engaged whatever the output, for example, in secretarial and selling staff.
- When periods of temporary idleness necessarily occur, for example, in repair work.

Piece rate system of wage payment

Piece rate system is a method of wage payment where workers are paid according e amount of work done.

Merits of piece rate system

- Eliminates the need for constant supervision of the workers leading to reduced costs of production.
- Minimizes labour strikes (industrial unrest) because it limits conflicts or disagreements over payments.

- Higher output is realized because workers are encouraged to produce more so as to earn high wages.
- Promotes team work / spirit among the workers leading to increased productivity.
- Workers do the work at their own pace thereby reducing overstraining.
- It is easy to calculate the wages because output is measurable.
- Dull and slow workers are stimulated to work hard in order to earn high wages.
- Encourages innovativeness among workers so as to produce a large output of and services to earn high wages.
- Faster workers earn more wages than slow / lazy workers which minimises seating in the payment of wages.
- Employers easily forecast output to be produced by the workers and this enables them to put aside the necessary amount of money for wage payment, that is, it simplifies employers costing calculations.
- It helps employers in identification of suitable workers by enabling them to remove the lazy ones and maintain workers who put in more effort.
- Tasks are completed faster since the system encourages hard work among the workers.
- Employers are protected from falsified payments since wages are directly related to the level of output.
- Output is increased and the cost per unit of a fixed factor of production employed reduces.
- Demerits of piece rate system
- Workers tend to over work themselves to earn high wages and this negative affects their health.
- Reduces the quality of work because of hurried work for higher pay.
- Leads to over production due to high output rates resulting into wastage of resources.
- A worker who genuinely misses work or falls sick is not paid for the missed. This causes wage / income instability.
- Hard working people are resented by the slow workers leading to conflicts arc income inequality.
- Leads to high risks of accidents because workers try to increase the speed of

work for higher wages.

- It undermines trade union solidarity because of variations in piece rates one place to another and due to the conflicts between the hard working people the slow workers.
- Slow but careful and efficient workers are discouraged since they produce output levels (and good quality output in a long time) that earns them low wages.
- Workers may resist being transferred from one form of work where they acquired more experience to another.

Circumstances under which piece rate system is preferable to time rate system of wage payment

- When it is possible to measure output either in terms of area covered or volume of output produced.
- If it leads to increased output per period of time since it motivates workers to work harder to produce greater units of output within the shortest period of time.
- When careful workers are not likely to suffer for doing quality work in lesser quantities thereby earning less than fast but careless workers who earn more producing output in large quantities but of poor quality.
- If it enables workers to become creative and innovative in order to increase output.
- When it is easy to check and avoid wastage arising from hurrying.
- When accidents at the work place can be avoided.
- When active workers who are creative or physically stronger or hardworking are not resented for producing more output thereby earning more than the other workers.
- When it is possible to forecast output and cost of production.
- When supervision of workers is not necessary, for example, when all workers know and do what they are required to do.

Theories of wage payment

1. **Wage fund theory.**This theory states that there should be a sum money put aside to pay workers.

The amount of wage given to each worker depends on the number of workers and the sum of money put aside.

2. **Bargainig power theory**. This theory states that wages are given to workers depending on the bargaining strength of trade unions and employers. strong trade unions earn more wages for their members while weak trade unions earn low wages for their members.

3. **Residual claimant theory**. This theory states that workers should be paid their wages after all other factors of production have been paid, that is, the employer should pay rent and interest before paying labour.

4. **Iron law/ subsistence theory of wages.** This theory states that a worker should be paid the bare minimum or subsistence wage which is just enough to meet the basic needs.

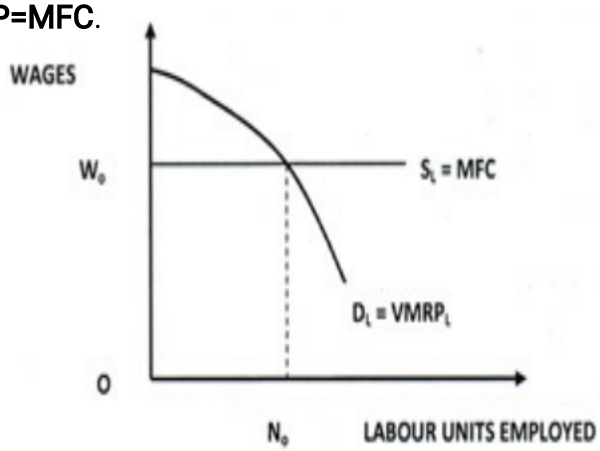
   An increase in wages above the basic needs (subsistence needs) leads to increase in population (and this' eats' the subsistence wage way).

   When population exceeds the basic/ subsistence wage, there is starvation, misery and death till the subsistence wage is restored again.

5. **Marginal productivity theory of wages.**This theory states that a **worker is paid a wage** equal to the **value of his marginal product** of labour increases, the wage given to labour should increase and when the marginal product of labour falls, the wage given to labour should reduce.

   or profit maximization requires that a producer should not pay a wage higher than the MRP of that worker, that is, the marginal value of its marginal physical product. Therefore, position of the wage will be determined at a point where **MRP=MFC**.

Illustration



Where;

SL is supply of labour.

DL is demand for labour.

MFC is marginal factor cost.

VMRPl is value of marginal revenue product of labour.

ONo is units of labour employed.

OW0 are the wages paid.

From the diagram above, the wage is determined at a point where the **MFC = MRP** of labour service and are equal to the average cost of the factor service.

Thus each labour service will be paid OW0 wages for ON0 units of labour employed.

NB: **Marginal revenue product of labour** is the addition made to total revenue resulting from employing of one more unit of labour.

Assumptions of the marginal productivity theory

- It assumes that there is full employment of labour.
- It assumes that all units of labour employed are homogeneous.
- Labour is assumed to be perfectly mobile.
- There is no government intervention in determining wages.
- It assumes the law of diminishing returns operates.
- It assumes labour knows his marginal product.
- It assumes there is perfect competition in the labour market.
- It assumes employers are able to measure the marginal product of labour.
- It assumes workers have sufficient bargaining power to determine the wages given to them.
- It assumes output can be measured or quantified in measurable units.

The relevance/ applicability of the marginal productivttt theory of wage determination

To a large extent, the theory is inapplicable or irrelevant because:

(Limitations of the marginal productivity theory of wages)

- All units of labour are not homogenous and workers productivity varies. A of labour differs from another in terms of skills, education attainment physical ability. Therefore, efficiency of labour differs from worker to worker, is therefore wrong to assume that all units of labour are homogeneous.
- Labour tends to be immobile yet the theory assumes perfectly mobility, theory assumes perfect mobility of labour between different employments places. However, labour tends to be immobile both occupationally geographically.

- Perfect competition does not exist in true market situation. There imperfection in labour markets due to government interference in fixing wages
- All units of labour are not fully employed as there are cases of unemployment and under employment. There is no full employment situation of labour in developing countries due to excess supply of unskilled labour resulting in some form of unemployment and underemployment.
- Government usually intervenes in fixing wages yet the theory assumes no government intervention. Government influences wages through fixing minimum and maximum wages as well as adopting policies such as wage freeze and wage restraint.
- It ignores the role of trade unions in bargaining for high wages. For example the Uganda Medical Workers' Union normally influences wages of their members through round table negotiations with the employers. This trade union pressure influences wage rate and not marginal productivity of labour, thus making the theory not applicable to developing countries.
- It does not consider the exploitation of workers by the capitalists, for example, underpayment of the workers. Wage rate is usually not equal to the value of the marginal product of labour
- because capitalists desire to remain with surplus fits and therefore, pay workers less than the value of their marginal product. This thus makes the theory not applicable to developing countries.
- The law of diminishing returns may not apply all the time. The theory is based n the law of diminishing returns but sometimes there is constant and increasing return because of inventions and innovations leading to technological development. This leads to an increase not decrease in output as more labourers are employed.
- It does not consider the level of education and training which may differ and thus influence the level of wages paid to labour. Highly educated labour earns more than less educated workers even if their marginal product is the same or even less.
- It is difficult to measure the marginal product of labour in some occupations or sectors for example the service industry like education and health sectors. Therefore, wages of workers in the service sector are determined using other factors thus making the theory irrelevant.
- It ignores historical factors in wage determination for example the inherited salary structure in developing countries. The colonial government had a wage structure for different categories of the civil service by which some categories of servants earned more wages than others. To-date government pays workers

according to wage rates inherited from the colonial times and not according to marginal productivity theory of distribution as applied to wages.

- Labour cannot be completely substituted in the production process as the theory assumes.
- It ignores the supply of labour in determining wages for example the supply of unskilled labour.
- Labour and the employers cannot determine the exact value of the marginal product since output is produced by many factors. It is therefore, not possible to calculate the marginal productivity of labour separate from the contribution of other co-operant factors thus making determination of wages on the basis of marginal productivity of labour difficult.
- Employer at times use the subsistence level as a measure of wages, which may be below or above the value of the marginal product. Workers are therefore, paid according to what the employers consider adequate for maintaining subsistence needs or cost of living but not according to marginal productivity of labour.
- Bargaining for wages by individual labourers is not taken into account by the theory. Sometimes wages are determined by workers ability to bargain and workers who have stronger bargaining power earn more than those who are poor at bargaining for higher wages.

To a minor extent, the theory can be applicable;

- It assumes that employers can vary the units of labour employed and this is largely true in most occupations.
- It assumes that workers with higher marginal physical product get higher wages than those with low marginal physical product and this is true in occupations where piece rate system applies.
- The government has no influence over wages in the private sector of ar. eloping countries like Uganda.
- Trade unions in developing countries are weak and have no or limited effect on wages.

Marginal productivity theory of distribution

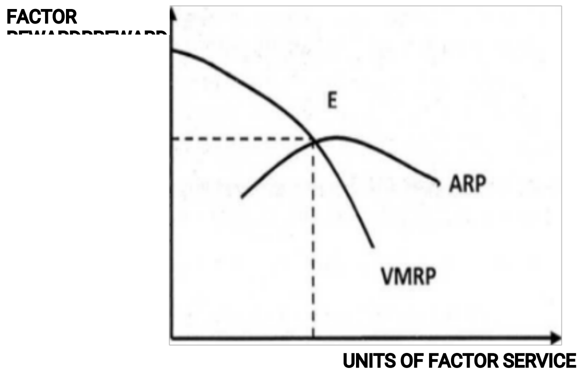
It states that a factor of production should be paid a reward equal to the monetary value of its marginal (physical) product.

OrIt states that profit maximisation dictates that a factor of production should be rewarded according to the value of its marginal product.

OrIt states that a factor of production must be paid a price equal to the value of m marginal revenue product.

Illustration

Where;



ARP is average revenue product.

VMRP is value of marginal revenue product

OQ0 is units of factor service employed.

OP0 is the factor price

From the diagram above, the factor price is determined at **point E** where **ARF-MRP**. Thus each factor service is paid **OP_0 p**rice for **OQ_0**units of output.

Assumptions of the marginal productivity theory of distribution

- It assumes that all units of factors of production are homogeneous.
- It assumes that marginal product of a factor of production can be calculated
- It assumes that output can be quantified into measurable units.
- It assumes fair and perfect competition in the factor market.
- It assumes perfect mobility of factors of production.
- It assumes full employment of factors of production.
- It assumes perfect knowledge in the factor market.
- It assumes no government intervention in determination of factor rewards.
- It assumes that the law of diminishing returns operates.

The relevance or applicability of the marginal productivity theory of distribution

To large extent, the theory is inapplicable because:

- All units of a factor input are not homogenous. The assumption that all units of a service are homogeneous is unrealistic. Fertility of land, for example, differ from one piece of land to another. Likewise, efficiency of labour differs worker to worker. It is therefore, not correct to assume that the different factor units of the same service are homogeneous.

- Factors are not perfectly mobile. The theory assumes perfect mobility of factors as between different employments and places. In reality, factors are mainly immobile. There is no automatic movement of factor units from one industry or place to another.

- Perfect competition does not exist in true market situation. Perfect competition does not exist in the factor and product markets. What is in existence is imperfect competition. This leads to exploitation of factors by being paid much lower than their marginal productivity.

- Factors of production are not fully employed. The theory assumes existence of employment in the economy. Otherwise in case of unemployment factor units offer their services even at a price less than their marginal product. Therefore, forms of unemployment and underemployment exist in all economics.

- Not all factors are divisible for example a blast furnace. The assumption that factor units are divisible and therefore can be increased by small quantities does hold true. It is not easy to vary a large or lumpy factor.

- Profit maximisation is not the main motive of production always. The theory les that the entrepreneurs are motivated by profit maximization that is why units of a factor service are employed when the firm finds the marginal revenue product of the service is higher than its price. This is not true because the entrepreneur is motivated by other factors besides profits.

- Production is not a result of one factor alone hence difficulty in determining the contribution of each factor to marginal output. Production is as a result of different factors and their units working together. It is therefore, not possible to calculate the marginal productivity of each factor unit separately.

- Assumes the law of diminishing returns which is unrealistic.

- The value of marginal product is not necessarily equal to the value of factor ruts used in producing it but determined by other factors for example forces of demand and supply.

- Government legislation of factor prices is not taken into consideration by the theory

- It ignores the fact that factor rewards can be bargained for such as the wage rate for labour.

- It ignores the use of other factors to reward the factors of production other than their marginal physical product for example skills and experience.
- It ignores the effects of historical factors in determining factor rewards for example the inherited wage / salary structure.
- To a minor extent, the theory can be applicable;
- The payment to a factor according to the value of its marginal product can be used where output can be quantifiable.
- Factor inputs tend to be relatively homogeneous for example unskilled labour, farm land and money capital.
- Technology in many developing countries has tended to be constantly rudimentally therefore, the theory can be applicable.
- The government has no influence over factor rewards in the private sector.

Factors that determine the level of wages in an economy

- Level of education and training. Highly skilled labour is paid more % because of the high productivity and efficiency than a worker with a low of education who is inefficient and needs further training.
- Cost of living. High costs of living like in urban areas leads to high wages to a worker to enable them sustain better standards of living while low costs living like in rural areas leads to low wages given to a worker because minimal cost required to sustain a given lifestyle.
- Level of talents and natural gifts. A highly talented worker is gifted contributes more to output hence earns more wages than a worker who is talented and contributes less to output.
- Nature of the job. Highly risky jobs results into high wages given to worker-compensate them for the risk they are exposed to while less risky jobs results low wages given to workers.
- Level of experience/ responsibility. High level of experience or more responsibilities leads to high wages given to a worker because of the high level of efficiency while limited experience or no responsibility leads to low wages given to a worker since he contributes less to a firm's output.
- The bargaining strength of the individual workers. A worker with a strong bargaining power is able to be paid a high wage because of his ability to convince the employer for better pay than a worker with low bargaining power who cannot easily convince the employer for a better pay even when they are of the same qualifications and do the same job.

- The number of hours worked (time rate system). More time spent worker at a given job leads to a high wage given to a worker because contributing more to output but less time taken on a given job, results into low wage given to a worker since the contribution to output is low.

- The strength of the workers' trade unions. Workers under trade unions with strong bargaining power earn more wages because of their ability to negotiate for better terms of employment but workers under weak trade unions are paid low wages since they cannot actively negotiate for better terms of service.

- Ability of workers to do work (piece rate system). More amount of work done high wages given to workers because of their high level of productivity but less amount of work done leads to low wages given to a worker due to the low levels of productivity.

- Government policy on wages. Government gives different wages to different civil servants in different departments. Some are paid high wages because of their

- levels of experience, education and productivity while others are paid low wages because of their low levels of experience and productivity.

- Level of discrimination in the labour market. Some employers pay high wages to some workers and at the same time other workers are paid low wages for the same occupation within the same company/firm basing on differences in age, religion, gender and political party.

- Employer's ability and willingness to pay. The higher the willingness and ability to pay the workers, the higher the wages given but when the ability and willingness to pay the workers is low, the wages given to the workers are low.

- Market forces of demand and supply of labour. A high demand for labour compared to labour supply leads to high wages paid to workers since there are more job vacancies than the job seekers but a high labour supply compared to demand for labour leads to low wages paid to workers as the job seekers are more than the job vacancies available.

Wage differentials

This is where different wages are paid to different workers depending on differences in occupations, gender, age, race, trade unions and political party. However, the differences in wages may be between jobs or within the same job.

Causes of wage differences in an economy

- Differences in the level of education and training. Workers who spend longer periods at school such as degree holders earn more wages because of the high skills possessed than diploma holders who spend fewer years at school but are serving in the same occupation or industry.

- Differences in the cost of living. Workers who work in areas where the cost of living in high such as urban centres earn higher wages to enable the work attain reasonable welfare than those serving in areas where the cost of living is low such as rural areas.

- Differences in the level of talents and natural gifts. Highly talented workers such as Musicians, painters, professional footballers and athletes' earn more wages because of r.cir innate abilities that make them contribute more to output than the less talented workers even in the same occupation whose contribution to output is low since they are gifted.

- Differences in the nature of the jobs. Workers employed in highly risky jobs such as pilots and miners are paid high wages than those who work in less risky jobs such as white collar jobs, in order to compensate workers serving in risky jobs for the high of health which they bear.

- Differences in the level of experience or seniority or responsibility. Workers who have worked for long in the same occupation earn high wages than those who have just joined the industry because senior employees need limited further training and supervision.

- Differences in the bargaining strength of the individual workers. Workers who are more eloquent in asking for higher wages are paid much more highly because of their ability to convince employers to pay them high wages than the less eloquent ones are poor at bargaining for wages.

- Differences in the number of hours worked or time spent on the job. Workers work longer hours put in more effort and produce high output hence earn more inc than those who put in less effort by working for shorter hours when the time rate me of paying wages is used.

- Differences in the strength of the workers' trade unions. Workers that belong to strong trade unions, that are capable of negotiating for wages for their members, higher wages than workers who belong to weak trade unions or un-unionised workers that cannot bargain for high wages.

- Differences in the ability of workers to do work or differences in quantities output produced. Workers who are hardworking produce large quantities of work therefore earn higher wages than the lazy workers who produce lesser quantities of output when the piece rate method of paying wages is used.

- Differences in government policy on wages. Government pays different wage rates different officials even when the officials have the same levels of education, experience and seniority. This is done to attract highly skilled workers to a particular industry or to promote integrity of the workers who are well paid.

- Differences in the elasticity of demand for the final product that labour helps to produce. Workers who produce products that are demand inelastic earn higher wages than those who produce products which are demand elastic. This is because prices products which are demand inelastic can be increased in order to earn wages for the workers that produced them whereas it is not possible to increase prices for products which are elastic in demand.

- Discrimination in the labour market in terms of race, sex, tribe or region Workers who are favoured by their employers on account of their race or tribe or religion or sex earn higher wages than those disfavoured by the employers even though they are doing the same job.

- Differences in employer's ability and willingness to pay. Different employers have different abilities to pay and workers being employed by the different employer or occupations earn differently.

- Differences in the elasticity of supply of labour to an occupation. Labour w inelastic in supply to an occupation such as highly skilled labour earns higher wages than labour which is elastic in supply to an occupation such as semi-skilled and unskilled workers especially when forces of demand and supply of labour influence wage rate.

- Differences in the degree of substitutability of labour by machines. Labour which is easily substitutable by machines such as unskilled labour earns lesser wages than professionals who are not easily substitutable by machines because their work involves either a very high degree of human touch or judgement.

Reasons for low wage levels in an economy: A summary

- Low level of education and training / low labour skills,

- Low cost of living especially in rural areas,

- Low level of (limited) talents and natural gifts,

- Less risky nature of the job.

- Low level of experience/ responsibility.

- Low bargaining strength of the individual workers.

- The limited number of hours worked.

- The limited strength of the workers' trade unions.

- The inability of workers to do work.

- Negative government policy on wages for example wage freeze and wage restraint to control inflation.

- High level of discrimination in the labour market.
- Low employer's ability and willingness to pay.
- Excessive supply of labour in relation to demand for labour.

Wage legislation

This refers to the government policy of fixing wages either maximum wage set below the equilibrium wage above which it is illegal to pay (employ labour) or minimum wage below which it is illegal to pay (employ) workers.

Therefore, **maximum wage legislation** is a government policy of fixing a wage rate below the equilibrium wage above which it is illegal to pay wages.

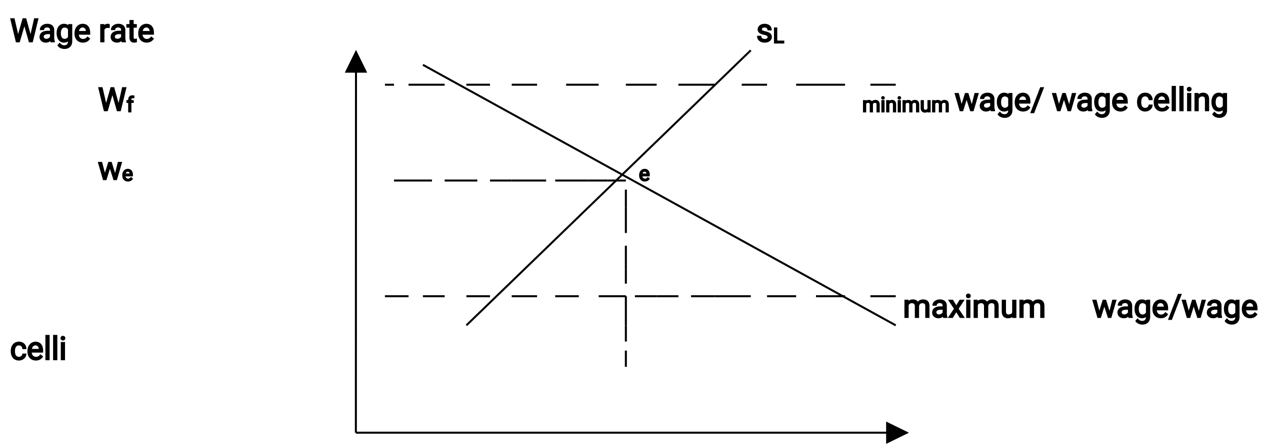
Minimum wage legislation is the setting of wages by the government above the equilibrium wage below which it becomes illegal to pay the workers.

N.B A **maximum wage** refers to a wage set below the equilibrium wage above which it is illegal to pay (employ labour).

While

A minimum wage is a wage set by the government above the equilibrium below which employers are not supposed to pay the workers. It aims at avoiding exploitation of the workers.

Illustration



Objectives / reasons for legislation of a minimum wage

- To enable workers meet the rising cost of living. Minimum wage legislation undertaken to enable workers to cope with the rising cost of living cause primarily by rising levels of inflation.
- To reduce brain drain. This applies especially when the minimum legislated wage

is higher than either the market wages or legislated wages in neighbouring countries. Workers would thus find no economic motivation to go and work in other countries where wages are lower than wages offered home.

- To reduce exploitation of the workers by employers. Minimum wage legislated reduces worker exploitation by the employer since the employer is not allowed to pay workers less than the minimum wage.
- To ensure industrial peace. Minimum wage legislation reduces workers' strikes for increased wages since workers are aware that they are paid wages which are higher than rates determined by market forces of demand and supply.
- To encourage labour mobility. Minimum wage legislation is aimed at increasing inter sectoral mobility of labour, say, from the private to the public sector.
- To expand the demand for goods and services. Minimum wage legislation increases the purchasing power of workers hence increased demand hence increased standard of living of the workers.
- To fight corruption or bribery among workers. Minimum wage legislation aims at reducing malpractices such as theft and embezzlement especially, if the minimum wage provides for workers basic needs of life.
- To increase labour productivity or efficiency. Minimum wage legislation enables workers to save for investment and this increases the productivity of me economy.
- To ensure fair distribution of income or wealth between different sectors and regions. Minimum wage legislation reduces wage differences between occupations in order to forge equity in income distribution.
- For political support. Minimum wage legislation aims at winning political good will and support from the workers who may fear a change of government because change of political leadership may put into power leaders who are not sensitive to workers welfare.
- To encourage savings or capital accumulation by the workers. Minimum wage legislation increases the level of savings and investment in an economy thus r creased output.
- To attract labourforce by reducing voluntary unemployment. Minimum wage legislation is aimed at attracting labour from other sectors of the economy into the public sector.
- To reduce labour instability such as moon lighting- a situation in which a worker holds more than one job simultaneously in order to make ends meet. Minimum wage legislation aims at making labourforce more stable as it avoids problems

of labour instability such as absenteeism and moonlighting in order to rake a living.

Effects of a minimum wage in a market economy

Positive effects

- Results into increased savings and investment by workers.
- Helps workers to meet the increasing cost of living.
- Promotes equity in income distribution when rationally implemented.
- Helps fight malpractices like corruption and moon lighting.
- Leads to increased government popularity.
- Leads to increased demand for goods due to increased incomes.
- Protects workers from exploitation by employers.
- Leads to increased efficiency of the workers.
- Leads to increased labour supply or reduced voluntary unemployment.
- Leads to reduced brain drain.
- Minimises labour unrest thus promoting industrial peace.
- Promotes mobility of labour.
- Leads to increased revenue to government through taxation.

Negative effects

- Leads to excess supply of labour in relation to its demand.
- Increases the costs of production due to high labour costs.
- Results into technological unemployment as employers replace labour with machines due excessive demand for a high wage.
- Worsens the income gap when not equitably implemented. High minimum wage increases income disparities between wage and non-wage earners because prices for products in the informal and agricultural sectors are low leading to earnings for workers in the sectors.
- Encourages rural-urban migration and its effects. Minimum wage legislation causes imbalances in income gap between rural and urban centres since formal employment which benefits from minimum wage legislation is rural based. This leads to influx of labourers from rural areas to urban areas in quest for high paid

wage employment.

- Leads to cost push and demand pull inflation. High minimum wage leads to increased aggregate demand leading to inflation if increased wages do not lead to corresponding increase in output of consumer goods and services.

- Discourages investment resulting into low entrepreneurship due to low profits. Investors are discouraged from investing in the economy for fear of high costs of production resulting in low profits or even losses.

- Causes budgetary deficits. A high minimum wage for public sector workers increases government wage bill and may cause government to incur a budget deficit.

Question:Assess the effects of a minimum wage policy in an economy.

Effects of a maximum wage legislation in a market economy

Positive effects of maximum wage legislation

- Encourages investment.
- Makes labour cheap and affordable.
- Controls inflation.
- Creates equity in income distribution.
- Controls a boom.
- Minimises labour unrest.
- Makes government popular.

Negative effects of maximum wage legislation

- Leads to brain drain.
- Causes voluntary unemployment.
- Depresses consumption leading to economic depression or stagnation.
- Causes unpopularity of the government.

Trade unions

A trade union is an association or organization formed by the workers with a primary objective of demanding for increased wages and improved conditions of work for its members.

Or it is an association of workers formed to achieve common objectives like fighting for higher wages for the workers, improved working conditions ant improved welfare.

Therefore, a trade union is formed by employees to ensure collective action against employers. Examples of trade unions in Uganda include:

- Uganda National Teachers' Association (UNATU).
- Uganda Law Society (ULS).
- Uganda Medical Workers Union.
- Uganda Railways Workers Union.
- Makerere University Academic Staff Association (MUASA).
- National Organisation of Trade unions (NOTU).

Types of trade unions

1. Professional / craft trade unions

These are associations that cover all workers with particular skills irrespective of the company or industry in which they are employed.

Or

These are associations of workers with similar skills (those who perform rro.ar tasks). The members may work with different industries or places. For example Uganda the National Teachers Association.

2. Industrial trade unions

These are associations of workers that bring together all workers in a particular industry irrespective of their skills. For example the Uganda Medical Workers Union .

3. Company trade unions

These is an association of workers of a particular company or factory or firm. It presents any worker of the company in question e.g. The Uganda Railway Workers Association.

4. General trade unions

These are unions of workers from different establishments, companies, occupations or skills from all associations of trade unions e.g. the National organization of Trade Unions in Uganda (NOTU).

5. Open shop trade unions

These are trade unions that accept all workers irrespective of their skills, that is, they do not put conditions or restrictions to workers who seek for membership.

Are trade unions where the employers do not require potential employees / workers to be members of a given labour union.

6. Closed shop trade unions

These are trade unions where membership is restricted or confined to workers with particular skills. They impose restrictions on workers who seek membership. They aim at maintaining a high quality of the labour so as to restrict its supply to ensure high wages for example the Uganda Law Society.

OrAre trade unions whose members have specialised professional training in a given for example Uganda Law Society, Uganda National Teachers Union, Uganda Medical Workers' Union among others.

OrAre trade unions in which employees must be members in order to obtain and in employment. Recruitment of members can also be restricted to possession of particular qualifications

acceptable to the union, for example, law (Uganda law Society) and medicine (Uganda Medical Workers' Union).

OrIs the type of a trade union where labour supply or number of workers or membership is highly restricted and the trade union fights for the rights of the registered members.

Functions of trade unions

- (Collective) bargaining for better wages. It is the responsibility of trade unions negotiate with their employer for pay increases to match with the economic conditions the time such as increased cost of living; increased worker productivity and increased employer profitability.
- Negotiating for better conditions of work. They negotiate for the improvement working conditions and fringe benefits such as better housing conditions, longer holidays or shorter working hours, cleaner and safe working environment.
- Protection of (protecting) members against unfair treatment. They protect workers against unfair treatment by employers through methods such as unjust dismissals, discriminative payment of wages and unfair promotions.
- Advising government on planning. Trade unions advise government on policies as minimum wages, wage freeze, wage restraint, manpower planning, labour employment policies.
- Improving members' skills through education. Trade unions educate members that members skills improve. This is attained through organizing seminars for members and giving members scholarships or bursaries out of union funds to enable members to pursue studies in institutions of higher learning.

- Providing an effective means of expression for the workers' views in society

Objectives of trade unions

- To demand for better working conditions, trade unions aim at enabling their member to enjoy better working conditions e.g. have a clean and safe working environment. They achieve this by representing their affected members in the negotiations for the better conditions of service.

- To bargain for wages collectively / To negotiate for better wages. The unions aim at negotiating for wages for their members. This is always when the cost of living increasing or when the prevailing wages c~ provide an acceptable standard of living. This they achieve through collective bargaining and other tools.

- To protect workers from abrupt or unfair dismissal / To p members from unfair treatment by employers. Trade unions aim at ensuring some degree of job security for the members. They achieve this through intervening with appropriate tools when members are unfairly dismiss, their employers.

- To improve the skills of their members. They aim at ensuring that their re¬members have high productivity so that they are employable .They achieve this by conducting regular workshop and seminars /short courses to enhance the skills of the members.

- To advise government on issues pertaining to manpower planning (labour and wages). They achieve this by rendering advisory services to the government in forecasting and training the manpower needed by the country -currently and in the future.

- To advocate for the human rights of the workers. Trade unions are set to agnate for basic human rights for the people in the country and as critics for government in the country. This they do by forming /sponsoring political parties and pressure groups' for example the labour party of UK.

- To forge unity among workers / To unite workers. Trade unions are formed to devise ways of creating sense of unity among all workers such that they are not exploited by the profit hungry employers' .This they achieve by consistent membership in the unions. They main old members and encourages new workers to join.

Methods / tools / instruments / weapons used by trade voons to achive their objectives

The methods used by Trade unions to demand for higher wages or any other objectives are either peaceful or violent. The violent methods are usually used as means of last resort. The methods used include.

- Collective bargaining. This involves peaceful round table negotiations/

discussions between employers and representatives of workers or trade unions regarding increasing in wages and improvement in conditions of work.

- Go slow method. This involves reduction in work effort / number of hours worked that is workers use time wasting techniques while at work. The purpose is to reduce output and cause losses to the employer so that he or she is forced to respond to the demands of the workers.
- Sit down strike. This is where workers report for duty but they do not do any inductive work. They put down their tools and simply sit down until management addresses their problems.
- Go on strike /industrial action/violent strike /destructive method. This is the strongest tool of trade unions .It is usually the tool of last resort. It involves the workers abstaining from work and becoming destructive to life and property till when they are listened to, for example by burning down the industrial plant.
- Sabotage / media wars/ boycotts and decampaigning. This involves the trade union officials persuading clients of the producers' product not to purchase any more. They may put negative campaign messages in the newspapers, on television, and other public media in an attempt to spoil the reputation of their employer.
- Picketing. This is the act of physically stopping members of union who may be loyal the employer from working even if it necessitate bearing them up. The employer is left in isolation until he respects the demand of employees.

  Or Is a situation where some members of a trade union of a given firm or institution are put at the entrance to stop any worker(s) from entering to work.

  OrIs a situation where some workers of a trade union are put to monitor the gates of the production unit so that no worker is allowed to enter or work as agreed by the trade onion.
- Mediation/industrial arbitration. This involves use of an influential body or person to both the workers and the employers in order to find a solution to the problem.
- Abduction of employer's officials. Here a key member(s) of management is/are abducted and treated like a hostage (s).this is common with those officials who reluctant or hostile to the demand of the employees, to save the abducted individuals the employer respects the demand of the employees.
- Demonstration. Here the workers make posters or banners describing their grievance and move around or in town appealing for public sympathy .The main intention is to make the
- problems public .In order to save the image of the company the employers is the demands of the employees so fast if they are genuine.

- Closed shop. Here the trade union highly restricts the supply of labour in a given field or profession by setting strict conditionality to membership (i.e. possession of particular skills for membership) .Their skills become scarce and they easily ask far higher wages from employers.

The tools used by management / employers to counter the actions of trade unions

1. Collective bargaining with the trade unions members
2. Lock out, that is, the employer may lock the union members from entering his or her premises in order to avoid destruction.
3. Use of strike missionaries, that is, employer may hire spies from and among employees to give him/her information about trade union activities and plans.
4. Government assistance, this involves the employer approaching government seeking for assistance.
5. Arbitration .i.e. use of an independent and influential persons or body reconciles the employer and the trade unions members.
6. Use of substitute workers, that is, the employer may ignore the striking workers and he or she employs alternative staff until the workers abandon their derr.sit .In most cases the functional workers are asked to reapply.
7. Use of the policy and other organization, here the employers seek the service of the police or army to stop demonstrations and violent strikes.

The basis of demand for wage increaments by trade unions

(Reasons why trade unions demand for higher wages)

1. An increase in the cost of living. A considerable increase in the cost of living forces trade unions to demand for a pay rise so as to match wages with the c living.
2. Higher wages being offered to workers of a similar industry. Trade unions demand for increased wages is justified when workers in similar firms are earning higher wages than them, the workers in the low wage earning firm ask for wage, increases for purposes of wage parity (uniformity).
3. Abnormal profits earned by the employer. A trade union can prevail on the employer to raise wages for their members when the employer is earning substantial (high) profits.
4. Increased labour productivity. An increase in workers' productivity forces tri; unions to demand for increased wages so that workers increase their gain fro- increased productivity by having their wages increased.
5. Wages offered being lower than or below the government set wage. Trade unions

can take industrial action against the employer to force him to honour the government legislated minimum wage.

6. Inelastic demand for goods of that particular industry. In circumstances where demand for products that labour produces is inelastic, trade union demand for wage increases receives favourable consideration by the employer.

7. Increased risks on the job. Trade unions are justified to demand for increased wages for their members to compensate members for the risks they go through

8. Failure to effect the agreed upon periodical wage increases. Employers usually agree to offer workers regular pay rises but later refuse to honour the agreements, making trade unions justified to take industrial action to force the employer to hour the agreement.

9. Workers' acquisition of better education and offering higher skills. Trade unions demand for pay rise for members when members' skills improve so as to compensate members for the costs incurred and time spent in acquiring more skills.

10. Inelastic supply of labour of a given industry. Trade unions are justified to ask for higher wages when the supply of labour is inelastic i.e. where labour is scarce and the employer can hardly produce goods without it.

11. Increased workload or hours of work and other responsibilities. Trade unions are justified to demand for pay increase to compensate the members for doing more work than previously.

12. An increase in prices of products produced by the workers. Trade unions can demand for a wage increase when a rise in the price of the product labour helps to produce does depress quantity demanded relatively little. This for example gives electric power workers strength to demand for a pay rise compared to shop workers in a single departmental store.

Conditions under which trade unions are justified to 3emand for wage increases

Question: Under what situations or circumstances are employees justified to demand for wage increments?

Ans N.B, study the circumstantial words.

1. When there is an increase in the cost of living. Here trade unions are justified to request for wage increments in order to enable employees adjust to the increasing cost of living .This is to help the members to maintain a given level of welfare.

2. When higher wages are offered to workers of a similar industry. When workers in a similar industry earn higher wages, trade unions demand for increase in wages. This is because workers have similar qualifications and they do similar related work.

3. When high or abnormal profits are earned by the employer. When there is a substantial increase in the level of profits, it implies that employees are working hard therefore they demand for higher wages to have a share on the fruits of their hard working.

4. When there has been increased labour productivity. Trade unions demand for higher wages when output per unit of labour increases. The increase in productivity results into higher sales and revenue and therefore workers wish « share part of this increased revenue.

5. When the wage being offered are lower than or below the government set wage. Workers are justified to demand for increase in wage such that their wage equated to the minimum wages legislated by the government.

6. In case of inelastic for goods of that particular industry. When the demand for the final products becomes inelastic, workers are justified to demand for high wages because the employer can easily meet the increase in wage by increasing prices without losing out on sales.

7. In case of increased risks on the job. When the hazards associated with the job increase, workers demand for higher wages as compensation to the exposure high risks.

8. In case the employers fail to effect the agreed upon periodical wage increase. Most when the contacts state periodic increase in wages and therefore employers fail to implement this, workers use their unions to demand for higher wage.

9. When the workers acquire better education and offer high skills. Incase: skills of workers improve due to further education and training, they are justified demand for higher wages .The main aim is to demand wages that match their upgraded skills.

10. When the labour supply becomes inelastic. When the supply of labour is inelastic, employees are justified to ask for higher wages i.e. where labour is scarce and the employer can hardly produce goods without it.

11. When there has been increased work load or hours of work. When workers spend more time at the place of work, they ask for higher wages as compensation to the leisure hours foregone for work.

12. When there has been an increase in prices of products produced by workers. Increase in the price of the products which employees help to produce leads to

increased sales revenue thus employees ask for a share from increased revenue.

13. When the workers feel that wages being paid to them are too low com to the services they render. When members feel that the employer is exploiting them by paying them less than they deserve they can decide to take industries action.

14. When the wages bill a small percentage of the total cost of production of the firm, here employees feel cheated and they demand for higher wages as a request for fairness in this case they are justified to ask for higher wages.

Characteristics of trade unions in developing countries

- Most lack permanent structure i.e. they are amorphous, they basically lack clear objectives.
- They basically have limited or small membership, that is, many unions have few members.
- They are mainly weak financially, that is, many have limited funds.
- Many unions experience frequent political interference, that is, they are largely influenced politically .
- The mainly suffer from wide spread discrimination.
- They basically have a low bargaining ability.
- Most of the trade unions have restricted membership.
- Many trade unions have inactive members.
- They are mainly urban based.
- Mainly skilled and semi-skilled membership.
- Mainly have poor leadership.

Factors affecting the strength of trade unions

1. Amount of strike funds. Trade unions that have adequate funds to finance their operations such as sustaining members during long periods of strike action are stronger than trade unions withinadequate funds. The financial position of unions is dependent on members' payment of membership and subscription fee as well as level financial accountability.
2. Degree of government interference into union affairs. Trade unions into whose affairs government interferes, by for example appointing their leaders or illegalizing union activities or dismissing either members or militant leaders from jobs are weaker than those into whose affairs government does not interfere.

3. Degree of organisation. Trade unions whose members are divided on sectarian grounds such as on the basis of tribe or religion or political affiliation are weak whereas trade unions which are organized on the basis of workers economic interests as well organized and strong.

4. Degree of unionisation. Trade unions in industries or firms were not all workers are members (open shop unions) are weak because of possibility of non-members stealing a march by negotiating independent wage bargains while were the trade anion can speak for all its members, employers know an agreement can be honoured and such unions are strong.

5. leadership skills and commitment. Trade unions whose leaders are committed to the advancement of members' interests and whose leaders do not only know labour laws but also have negotiation skills are strong while trade unions whose leaders are either unskilled or are opportunistic and use trade unions as instruments for the advancement of personal interests are weak.

6. Level of unemployment. Trade unions are very strong during periods of full or near full employment but weak during periods when the economy is experiencing high levels of unemployment because trade unions demand for increase in wages can be met by laying off of workers and recruitment of new ones from the pool of the unemployed.

7. The level of productivity of members. Trade unions with highly productive members such as manufacturing industry workers, are stronger than those with members that are little productive such as agriculture sector workers. This is because the latters' taking up of industrial action against the employer does not lead to significant reduction in output. Therefore, demand for increased wages and better conditions of work by the latter can be ignored whereas for the former cannot be ignored.

8. Elasticity of demand for the products that members produce. Trade unions that produce products that are inelastic in demand (such as power sector workers) are strong while trade unions that produce products that are elastic in demand (such as domestic appliance industrial workers) are weak because there is less disruption the production process in case they take industrial action in form of a strike.

9. Prevailing economic performance. Trade unions are stronger during periods economic boom but weaker during inflationary periods because during inflation period trade unions demand for increased wages fuels inflation while during a boom employers accept trade unions demand for increased wages.

10. The elasticity of supply of labour (members). Trade unions which are made up members that areelastic in supply such as unskilled labour are weaker than unions with members that are inelastic in supply for example skilled labour.

11. The elasticity of demand for labour and substitutability of labour. Trade with members whose demand is inelastic and whose members are not substitutable by co-operant factors are stronger than unions with members w: demand is elastic and can be easily substitutable by other factors especially machines.

Problems faced by trade unions in developing countries (factors that limit the ability of trade unions to wages)

1. Poor leadership (limited leadership skills). The leadership of trade unions not have the necessary skills to manage them well. They have limited organization and mobilization skills. They therefore fail to consolidate the relationship between workers in the different unions .The limits their ability to convince employers to raise wages.

2. Small/ limited membership or low level of unionisation. Many trade unions not have all workers of the industry as members partly due to apathy and partly due to target working. This makes it difficult for union leaders to negotiate employers as representatives of all workers.

3. Limited funds. Trade unions do not have enough financial resources to fir their activities, for example, inadequate funds to sustain strikes. This is be most of the members are low income earners and are not able to pay reasonable amounts of subscription and membership fees.

4. Limited skills of members. Many of the trade union members are not trained. They do not have specialised skills. They are basically substitutable i.e the employers can replace them any time .They thus fail their struggle to have a better pay.

5. High levels of unemployment. The level of unemployment in developing countries is so high due to factors such as seasonal variations in climate, change techniques of production from labour to capital intensive techniques of production and other factors. The trade unions find it difficult to press for higher wage^ members for fear of being laid off from work since there are many unemployed people who are willing to work at even lower wage rates.

6. Low demand for products produced by members of the trade unions. This is mostly due to the high levels of poverty in most developing countries. This after: the sales and revenue of the employer. The employer is thus unable to raise enough money to improve wages of his employees thus the failure of the union to raise wages.

7. Low demand for labour. Some employers have limited demand for workers because they can easily use machines, for example, some firms can easily substitute the workers with machines that are more efficient. They thus refuse to

raise the wage of their workers and this renders trade unions weak.

8. High levels of corruption (low level of accountability). The union members especially the leaders receive bribes from the employers .They thus work against (sabotage) the activities of the unions. This leads to failure of achieving die general demands of the unions.

9. Poor communication /poor infrastructure. The poor infrastructure hinders the passing of information among members and between unions .It also limits the co-ordination of union activities across the entire country. This leads to failure of trade unions in developing countries.

10. Government (political) interference into trade union affairs. Government interferes into union activities by influencing the election of union leaders and by threatening to sack union members and leaders. This is in particular the case with public sector workers.

11. Poor organisation of trade unions (disunity of members). Many trade unions are afflicted by the division of members on sectarian grounds such as on the basis of religion, tribe and political affiliation. This makes it difficult for union members to come together solidly under one body.

12. Inelastic supply of labour. The supply of unskilled and semi-skilled labour in Uganda is inelastic. Since union leaders cannot control the supply of labourers into an industry, by for example limiting entry into an occupation by specifying minimum entry requirements, it makes it hard for them to negotiate for a fair wage for their members.

13. Low productivity of members.

14. Apathy or ignorance of workers of their rights.

15. Poor economic performance (low profitability of firms)

16. High proportion of the wage bill to total costs.

17. Existence of transitory incomes (availability of alternative sources of income or limited commitment of members).

Question

1. a) Mention the differences between trade unions in LDCs and those in MDCs.

   b) Explain the factors limiting the ability of trade unions to raise wages in country.

The role of trade unions in the development of Uganda’s economy

positive role

- They enable members secure better positions leading to greater productivity

- They promote the human rights of the workers hence improving the productivity of the members.
- They help in bringing about governance which leads to political stability.
- They help in reducing income inequalities to ensure improved demand for goods and services.
- They help workers earn high wages and hence encouraging them to supply greater effort in production.
- They advise government on manpower planning ,employment policies arc wage policies .
- They promote unity among workers thereby enhancing team work and greater productivity.

Negative role

- They increase the cost of production through increasing wages and this leads to cost push inflation.
- They organize strikes that are destructive to life and property
- They discourage foreign investment because they make labour expensive
- They promote exploitation of consumers due to high prices set by employers in order to raise the high wages demanded.
- They worsen income inequality especially when their activities are fairly distributed.
- Some of their activities promote political instability.
- They lead to low production of goods and services or shortage commodities in the market for example when they organize sit down strikes
- They worsen the unemployment problem because they make employer prefer the use of machines.

Circumstances under which trade union activities in al economy are undesirable

A trade union as an association of **workers** is supposed to use peaceful or forceful means to safeguard the interest of workers. However, some of the rights of trade unions may be misdirected and their activities become undesirable if:

- If trade unions demand for higher wages than the value of their output and me increased wages lead to increased cost of production which forces the produce out of market.
- When trade union activities sabotage government policies such as wage freeze, wage restraint and maximum wage legislation.
- When union activities are likely to cause inflation due to increased costs production that leads to increase in prices of goods and services.
- If their demands create wider income inequalities for example, by making unionized workers to earn much higher wages than ununionised work;, workers in weaker trade unions.
- If the level of employment falls because of union activities, for example, discouraging investment due to high costs of labour or on reduction of employed labourforce through substitution of labour by machines so as to reduce labour costs.
- If the activities are politically rather than economically motivated, for example when trade unions strike in order to demand for the resignation of a government from power instead of striking to demand for wage increases and better conditions of work.
- If their activities lead to a reduction of output and reduction in economic growth due to need to reduce the number of workers employed and reduce labour costs.
- If their activities promote opportunists such as unscrupulous or unserious union leaders who use unions as instruments for advancement of self interests such a fame political gain or promotion to other higher trade unions.

TOPIC 6: THE UNEMPLOYMENT PROBLEM

Meaning:

According to **Lipsey** unemployment refers to the percentage of the workforce seekingemployment.

Simply put, **unemployment** is the situation where labour is able and willing to work at the ongoing wage rate but cannot find a job.

Types of unemployment

There are two major types of unemployment, namely

1. **Voluntary unemployment.**

2. Involuntary unemployment.

Voluntary unemployment

This is a situation in which people who are able are not willing to work (at the mooing wage rate) yet employment opportunities exist.

Or Is one in which labour is not willing to work at the ongoing wage rate yet there are jobs.

Causes of voluntary unemployment

- Laziness or poor attitude towards work. Jobs are likely to be available but some people are naturally lazy to take on the available job opportunities. They do not want to do manual work and this gives rise to voluntary unemployment.
- Desire for leisure. Some individuals also refuse to take on the available jobs at ere current wages in order to enjoy their earned incomes. Individuals who prefer leisure to work are reluctant to get jobs which reduce their time for leisure and recreation hence creating voluntary unemployment.
- Low wages given in the available job. Some individuals refuse to work because they do not accept the current wages. They do not take on such jobs with low wages and benefits and this causes voluntary unemployment.
- Poor working conditions existing in a given job for example long hours of work and poor housing discourage labour to take on the existing jobs. The unemployed fear to apply for such jobs due to the poor working conditions hence causing voluntary unemployment.
- High level of social ties or cultural attachment. This makes an individual to refuse job opportunities in distant areas hence causing voluntary unemployment.
- High level of education or qualifications. Some individuals refuse to take on certain jobs because they are not equivalent to the qualifications attained hence causing voluntary unemployment.
- Political instability in a given area. This scares away labour for fear of losing their lives even when jobs are available hence causing voluntary unemployment.
- Low status esteem attached to the available jobs. Some individuals despise certain jobs that they are of a low status compared to their level of education or skills. Due to this attitude, some individuals do not take on these jobs and this

causes voluntary unemployment.

- Good economic background of the unemployed. Some individuals prefer to remain unemployed and live on the family's wealth or riches. Such people feel that they can comfortably survive on the accumulated wealth inherited from their parents instead of taking on jobs and be employed. This creates voluntary unemployment.

- High risks involved in doing the job. Some individuals fear to take on certain jobs that are available because of the high occupational hazards involved for example fishing, guarding and mining. A person would rather remain unemployed instead of doing a very risky job and this causes voluntary unemployment.

- Desire of the unemployed to depend on past accumulated savings or income. Individuals who have saved part of their incomes refuse to accept any job at the current wage rate in order to enjoy the accumulated income. The individuals find it not necessary to be employed by others which creates voluntary unemployment.

- Social and religious restrictions. An individual may not take on a job for fear of violating certain social and religious norms. For example a person practicing Islam as his or her religion cannot get employed in a brewery hence causing voluntary unemployment.

- Unfavourable geographical location of jobs. Jobs may be available but an located in hard to reach areas or in very remote areas or in areas which are pre re to natural disasters like landslides and earthquakes the job seekers may fear to work in such areas and this creates voluntary unemployment.

- Presence of target workers. Some workers after achieving their targets decide not to continue working hence causing voluntary unemployment.

Involuntary unemployment

This is a situation in which people who are able and willing to work at the current wage rate are unable to find jobs.

OrIs one in which labour is willing to work but is unable to find work at the ongoing wage rate.

Other types of unemployment

1. Technological unemployment

This is where labour is rendered redundant as a result of machines replacing human labour in the production process.

OrIt occurs when there is a change in the techniques / methods of production such that machines replace human labour.

Solutions to technological unemployment

- Encourage employees to be with multiple skills / diversification of skill retraining labour to acquire multiple skills.
- Use of labour intensive or capital saving techniques of production.
- Control of rapid advancement in science and technology.
- Find alternative work for those who have lost jobs.

2. Residual unemployment

This is one due to physical or mental disabilities that makes such people unemployable due to their low standards of efficiency.

3. Casual / erratic unemployment

This is where labourers are employed only when there is demand for their labour and they become unemployed when the job is done for example tailors, barbers, bodaboda riders, mechanics and building contractors

Is one which is caused by expiry or end of contracts.

OrIs one which is caused by a temporary end of demand for labour with specific skills

4. Seasonal unemployment

This is where people are unemployed due to changes in climate or weather conditions especially in agriculture between harvesting and planting.

Examples of seasonal unemployment in an economy

- During bad weather in the case of outdoor activities like construction.
- Period between harvesting and planting in case of a farmer or agriculture.
- Dock workers when there are no ships due to bad weather conditions.

Causes of seasonal unemployment in an economy

- Climatic changes for example in agriculture.
- Failure to tame nature.
- Periodic variations in demand.

Remedies for / solutions to seasonal unemployment

- Modernising agriculture so that it is less dependent on nature for example irrigation during the dry season.
- Diversification of the agricultural sector.
- Diversification of the economy i.e. creating many activities within the economy.
- Acquisition or equipping people with multiple skills / Training labour to do many jobs Diversification of skills within the same occupation. .

5. Frictional / transitional / search unemployment

This is one that arises due to labour switching or changing jobs in the short run.

Or It is one that arises due to mismatch between demand and supply of labour in the snort-run.

Causes of frictional unemployment

- Ignorance of existing job opportunities elsewhere. Employment opportunities rest but labourforce is ignorant of their existence and therefore cannot get work. 7nis is brought about by failure of employers to disseminate information about the employment opportunities which they have.
- Automation or technological development. The use of modern technology industrial operations causes unemployment to human labour as it is replaced by machines.
- Temporary breakdown of machinery and closure of plant in order to carry out renovations. This causes unemployment for short durations pending the repair of plants.
- Changes in demand and supply conditions in the labour market. This occurs when supply of labour for particular jobs in the short run is higher than the demand for labour because the employers need for labour is fixed.
- Shortage of raw materials during certain periods. Absence of raw materials, during certain periods due to seasonal supply of raw materials or due to temporary shortage of finance to buy raw materials from within and abroad can cause unemployment till raw materials are made available.
- Structural breakdown in the sector or industry. The breakdown of an industry or sector of production causes unemployment for short durations.

Solutions to frictional unemployment

- Increasing the mobility of labour for example by maintaining political stability.
- Improving on the skills of workers through training.

- Providing information in the labour market for example through job adverts.

6. Natural unemployment

This is one experienced under conditions of full employment when the demand for labour is equal to the supply of labour.

7. Structural unemployment

This is one that arises from changes in the patterns of demand and supply in the economy.

OrIt is a type of unemployment due to structural changes in the economy causing fall in demand for goods and services.

OrIt is one where labour is unable to find jobs due to changes in the structure of the production process (changes in the patterns of demand and supply).

Causes of structural unemployment

- Political instability which causes total breakdown in the production process Poor political atmosphere (climate) leads to destruction of productive activities and production infrastructure. This has led directly to unemployment in the areas experiencing political instability and indirectly to unemployment in areas which are stable but which depend on the supply of raw maters inputs from areas experiencing instability since the raw materials are m longer obtainable from the areas.
- Poor education system that emphasizes theoretical subjects and white collarjobs.
- Technological advancements in form of computerisation or use of capital intensive techniques of production. The use of complicated machines such as tractors, computers, weight lifters and robots has led to a reduction in number of workers employed by firms thereby leading to unemployment.
- Depletion or exhaustion of a natural resource or major raw materials
- For example the decline in copper ores at Kilembe, declining soil fertility some parts of Uganda and declining timber and fish stocks has led to openunemployment and underemployment in the mining, mining, fishing, lumbering industries and agriculture.
- Poor government policy on labour for example Structural Adjustment Programmes (SAPs) of the International Monetary Fund (IMF) like privatisation, retrenchment and demobilisation given to countries as conditionality for getting loans have greatly contributed to unemployment in the developing countries.
- Long periods of training causing labour immobility due to limited skills.

- Depression in the economy, that is, a period of low economic activity.
- Changes in demand for a commodity due to changes in tastes / preferences / fashions. Decline in demand leading to collapse of local firms especially in the fashion and confectionary industries has led to unemployment in the industries which have lost market for their products.

Solutions for controlling structural unemployment

- Retraining of workers to improve on labour skills. Ensuring political stability to widen job opportunities.
- Encouraging diversification of production so as to widen job opportunities.
- Equipping workers with many skills.
- Encouraging proper manpower planning by the government such that demand for labour is equal to supply of labour.
- Importation of raw materials to ensure continuous production.
- Encouraging use of appropriate technology for example labour intensive methods.
- Widening markets through regional groupings to create more jobs for example EAC and COMESA.
- Undertaking flexibility in production to allow industries to adjust with changes in tastes or fashions.

Measures that should be employed to solve structural unemployment include:

- Structural adjustment and re-adjustment policies to counter the effects of structural changes and Structural Adjustment Programmes (SAPs).
- Educational reforms aimed at acquisition of practical skills for self-reliance.
- Retraining programmes for labour aimed at acquiring new skills.
- Research in new commodity uses and flexibility in production to counter the effects of changes in tastes and preferences.
- Economic diversification to widen opportunities for absorbing victims of structure change.
- Use of labour intensive techniques of production that are more employment creating.

8. Export / international unemployment

This is one that arises due to loss of export markets by the export oriented industries forcing them to reduce the labour employed.

9. Cyclical / Mass / Keynesian unemployment

This arises due to fall or deficiency in aggregate demand for goods and services.

Or It is one that arises due to down string of the trade cycle, most especially, during periods of economic depression or slump or recession.

Causes of cyclical unemployment

- Fall in investment resulting into a fall in the demand for resources.
- Fall in exports leading to a decline in export earnings.
- Drop or fall in prices which discourages production.
- Fall in savings which reduces the level of investment.
- Decrease in interest rates on deposits.
- Increase in importation that reduces the demand for local goods.
- Reduced government expenditure.
- Decrease in incomes such that people hardly afford to buy goods produced.

Solutions to overcoming the cyclical / Keynesian unemployment

These aim at increasing aggregate demand in the economy and they include

- Reducing direct taxation in order to increase the disposable income.
- Increasing government expenditure through investing in employ-generating activities.
- Using expansionary monetary policy / increasing money supply, for example, reducing interest rates.
- Improving investment climate so as to promote private investment I providing tax holidays / tax waivers.
- Subsidising consumers so as to increase on their demand for goods and services.
- Encouraging exports by finding new markets.

Disguised unemployment

This is a situation whereby labourforce or a worker is actively involved production but the marginal product is zero or negative or neglible.

OrIt is a type of unemployment where the work available is insufficient for the workforce such that the marginal product of labour is zero or negative.

Causes of disguised unemployment

- Inadequate supply of capital. This limits expansion of production units leading to employment of many workers in the small scale firms.
- Nepotism. This results into over recruitment of labour in some jobs.
- High population growth rate leading to increase in labour supply. This causer employers to employ excess labour in a given job.
- Poor and unco-ordinated manpower planning. The unco-ordiny, manpower planning results into excess labour supply in some jobs thereby bringing about disguised unemployment.
- Poor land tenure system. This causes shortage of land hence encouraging small scale subsistence agriculture in the rural areas.
- Inadequate skills. This limits specialization of labour in the production process thereby, employing too many people in a given job or sector.
- Limited information about the existing jobs. This limits mobility of labour as many people remain employed in a specific job.
- Excess supply of labour to an occupation. This results into increase in job seekers without increasing the number of job opportunities.
- Desire to retain workforce for future use. An industry with hopes of expanding in the near future can decide to retain the excess labour supply in some jobs thereby, causing disguised unemployment.

Measures aimed at controlling disguised unemployment in developing economies (Solutions to disguised unemployment)

- Training and retraining of labour. This is through carrying out education reforms to enable labour get the necessary skills for employment.
- Controlling population growth rate. This is through encouraging the use of family planning methods so as to reduce on the excess supply of labour.
- Changing the land tenure system / encouraging land reforms. This aims at increasing access to land for increased production and employment.
- Encouraging the development of agriculture. This is aimed at expanding investment, promoting labour mobility and increasing employment chances in

other areas.

- Encouraging privatisation. This leads to expansion of the private sector suiting into increased employment in the long run.

- Encouraging economic diversification. This leads to creation of many job opportunities from the different activities carried out.

- Availing firms with affordable capital for investment. This is through giving credit facilities to small and large scale enterprises so as to increase production and create more job opportunities.

- Developing entrepreneurship. This leads to increased investment from the capital injected and creation of many jobs.

- Encouraging management reforms. This especially helps in avoiding nepotism in some sectors.

- Hidden unemployment; those who are engaged in "second choice" non-employment activities (in education and household activities) because job opportunities are not available at the levels of education already attained or for women, social mores restrict them to domestic work.

- Open unemployment is one where labour is rendered unemployed and is actively looking for jobs.

Theories on causes and solutions to unemployment keynesian theory of unemployment

(Advanced by John Maynard Keynes)

According to Keynes, unemployment arises due to deficiency of aggregate demand in the economy especially in times of depression/recession

Due to a fall in aggregate demand for goods, firms are forced to reduce their level of output which in turn calls for less labour to be employed. Incomes and demand rail further through the multiplier process, investment is discouraged resulting into further lay-offs of labour and less capital employed.

According to Keynes, the major remedy or solution to such unemployment is to **increase Aggregate demand** in an economy.

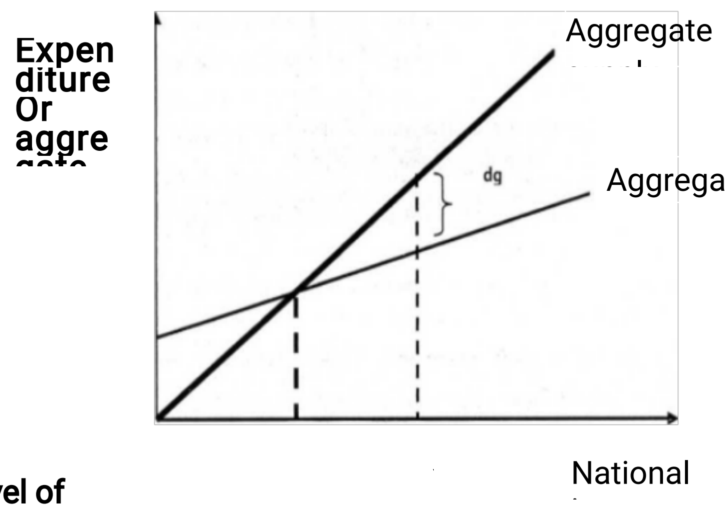
Keynes suggested that Aggregate demand can be increased by using the following measures:

- Reduce direct taxes/ reduce taxes on income.

- Subsidization of consumers.

- Use of expansionary monetary policy.
- Increase government expenditure.
- Increase wages of labour.
- Encourage private investment through provision of incentives like tax holidays. Therefore, the focus of Keynes is to increase Aggregate demand in an economy and his solutions are the ones that apply to cyclical unemployment.

Illustration of Keynesian unemployment:



Level of

Unemployment

NB: The level of unemployment is shown by the gap Ye - Yf

Assumptions of the keynesiantheory of unemployment

Keynes made the following assumptions when analyzing cyclical unemployment

- Existence of an industrialised economy.
- He assumed conditions of full employment of resources.
- He assumed the existence of a highly monetized economy.
- He assumed existence of a big and strong private sector.
- He assumed existence of a closed economy.

- He assumed the existence of well-functioning and developed product, factor and money market.
- He assumed that there is deficiency in aggregate demand during an economic recession

Applicability/relevance of the Keynesian theory of employment to developing economies like Uganda

N.B: It is noted that to a greater extent, the theory is not applicable or relevant in developing countries because it was designed in the context of a developed economy. However, to a minor or lesser extent, the theory has some applicability or relevance in developing countries.

The greater extent to which the theory is not applicable in developing countries:

The Keynesian theory of unemployment is said to be irrelevant or less applicable to developing countries because of the following:

1. It mainly affects industrialised economies yet developing countries are basically agro-based economies (agrarian economies). Developing countries depend on agriculture where supply is inelastic even if demand increased, resources would not automatically be employed to increase supply.
2. The theory is mainly concerned with deficiency in aggregate demand yet unemployment in developing countries basically arises from the supply side. This supply side involves shortages of basic inputs and other co-operant factors like skills, capital and infrastructure. Production in firms drops. As a result, some units of labour can be laid off which creates unemployment but Keynes ignored this possibility.
3. The theory of Keynes works under conditions of full employment of resources yet such conditions are not found in developing countries which are characterized by under-utilisation of resources. This makes the theory of Keynes to be less relevant in developing countries.
4. The theory is based on an assumption of a highly monetised economy yet developing countries are basically subsistence (where many people produce goods for their own consumption or use). Increased aggregate demand does not lead to change in the activities in the subsistence sector since it is not affected by changes in the monetary conditions of the economy.
5. Keynes based his theory on the existence of a big and strong private sector yet in developing countries, the private sector is still weak and small. An increase in aggregate demand does not lead to rapid increase in employment generation since the private sector is small and cannot expand quickly.
6. Keynes based his theory on a closed economy yet developing countries operate as

open economies in which foreign trade plays a dominant role in developing them. They primarily depend on the exports of agricultural and industrial raw materials and the import of consumer and capital goods her..: making the Keynesian theory irrelevant to the developing countries.

7. In developing countries, the product, factor and money markets are still under-developed and weak yet Keynes assumed that such markets are functional and well developed. This renders the theory to be less applicable in developing countries.

8. The theory of Keynes puts emphasis on the investment multiplier as the biggest contributor to employment creation yet in many developing countries it is the export multiplier which contributes greatly to the creation of employment. Increase in investment does not lead automatical to sustainable creation of employment due to small domestic market. Increase in the export markets however, creates need to increase output leading increased capital employment of labour.

9. As a solution to unemployment, Keynes suggested or prescribed measure which increase levels of aggregate demand by adopting an expansionary monetary policy. However, these measures cause inflation in developing countries when applied {too much money chasing few goods} therein making the theory of Keynes to be irrelevant or less applicable in developing countries.

The smaller /minor extent of applicability (relevance) of Keynesian theory of unemployment in developing countries

To a minor extent, Keynesian theory of unemployment has some relevance developing countries as justified below:

1. At times unemployment results due to fall in demand, both domestically and abroad. Domestically, a decline in demand for products produced local firms lead to their reducing production or even closure hence causing unemployment.

2. Even internationally, a decline in demand for export products leads decline in production and employment at home, especially in the agricultural sector, thus making the theory applicable.

3. In developing countries there is an element of industrialisation hence theory of Keynesian unemployment may not completely be ruled out. Increasing the demand for products of the industrial sector can cause me sector to increase the volume of capital and labour employed to increase output hence making the theory applicable.

4. In the long run as supply of co-operating factors for labour increase, the theory is likely to become relevant. Since unemployment in development countries arises from the supply side due to lack of co-operant factors, in the long run when skills increase, capital becomes available, techniques production improve and organization improves, output and employment increases thus making the theory

relevant to the developing countries.

5. Investment climate affects employment levels and therefore promotion investment will expand employment. In developing countries like Uganda, the provision of investment incentives such as tax holidays to investors, leadsto increased investment which creates incomes to increase demand which creates further investment and employment in the economy.

6. Measures to stabilise export earnings through IMF compensatory arrangements to ensure stable export markets can reduce unemployment.

   For example, developing countries are encouraging export promotion so as to increase export earnings, income and aggregate demand thereby creating more employment. This renders the theory of Keynes relevant to developing countries because one of his solutions to this kind of unemployment was to find new markets for exports.

7. The use of expansionary monetary policy as suggested by Keynes has some application in developing countries because it increases the purchasing power of the people. As purchasing power increases, the market for products of firms expands. Producers are encouraged to increase output and more labour gets employed in firms. This makes the theory to have some applicability in developing countries.

Solutions to unemployment according to Keynes

According to Keynes, the solution to unemployment is to increase aggregate demand in the economy. He prescribed measures such as:

- Increase government expenditure. Government can increase her expenditure inthe provision of social infrastructures. This raises incomes of people employed it provision of infrastructures which in turn leads to increased consumer demand, increased consumer demand stimulates producers to increase production hence increasing the level of employment of capital and labour.

- Subsidiseconsumers. Government can subsidise consumers by providing feces and services especially education and health either free of charge or at low prices. Consumers then re-channel incomes that they would have spent on purchase of public goods to the consumption of goods produced by private producers. This leads to increased aggregate demand. Increased aggregate demand encourages producers to increase output by employing more capital and labour hence reducing unemployment.

- Reduce direct taxes. When income taxes are reduced, consumers' disposable incomes increase. This enables consumers to increase their demand for goods and services, thus increase in aggregate demand. Producers respond to increasedconsumer demand by increasing investments so as to increase output hence g the level of employment.

- Useexpansionary monetary policy especially lower the interest rates. Reducing interest rates increases the level of liquidity preference as savings are discouraged by the low levels of interest. This increases the level of consumption which in turn encourages investors to increase output hence increased employment.

- Increase wages of labour. This enables consumers to increase their demand for goods and services, thus increase in aggregate demand. Producers respond to increased consumer demand by increasing investments so as to increase output hence raising the level of employment.

- Promote private investment through provision of incentives like tax holidays. Favourable investment climate can be created through provision c investment incentives such as tax holidays to investors. This leads to increase-investment which creates income to increase demand which creates further investment and employment in the economy.

Questions:

1.(a) Explain the Keynesian theory of unemployment,
(b) To what extent is this theory of unemployment applicable to your country?

2. (a) What, according to J.M Keynes, is the solution to the unemployment problem?

(b) Explain the limitations of the Keynesian theory of unemployment developing countries.

3. (a) What are the solutions to unemployment according to Keynes?
(b) Examine the relevance of the Keynesian theory of unemployment to the

developing countries.

Costs of unemployment in an economy

Costs of unemployment are the adverse effects that unemployment has on theeconomy, the unemployed, their families and society at large.

Costs or effects of unemployment in an economy include:

- Leads to decline in the level of acquired skills. The unemployed people not get the opportunity to put into practice the skills or knowledge they acquired during training in schools, colleges and universities. There is decay of knowledge and loss of skills which hinders professional or career development.

- Leads to low aggregate demand for goods and services.The unemployed people have no money to buy goods and services and this causes a reduction in aggregate demand for goods and services hence liming investment.

- Worsens income and wealth inequality.The unemployed people who are not earning income are not able to accumulate wealth while those people who areemployed are able to earn income, save, invest and accumulate wealth. This leads to wealth and income inequalities.

- Results into low production or low output.Due to the rising level ofunemployment, the purchasing power of the people is low because they areearning less or low incomes. As a result, firms reduce their levels of output n: this leads to low GDP or low economic growth.

- Increases the dependency burden of the unemployed on the employed.

- The unemployed people have to survive by depending on the few individuals v. - are employed. This heavy dependency burden reduces levels of savings for those who are employed.

- Leads to low government revenue.The unemployed people are not ear income and therefore, they do not pay direct taxes to the government. This resultslow tax revenue to the government hence limited funding of development projects by the government.

- Leads to high crime rates and social evils (immorality).The unemployed people who are not earning income resort to all sorts of immoral acts like theft and prostitution so as to earn a living. They resort to illegal ways of getting money so that they can survive.

- Leads to underexploitation of productive resources hence wastage, Seasonal unemployment in the agricultural sector causes excess capacity. As a -suit of this, there is wastage of resources that could have been put to use.

- Leads to low standards of living and misery due to low or no incomes. Individuals who are jobless find it difficult to buy or access basic necessities of life. As a result, their standard of living drastically falls or declines hence causing misery and suffering.

- Creates political tension or unrest. Unemployment makes the government unpopular among the masses. The unemployed people are easily mobilised to stage rebellions against the government and this has disastrous consequences.

- Encourages rural-urban migration with its associated evils. The unemployed people move from rural areas to urban areas in search for jobs leading to increased crimes.

- Discourages investment in education. The unemployed people are not able r meet the cost of educating their children. This reduces the quality of education m an economy. At the same time, when the educated people fail to get jobs, other people get discouraged and they may not study or invest in education.

- Leads to brain drain. After failing to get jobs in the home country, highly trained professional people move to other countries in search for jobs. This has a larger of reducing the size of the skilled manpower available in the home country mi thus the development process is retarded.

- Leads to increased social unrest / instabilities in families. Social instabilities tend to increase due to lack of incomes leading to violence, divorce sec family break-ups.

- Leads to high government expenditure. The government spends heavily on supporting projects which are aimed at creating more jobs for the people. Government finances self-help projects, programmes for the disabled, aged and ne youths. This exerts pressure on the national budget in terms of expenditure.

Reasons for the control of unemployment problem in developing countries

- To increase the level of acquired skills among the labourforce. This is because controlling unemployment enables the people get the opportunity to put into practice the skills they acquired during training in various institutions oflearning.

- To increase the level of aggregate demand for goods and services hence stimulating investments and growth.As more people get employed, theygenerate money to buy goods and services and this results in an increase u aggregate demand for goods and services hence stimulating investment.

- To reduce income and wealth inequality. As more people become employed, they earn income, save, invest and thus are able to accumulate wealth. This leads to equity in income distribution in the society.

- To promote increased production/ output. As more people get employee they engage in productive work. This leads to production of more goods arc services hence contributing to an increase in Gross Domestic Product.

- To reduce the dependency burden. As more people become employed, number of individuals who are depending on the working group reduces. This helps to increase levels of savings and investment in the economy.

- To increase government revenue. As unemployment reduces, government is able to impose taxes on incomes of the employed people through PAYE. The tax revenue generated is used in financing development activities in the country.

- To reduce crime rates and social evils like prostitution and theft associate with the lack of job opportunities. As more people become employed, the income earning opportunities enable them discard illegal ways of getting money for survival.

- To reduce social unrest / instabilities in families that tends to increase dueto lack of incomes. As more people employed, they generate income to enable them meet the needs of their family members. This creates happiness between husbands, wives and children due to availability of income to sustain a desirable standard of living.

- To encourage exploitation of productive resources hence reducing waste*

- This is because controlling unemployment through measures like agriculture modernisation involving irrigation reduces cases of seasonal unemployment that causes excess capacity. As a result of this, more resources are put to use thereby avoiding wastage.

- To ensure peace and stability because of having a contented population. This is because controlling unemployment makes people contented and raises ire popularity of the government in power among the masses. This creates relative peace in the country and gives confidence to investors to carry on production.

- To reduce rural-urban migration with its associated negative effects. Asunemployment reduces, people in the rural areas get opportunities of generating income. This helps to control the problem of rural-urban exodus.

- To promote / encourage investment in education.This is because controlling unemployment, gives people income earning opportunities tin enables them to meet the cost of educating their children. This encourages peer to invest in education and increases the level of literacy in the country.

- To reduce brain drain with its negative effects on the economy. His because controlling unemployment, enables the highly skilled manpower access income earning opportunities in the domestic economy thereby reducing r danger of brain drain.

- Toreduce government expenditure on supporting the unemployed hence diverting those funds to other productive ventures for example roads. As unemployment reduces government spends less money on projects aimed at supporting the unemployed population and thus more funds are geared towards expanding productive sectors and creating more jobs.

Rural-urban migration

Rural migration is the movement or exodus of people from rural areas to urban areas. This results into increase in labour supply in urban areas and causes open urban unemployment.

Causes of rural-urban migration

Rural-urban migrations is as a result of push and pull factors. Push factors refer to where unfavourable conditions in rural areas force people to move to urban areas while pull factors refer to good conditions in urban areas that attract people from the rural areas to the urban areas.

Push factors

- Insecurity in rural areas has driven many people to urban areas that are relatively stable.
- Famine in the rural areas has forced people to move to urban areas.
- Conflicts among the rural population due to criminal cases like witchcraft, murder, rape and defilement.
- Poor land tenure system where most of the youth do not have access to land.
- High population growth rates in the rural areas causing pressure on land.
- Natural hazards in rural areas, for example, landslides in Bududa, earthquakes in Bundibugyo, floods in Teso and Kasese.
- Socio-cultural factors have tended to encourage people to migrate to urban areas due to the desire to break away from practices like forced marriages, circumscion, female genital mutilation among others.
- Higher wages or incomes earned by workers in urban areas attract the rural people.

Pull factors

- Higher wages or incomes earned by workers in urban areas attract the rural people.
- High job opportunities in urban areas due to industrial development.
- The highly developed infrastructure in urban areas like schools, hospitals and soon.
- The poor education system that is theoretical in nature attracts people to move to urban areas for white collar jobs.
- Staying in urban areas is looked at as prestige by some people.

Effects of rural-urban migration

Positive effects

- Reduces pressure on land in rural areas.

- Leads to increase in cheap labour supply in urban areas.
- Encourages government effort to provide social services to the rural people.
- Reduces the dependence burden in rural areas.

Negative effects

- Leads to open urban unemployment because of increase in labour supply.
- Leads to break up of family and cultural ties.
- Leads to high population in urban areas hence causing congestion.
- Encourages high crime rates or immoral acts like theft and rape.
- Worsens the housing crisis in urban areas leading to overcrowding and increase in house rent.
- Causes a fall in agricultural output because of the movement of young energetic members from rural areas.
- Leads to the development of shanty towns where sanitation is poor.

Solutions of rural-urban migration

The following measures can be used to overcome rural-urban migration:

- Encourage agricultural modernisation through irrigation to increase employment in rural areas.
- Maintain political stability in rural areas so as to promote investment.
- Encourage land reforms so that there is increased access to land for invest in the rural areas.
- Encourage small scale industries in the rural areas to create jobs.
- Government should develop infrastructure in rural areas so as to encourage development.
- Credit facilities should be given to fanners to encourage large scale agriculture
- Educational reforms should be encouraged so as to promote practical educator.
- Encourage settlement and resettlement programmes in the rural areas to reduce population pressure , for example, Mobuku irrigation scheme in Kasese.
- Abolish traditional or cultural practices that make the youth run away from areas.

Open unemployment

This is a type of unemployment where labour is rendered unemployed and actively looking for jobs.

OROpen unemployment is a situation in which labour is unutilised in urban centre both voluntarily and involuntarily.

OROpen unemployment- is one where labour is rendered unemployed and is active-looking for jobs.

Causes of open urban unemployment in market economies

- Technological development leading to technical unemployment. Due to change in technology employed from labour intensive to capital intensive, many workers have been substituted by machines hence becoming unemployed in urban centres.

- Unfavourable political climate. Political instability leads to destruction of productive infrastructure in urban centres leading to unemployment. Secondly, creates uncertainty which discourages investments that would have create employment opportunities in urban centres.

- Lack of information about jobs yet jobs exist. Some people are unemployed in centres despite existence of employment opportunities due to poor flow of information about existing job opportunities. People thus remain unemployed rite the existence of employment opportunities.

- Discrimination in the labour market on the basis of sex, tribe, religion and race, rue to discrimination in the labour market some people who are qualified but disfavoured are denied jobs while those favoured even when they are less qualified are given jobs. This leads to open unemployment of those disfavoured.

- Structural adjustment policies of retrenchment. The retrenchment of civil servants and demobilisation of soldiers due to IMF conditionalities causes urban unemployment. Most of the retrenched labourers are workers previously employed in urban centres and upon being retrenched, they remain in urban centres in search of employment opportunities in the private sector which are non¬existent.

- Unfavourable climatic conditions. Unfavourable changes in climate which affects output and consumption causes open urban unemployment. A decline in agricultural performance affects agricultural processing industries based in the urban centres negatively hence unemployment.

- Low rate of industrialisation. The rate of growth of the industrial sector is too low to absorb the available urban labourforce. Since the rate of growth of the industrial sector is not fast enough to absorb the ever growing labourforce, some labourers become unemployed in urban centres.

- Rapid natural growth of urban population. Urban population grows rapidly through natural means due to high fertility rates. This leads to a situation where urban populations exceed urban resources and employment opportunities thus leading to unemployment.

- Rural-urban migration. Many people migrate from rural to urban centres, among other reasons, to look for better employment opportunities. Unfortunately, the rate of rural-urban migration surpasses the rate of job creation in the developing countries. The majority of rural-urban immigrantstherefore, remain unemployed.

- Employment of foreign experts. The employment of expatriates in positions which can be filled by local skilled labour leads to the unemployment of the local labourforce in the urban centres thus causing urban unemployment.

- Limited capital.

- Switching jobs by labour.

- Limited skills.

- Poor land tenure system.

- Decline in the demand for products produced.

- Exhaustion of raw materials.

- Breakdown of industrial firms.

Measures of controlling open urban unemployment in Uganda

- Providing investment incentives.

- Undertaking education reforms.

- Carrying out land reforms.

- Controlling population growth rate.

- Widening markets.

- Providing investment credit.

- Developing infrastructure.

- Ensuring political stability.

- Modernising agriculture.

- Advertising jobs.

- Diversifying the economy.

- Encouraging the use of appropriate technology.
- Liberalisation of the economy.

Measures that should be taken to reduce or control open urban unemployment in a market economy

Strictly use should / can / may

- Effective land reforms. Government should restructure the land tenure system which leaves large tracts of land in the hands of a few individuals and majority of the people either landless or tenants of the absentee landlords, can be achieved through land redistribution that enables squatters and the landless bonafide land owners.
- Education reforms. The education system should be made more practical than theoretical in order to equip school leavers with skills for self-employment.
- Control population growth rate. Measures should be taken to control population growth rate through family planning. This would avoid a situation in wh. population grows faster than the rate of job creation that causes unemployment
- Ensure political stability. The problem of political instability should be tack, through dialogue and constitutionalism instead of military confrontation: destroys productive infrastructures even in urban centres as well as cause rural-urban migration and its consequent open urban unemployment.
- Encourage the use of appropriate technology. The use of intermediate appropriate technology which creates more employment opportunities should encouraged instead of relying on capital intensive techniques of production which substitutes labour in production and creates unemployment.
- Liberalisation of the economy.
- Widen markets.
- Provide investment credit.
- Develop infrastructure.
- Modernise agriculture.
- Advertise jobs.
- Diversify the economy.
- Provide investment incentives.

Underemployment

This refers to the state of underutilisation of economic resources especially labour.

Forms of under employment.

- Working less hours than desired.
- Working full time but marginal product is zero.
- Working in jobs where the requirements are below the skill level.
- Working full time but the co-operating factors are inadequate to ensure productive rewards.

Causes of underemployment of labour in an economy

- Shortage of co-operant factors.
- High population growth rate.
- Poor land tenure system.
- Small or limited markets.
- Political instability.
- Limited skills.
- Seasonal changes especially in agriculture.
- Ignorance of people about availability of jobs.
- Poor attitude of people towards work due to low wages and desire for leisure.
- Desire to retain labourforce by trade unions or employers for future use.
- Increased rural-urban migration leading to underemployment in urban areas.
- Poor manpower planning.
- Limited raw materials.
- Discrimination in the labour market.

Full employment

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

OrA situation where the number of unfilled vacancies equals the number of job seekers.

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

OrA situation where unemployment in the economy is 3% or less.

Demerits of full employment:

- Leads to inefficiency of labour.
- Results into inflation because of high income.
- Leads to labour immobility.
- Leads to resource misallocation to non-priority areas.

Reasons as to why it is difficult to attain full implyment in an economy

It is difficult to attain full employment in an economy because of limitations of the measures aimed at reducing unemployment in an economy. These may include:

- Use of inappropriate technology. This is particularly common with foreign investors who use capital intensive techniques of production thereby displacing labour in production.
- Increased rural urban migration. There is rampant rural exodus resulting in ugh levels of open urban unemployment.
- Rapid population growth rate in an economy. The high population growth rates in an economy where labourers are far beyond the job creation capacity hi; frustrated efforts to reduce unemployment.
- Immobility of factors of production. The immobility of factors of production between jobs and regions, for example, labour is prevented by social and culture, ties from taking up jobs available in other areas.
- Poor manpower planning. The weak government policies on manpov.tr planning, for example, preference of foreign workers, privatization arc retrenchment limit the level of employment of the local labourforce.
- Inappropriate education system. The poor education system in mar} developing countries produces many job seekers in excess of the job opening: This increases the rate of unemployment of the graduates or school leavers.
- Shortage co-operant factors. The absence of co-operant factors in form limited capital and limited skills makes it hard to solve unemployment by set up production units.
- Existence of a large subsistence sector in developing countries. This limits the level of employment since family labour is mainly used.
- Low aggregate demand or low domestic and foreign markets. This cause few people to be employed since the demand for labour is a derived demand.
- Heavy capital outflows. This limits investment and reduces the capacity;

developing countries to create more job opportunities and reduce the level unemployment.

- Trade union restrictions. The existence of strong trade unions and profession bodies that restrict entry of new employees or workers in order to maintain wages for the already employed people, is a cause of failure to attain employment.
- Structural changes in the economy. The structural changes in the economy-may cause temporary unemployment because of constant dislocation of labour.
- Political instability. This discourages any productive activity aimed at creating more employment opportunities by scaring away potential investors.
- Heavy dependence on nature. This is a major cause of seasons, unemployment especially in the agricultural sector between harvesting arc planting.
- Social barriers, for example, discrimination in the labour market basing >: sex, religion, tribe, political party among others, making it hard to reduce the le .of unemployment in the economy.

Causes of unemployment in developing countries

(The causes of Involuntary Unemployment in Uganda) Unemployment in developing countries is attributed to the following factors:

- Technological progress and the increased use of capital intensive methods resulting into technological unemployment. The use of labour saving techniques of production such as tractors, cranes and computers has resulted in unemployment of people previously employed to perform manual tasks.

- Unfavourable change of climate or Changes in seasons and seasonal nature of some occupations. This leads to seasonal unemployment in the agricultural sector and agro-based industries. Change in climate from rainy to dry or drought conditions, for example, leads to unemployment of farmers during the dry season.
- Changes in tastes and / or changes in demand resulting into structural unemployment. Unemployment is caused due to decline in demand for products of some firms due to change in consumer tastes and preferences leading to closure of the firms hence unemployment.
- High population growth rates and consequent growth of labourforce.
- Most developing countries experience high rates of growth of population of about 3 % per annum yet the productive resources (co-operant factors of production) ire not increasing at a faster rate. This results in the unemployment of some of the labourforce.

- Poor political atmosphere which destroys productive infrastructure. Political insecurity destroys productive infrastructures and disrupts production activities leading to unemployment in areas where insecurity occurs.

- Discrimination in the labour market in terms of sex, nationality, religion, political affiliation and race. Some people who are capable and willing to work ire left out of the job market due to discrimination on the basis of sex, nationality, religious belongingness, political affiliation and race.

- Structural adjustment programmes of the I.M.F. and World Bank in form of retrenchmentin order to cut costs resulting into structural unemployment. The International Monetary Fund and World Bank's structural adjustment programmes (SAPs) given as conditionalities to developing countries to amongst other things carry out retrenchment from the civil service as a pre-requisite for getting loans has led to unemployment.

- Poor education system that tends to create job seekers and in some cases unemployment is due to lack of appropriate skills. The education system prepares job seekers instead of job creators due to the theoretical nature of the systems.

- Since white collar jobs are in short supply yet the turnover of the education -tem at all levels is very high, many school leavers remain unemployed.

- Rampant rural-urban migration resulting into open urban employment. Due to rural-urban wage gap and other factors, most people migrate from rural areas to urban centres primarily in search of better wage employment opportunities. Since the rate of rural urban migrations is higher than the rate of urban employment creation, many immigrants from rural areas become unemployed in urban centres.

- Inadequate information about existing job opportunities by people who are capable of working. Some people are unemployed because they lack knowledge about existence of employment opportunities yet employment opportunities exist. This is due to poor dissemination of information about employment opportunities in firms.

- Poor land tenure system. A few people own large chunks of land while the majority are either tenants or landless, which has resulted in under-employment and unemployment of the landless.

- Limited co-operant factors particularly capital. This limits expansion of production units thereby causing unemployment of many workers in the small scale firms.

- Breakdown of industrial firms / breakdown in the production process. The breakdown of machinery and closure of plant in order to carry out renovations.

This causes unemployment for short durations pending the repair of plants.

- High degree of specialisation of labour. This results into occupation immobility of labour due to the possession of specialized skills that cannot be applied in other jobs.
- Underdeveloped infrastructures. The basic infrastructure like roads is poor which has hindered producers to transport their goods to markets. This has discouraged further investment and production. As a result, few jobs have been created for the people hence increase in unemployment.
- Physical and mental incapacitation resulting into residual unemployment. The physical or mental disabilities make such people unemployable due to their low standards of efficiency.

Steps that have been taken to solve the problem of unemployment in developing countries

- Developed infrastructures. The government has improved basic infrastructure like roads which has enabled producers to transport their goods to markets. Thus has encouraged further investment and production. As a result, more jobs have been created for the people hence a reduction in unemployment.
- Diversified the economy. The government has diversified the economy in order to reduce dependence on only one sector, agriculture. The government has encouraged growth of sectors such as mining, industry, fishing and tourism, in order to increase the rate of job creation and of the growth of the economy.
- Liberalised the economy. The removal of unnecessary government controls trade has increased the number (range) of trade or economic activities carried out in Uganda. The expansion in economic activities has provided more jobs to the people. Consequently, unemployment has been controlled or reduced.
- Privatised public enterprises. Public (government/state) enterprises have been diverted / transferred to private ownership to create efficiency. This efficiency has enabled firms to expand their scale of production and they have generated more jobs to the people in the long-run.
- Controlled population growth rate. Measures have been taken to Conn population growth rate through family planning programmes. This has been done to reduce the rate of growth of population so that population size does not exceed the available resources in the economy resulting in unemployment.
- Provided affordable credit for investment. Government has provided soft loans to people to enable them to invest and create employment opportunity. This has been done through schemes such as Poverty eradication action plan.
- Reformed the education system. Attempts have been made to make education

more relevant to the needs of the country. This has been done through measure such as vocationalisation of education in order to make graduads of the education: -system job makers not job seekers.

- Modernised the agriculture sector through research. The agricultural sector has been modernized through research into better techniques of production, better seed and animal breeds, more drought and disease resistant varieties in order to use output and reduce underemployment and unemployment

- Encouraged use of appropriate technology. Unemployment has been fought through encouragement of the use of techniques which are more appropriate to the needs of the country, for example, the use of the ox-plough.

- Advertised existing jobs. Measures have been taken to make information about existing employment opportunities available to job seekers through advertisements of existing job opportunities in the mass media. This has created a between job seekers and employers thereby reducing frictional unemployment caused by ignorance of employment opportunities.

- Widened market, for example, by joining economic integration. Government has joined regional organizations such as East African Community in order to urease markets for local products, increase output and create more employment opportunities.

- Improved the political atmosphere. Government has created law and order inparts of the country. This has considerably reduced unemployment caused by political instability such as disruption of production activities, displacement of settled people and destruction of economic and social infrastructures.

- Undertaken special programmes for persons with special needs or persons with disabilities. The government has financed the income generating projects for disabled people. Such projects include shoe-making, tailoring, making crafts among others. The disabled people earn income from these projects and they have become employed. This has helped to reduce (residual) unemployment.

- Promoted further industrialisation based on labour intensive techniques. Measures have been taken to encourage large scale industrialisation. Such industries create linkages in the economy and are labour intensive in nature. This has helped to create job opportunities for the people which has reduced unemployment.

- Provided tax incentives to investors. Government has encouraged foreign investment through provision of investment incentives to the foreigners in form of ax holidays and tax rebates. This has led to increased investment and creation of employment.

- Exported surplus labour to other countries. Government has encouraged private organizations to export surplus labour to countries in the Middle East. This has help to ease the unemployment problem in the country since more job opportunities have been opened up.

- Reformed the land tenure system. Government has attempted to reform the land tenure system in order to make the landless people more productive as well as to create stability of tenure which encourages people to have long term plans for land use. This has been attained through the passing of the Land Act, which outlaws the eviction of squatters by landlords without compensation.

Measures being taken to tackle the unemployment problem in uganda

Measures being taken to tackle the unemployment problem in my country include the following:

- Education reforms are being implemented to impart practical and vocational skills aimed at producing job makers rather than job seekers. The government is setting up vocational institutions and community polytechnics to train people in practical skills like carpentry, building, metal work, tailoring and agri-business. Such skills are intended to create job makers rather than job seekers.

- Population control measures are being implemented to check the high population growth rates. Controlling population growth rate is being carried out through family planning programmes so that the rate at which the population h rising is proportionate to the rate at which jobs are being created. This helps to reduce the excess labour supply in relation to available job vacancies thereby reducing unemployment.

- Existing jobs / employment opportunities are being advertised to increase job awareness. Measures are being taken to make information about existing employment opportunities available to job seekers through advertisements existing job opportunities in the mass media. This helps create a link between job seekers and employers thereby reducing frictional unemployment caused by ignorance of employment opportunities.

- Land reform policy being undertaken. Government is undertaking reforms in the land tenure system in order to make the landless people more productive r» allowing more people access land and to create stability of tenure which encourages people initiate long term plans for land use. This is through re passing of the Land Act, which outlaws the eviction of squatters by landlord without compensation.

- Infrastructure is being developed to ease labour mobility. The government is improving basic infrastructure like roads which enables producers to transport their goods to markets. This encourages further investment and production. As result, more jobs are created for the people thereby reducing unemployment.

- Agricultural modernisation is being carried out. The agricultural sector is being modernised through research into better techniques of production, better seed and animal breeds, more drought and disease resistant varieties in order to increase output and income thereby reducing underemployment and unemployment.

- Attempts are being made to expand the manufacturing / industrial sector in order to increase the country's absorptive capacity thus create more employment opportunities. Measures are being taken to encourage large scar industrialisation. Such industries create linkages in the economy and are labour intensive in nature. This creates job opportunities for the people, thereby reducing unemployment.

- Setting up institutions to promote investment, for example Uganda Investment Authority (UIA) so as to increase employment opportunities.

- Joining of economic integration to expand market and thus create more job opportunities. Uganda is a member of regional organisations such as lie" African Community and COMESA. This is aimed at increasing the market for local products, increase output and thereby creating more employ opportunities.

- Undertaking economic diversification by setting up small scale industry and pursuing other economic activities. The government is encouraging diversification of the economy in order to reduce dependence on only one sector agriculture. The government is encouraging the growth of sectors such as mining industry, fishing and tourism. These activities help to increase the rate of job creation thereby reducing unemployment.

- Privatisation policy is being implemented. State enterprises are being transferred to private ownership to create efficiency. This efficiency is to enable firms to expand their scale of production and generate more jobs to the people in re long-run.

- Economic liberalisation is being undertaken. The removal of unnecessary government controls on trade is increasing the number (range) of trade or economic activities carried out in Uganda. The expansion in economic activities providing more jobs to the people. Consequently, reducing unemployment.

- Ensuring the provision of credit facilities or startup capital to local investors. Government is encouraging Micro Finance Institutions to provide soft cans to people to enable them to invest through setting up income generating projects. Such projects are providing jobs to the people who would have remained unemployed.

- Ensuring political stability. Government is creating law and order in most parts of the country so that more investors are attracted to the country. This is considerably promoting investment by private entrepreneurs and in the process -

ore jobs are created in the country hence reducing unemployment.

The possible measures that should be taken to solve the unemployment problem in Uganda

The possible measures of reducing the unemployment problem in my country are:

(Use Should / May / Can in the explanation of the points).

- Control population growth rates. Measures should be taken to control to population growth rate through family planning programmes. This can be done to seduce the rate of growth of population so that population size does not exceed the available resources in the economy. This can reduce unemployment.
- Train labour / carry out education reforms / undertake manpower planning. Attempts should be made to make education more relevant to the needs of the country. This can be done through measures such as vocationalisation of education in order to make graduads of the education system job makers not job seekers.
- Liberalisation of the economy. The removal of unnecessary government controls on trade can increase the number (range) of trade or economic activities carried out in Uganda. The expansion in economic activities can provide more jobs to the people. Consequently, unemployment can be controlled or reduced.
- Further privatisation. Public enterprises should be transferred to private ownership to create efficiency. This efficiency can enable firms to expand their scale of production and thereby generate more jobs to the people in the long-run.
- Diversification of the economy. The government should diversify the economy in order to reduce dependence on only one sector, agriculture. The government can encourage growth of sectors such as mining, industry, fishing and tourism, in order to increase the rate of job creation and of the growth of the economy.
- Reform the land tenure system. Government should attempt to reform the land tenure system in order to make the landless people more productive as well as to create stability of tenure which can encourage people to have long term plans for and use. This can be attained through the passing / enacting of the Land Act, which outlaws the eviction of squatters by landlords without compensation.
- Improve the political atmosphere. Government should create law and order in most parts of the country. This can considerably reduce unemployment causer by political instability such as disruption of production activities, displacement settled people and destruction of economic and social infrastructures.
- Encourage use of appropriate technology. Unemployment should be fought through encouragement of the use of techniques which are more appropriate to the needs of the country, for example, the use of the ox-plough.

- Improve investment climate / provide tax incentives to investor. Government should encourage foreign investment through provision investment incentives to the foreigners in form of tax holidays and tax rebates this should lead to increase in investment and creation of employment.

- Advertise jobs. Measures should be taken to make information about existing employment opportunities available to job seekers through advertisements existing job opportunities in the mass media. This can help create a link between job seekers and employers thereby reduce frictional unemployment caused I ignorance of employment opportunities.

- Widen market for example by joining economic integration. Government should join regional organisations such as East African Community in order to increase markets for local products, increase output and create more employment opportunities.

- Modernise agriculture. The agricultural sector should be modernized through research into better techniques of production, better seed and animal breeds, more drought and disease resistant varieties in order to increase output. The increase commercial production can reduce underemployment and unemployment.

- Develop infrastructure. The government should improve basic infrastructure like roads which can enable producers to transport their goods to markets can encourage further investment and production. As a result, more jobs may be created for the people hence a reduction in unemployment.

- Promote industrialisation. Measures should be taken to encourage large scale industrialization. Such industries can create linkages in the economy and are labour intensive in nature. This can help to create job opportunities for the people which may reduce unemployment.

- Provide social programmes for persons with disabilities. The government should finance the income generating projects for disabled people. Such projects include shoe-making, tailoring, making crafts among others. The disabled people ¬can earn income from these projects and they may become self- employed. This may help to reduce (residual) unemployment.

- Provide credit facilities for example start-up capital. Government may encourage Micro Finance Institutions to provide soft loans to people to them to invest and create employment opportunities. This should be done through schemes such as Poverty eradication action plan (PEAP).

- Export surplus labour to other countries. Government should encourage private organisations to export surplus labour to countries in the Middle East. This can help to ease the unemployment problem in the country since more opportunities may be opened up.

Review questions:

Section A

i. Define the term underemployment.
ii. Differentiate between frictional unemployment and seasonal unemployment.
iii. Mention any two examples of seasonal unemployment in an economy.
iv. Give any two remedies for seasonal unemployment in your country.
v. Define the term voluntary unemployment.
vi. State three causes of voluntary unemployment.
vii. What is full employment?
viii. State three reasons why it is hard to achieve full employment in your country.

Section B

a. Explain the causes of voluntary unemployment in your country.
b. What are the possible solutions to voluntary unemployment in your country?

a. What is meant by the term "full employment?"
b. Explain the reasons why it is hard to achieve full employment in developing economies

    a. Examine the causes of the unemployment problem in your country.
    b. What are the measures being taken to control the unemployment problem in your country?

    a. Account for the unemployment problem in your country.
    b. Explain the steps being taken to reduce unemployment problem in your country.

    a. Differentiate between casual unemployment and under employment.
    b. What are the costs of unemployment in your country?

    a. What are the causes of structural unemployment in an economy?
    b. Explain the measures that can be employed to solve structural unemployment in an economy.

    a. Suggest measures that could be taken for the control of unemployment in our country.

b. Discuss the factors that have frustrated Uganda's efforts to curb the unemployment problem.

c.

TOPIC 7: MONEY AND BANKING

MONEY

Money refers to anything that is generally acceptable as a medium of exchange by the society for the settlement of debts or for the making of payments for goods and services.

Money in a particular country is **legal tender, that is**, by law it has to be accepted as a means of settling debts and for the exchange of goods and service within the country up to the denomination presented.

Barter trade

Before money was invented, the primitive world's trade was carried out according to the barter system of exchange.

Barter exchange refers to the exchange of goods for goods or services. Barter system can work when there exists 'double coincidence of wants': Double coincidence of wants refers to the simultaneous fulfillment of mutual wants of buyers and sellers. However, it is difficult to find double coincidence wants in real life.

Advantages of barter exchange

Some countries still depend on barter trade because of the following advantages the system possesses:

- Solves the problem of scarcity of foreign exchange.
- Widens the market for surplus not sold under the monetary system.
- Solves balance of payment problem since it encourages exchange of goods of value for value.
- Preserves foreign exchange for essential goods.
- Does not involve foreign exchange hence eliminates the problem of currency differences among trading countries.
- Promotes good relationship among trading countries.
- There are few or limited procedures involved in barter trade.
- Eliminates imported inflation.

Obstacles to the success of barter trade

The major limitations of barter exchange are:

- Perish ability of the product (lack of store of value). Under barter system, difficult for people to store wealth for future use because most of the goods (wheat, rice and vegetables) do not possess durability, that is, their quality deteriorates with passage of time.

- Problem of double coincidence of wants. Barter system can only work when both buyer and seller are ready to exchange each other's goods. For example, A can exchange goods with B only when A has what B wants and B has what Awants. However, such double coincidence is rare.

- Lack of common measure of value. In the barter system, all commodities are of equal value and there is no common measure (unit) of value of goods and services, in which exchange ratios can be expressed. For example, if A has wheat and B has rice, then it is difficult to decide, how much wheat is needed to exchange with one kilogram of rice. In the absence of a common measure, the exchange ratio is fixed randomly, in which one of the party generally suffers.

- Transport problems because some goods are bulky. Some of the goods to be exchanged were very bulky making it difficult to transport them from one place to another.

- Lack of standard of deferred or future payments. Under barter system, contracts involving future payments or credit transactions cannot take place with ease because of the following reasons:

a. The borrower may not be able to arrange goods of exactly same quality at the time of payment.

b. The commodity to be repaid may lose or gain its value at the time of repayment.

c. There may be conflicts regarding which specific commodity to be used for repayment.

With so many difficulties, barter exchange could not continue for a long time. As a result, it was replaced by monetary exchange, that is, the buying and selling of is and services with the help of money.

Evolution of money (origins of money)

The earliest method of exchange was barter in which goods were exchanged directly for other goods. Problems arose when either someone did not want what was being offered in exchange for the other good, or if no agreement could be reached over how much one good was worth in terms of the other.

The history or evolution of money concerns the development of means of carrying out transactions involving a physical medium of exchange. Money is any dearly definable object of value that is generally accepted as payment for goods and services and repayment of debts within a market or which is legal tender within a country.

Many things because of their intrinsic value have been used as medium of exchange in markets including, for example, livestock and sacks of cereal grain things directly useful in themselves, but also sometimes merely attractive items such as cowrie shells or beads were exchanged for more useful commodities.

Valuable metals such as gold and silver began acting as a medium of exchange. Governments then decided to melt down these metals into coins. Precious metals like gold and silver are the most common and stable items backing commodity money because they have certain characteristics that make them attractive or useful to almost everyone. Gold and silver can be measured in precise quantity, purity and are easily divisible. They are a storehouse of value and can be exchanged at a later time for something else.

By the seventeenth century people were leaving gold with the local goldsmith for safe keeping. Receipts of £1 and £5 in England were issued which could then be converted back into gold at any time. Soon these receipts were recognised as being 'as good as gold' and were readily taken in exchange for goods. Goldsmiths became the first specialist bankers and their receipts began to circulate as banknotes.

Only the Bank of Uganda can now issue coins and banknotes in Uganda. However, notes are not usually used to buy expensive items such as cars. The buyer is more likely to write out a cheque,which instructs his bank to transfer money from his account into the account of the seller. Hence bank deposits act as money.

Functions of money

The following are the functions of money:

1. Medium of exchange. Money allows the exchange of goods and services without physically involving them, that is, it is used to possess 35 other goods and services.

2. Unit of account. Transactions are recorded in money terms, that is, it is a unit of value for carrying out calculations and accounting procedures to effect business transactions.

3. Standard of deferred or future payments. Money is used as a means of settling debts for goods taken on credit.

4. Store of value. Money is the most convenient way of storing value since it can be kept for longer periods than other goods.

5. Measure of value. Money is used to determine the value of goods and services as expressed in monetary terms.

Qualities or properties of good money

A good money material should possess the following qualitiesor characteristics:

- Acceptability. Money should be generally acceptable as a medium exchange for goods and services by the state, society or the citizens.

- Scarcity. Money should be valuable and limited in supply so that people work for it.
- Portability. Money should be light in weight to ensure that it is easily carried from one place to another.
- Divisibility. Money should be capable of being divided into small units denominations to enable purchase of goods whether large or small.
- Durability. Money should have the ability to last long, that is, good m must not be easily destroyed or changed into other shapes, sizes and colour.
- Uniformity or homogeneity. Money should look alike within a particular denomination and have the same value.
- Stability in value. Money should not lose its value so easily but should fairly stable so as to maintain its worth.
- Cognisability. A good money material must be easy to recognize or identify or differentiated. Different denominations must be easily differentiated from one another.
- Difficult to forge or copy. The material used for making money should be difficult to copy or imitate in order to make counterfeits difficult.

Characteristics of good money

- Should be acceptable.
- Should be durable.
- Should be divisible.
- Should be relatively scarce.
- Should be portable.
- Should be homogeneous.
- Should be easily recognisable.
- Should be malleable, that is, the material out of which it is made should be easy to design or print.

Money supply

Money supply refers to the total amount of money both in circulation and the bank deposits.

OrIt refers to the quantity of money which is in circulation in a given country at a given time and the bank deposits.

N.B.Exogenous money supply is one that is determined by the central bank or minting authority and is always fixed.

While

Endogenous money supply is one that depends on the level of economic activities.

Determinants of money supply include:

- Government monetary policy. An expansionary monetary policy leads to increasedmoney supply while a restrictive monetary policy reduces money supply.
- Level of credit creation.
- Issuing policy of the central bank.
- Level of liquidity preference. An increase in the level of liquidity preference leads to greater supply of money while low levels of liquidity preference reduce money supply.
- Level of monetisation. High level of monetisation leads to greater money supply since exchange of goods and services is done by use of money while a big subsistence sector reduces money since transactions are mainly in form of barter exchange.
- General Price level.
- Interest rates. This has an impact on lending and saving habits. An increase in interest rates discourages people from borrowing from financial institutions thereby reducing money supply while reduced interest rates on borrowed money results in increasedmoney supply.
- Level of economic activity. An increase in the level of economic activities results in greater money supply while a reduced level of economic activities leads to low money supply.
- Balance of payments position. A surplus BOP position of a country results into increased money supply while a deficit BOP position of a country results in reduced money supply.

- Rate of sale of government securities.
- Level of foreign reserves held.
- Level of capital inflows and outflows (capital movements). An increase in the inflow of funds from abroad leads to increased money supply while increased outflow of capital reduces money supply.

Monetary measures that can be used to reduce money supply developing countries

- Sale of government securities, for example, sale of treasury bills.
- Increase bank rate.
- Increase variable reserve requirements / increase cash and liquidity ratio.
- Increase or set high legal reserve requirements.
- Call for (enforcement) supplementary legal reserve requirements / special deposits.
- Selective credit control.
- Currency conversion.
- Increase the margin requirement.
- Direct action.
- Moral suasion.
- Increase in legal reserve requirement.
- Ration credit.

Measures being used to reduce money supply in Uganda

- Selling of government securities for example treasury bills and bonds.
- Increasing the bank rate.
- Increasing the minimum legal reserve requirement.
- Increasing the variable reserve requirement / increasing the cash ratio and liquidity ratio.
- Calling for special deposits.
- Increasing the margin requirement.
- Implementing a selective credit control policy (system).

- Embarking on moral suasion / persuading commercial banks to restrict lending
- Rationing of credit.

Measures used to increase money supply in developing countries

- Buying of government securities.
- Reduction in the bank rate.
- Reduction in margin requirement.
- Decrease in variable reserve requirement.
- Reduction in legal reserve requirement.

Role of money in a modern economy

Money plays the following dynamic role in an economy:

- Leads to division of labour and specialisation. Money promotes specialization which increases productivity and efficiency.
- Promotes lending and borrowing.
- Avails payments for services. It facilitates exchange of goods and services and helps in carrying on trade smoothly.
- Helps to increase commercial activities due to its functions like acceptability.
- Solves barter trade problems.
- Promotes savings and investment.
- Money enables production to take place in advance of consumption.
- Provides incentives to work because payments are in money form.
- Enables valuing of commodities and payments.
- Facilitates economic growth and development.
- Money helps in maximizing consumer's satisfaction and producer's profits.
- It facilitates planning of both production and consumption.
- Money can be utilised in reviving the economy from depression.
- It is the institution of money which has proved a valuable social instrument of promoting economic welfare.

Determinants of the demand for loans

- The interest rates charged on loans.
- Investment opportunities.
- Political climate.
- Level of subsistence / monetisation.
- Availability of collateral security.
- The returns on the capital borrowed.
- Availability of entrepreneurs.

Determinants of the supply of loanable funds in the bank

- Income level.
- Level of savings by the general public.
- Liquidity preference.
- Rate of inflation in the economy.
- Level of monetization or subsistence.
- The reserve ratio.
- The interest given on deposits.
- Availability of collateral security.
- The confidence the general public has in the banking sector.

Interest rates

Interest rate refers to the proportion of capital borrowed that must be paid to the lender in addition to the principle, as reward to capital as a factor of production.

N.B. **Interest** is the monetary payment for use of capital.

Determinants of interest rates on loans

- The demand for loanable funds or investment capital by the general public. A high demand for loanable funds results into a high interest rate but low demand for loanable funds by the public leads to low interest rate.
- The level of liquidity preference. A high liquidity preference implies low savings in commercial banks leading to charging of high interest rates while i low liquidity preference implies that there are more savings in the banking system leading to charging of low interest rates.

- The bank rate or the monetary policy of the central bank. A restrictive monetary policy leads to charging of high interest rates while an expansionary monetary policy leads to charging of low interest rates.
- The level of development of the banking sector. High level of development of commercial banks leads to low interest rates due to competition while low level of development of the banking sector leads to high interest rates.
- The supply of liquid or investment capital. A high supply of loanablefundsor liquid capital results into a low interest rate but low level of supply of liquid capital leads to high interest rate.
- Period of loan repayment. The longer the period of loan repayment, the higher the interest rate but the shorter the period of loan repayment, the lower the interest rate.
- The money supply in the economy. Increased money supply leads to high interest rates while decrease in money supply leads to low interest rates.
- The economic situation or rate of inflation. In periods of high rates of inflation, high interest rates are charged while in period of a deflation, low interest rates are charged.
- The policy of the individual lender whether it is liberal or hard. When the policy of the lender is liberal, interest rates are low but when the policy of the individual lender is hard, interest rates are high.

The causes of high interest rates in Uganda

- Low level of savings / low supply of loanable funds.
- High demand for loanable funds.
- The greed for profits by financial institutions.
- High risks of investment.
- High interest rates on government borrowing / government securities.
- Few financial institutions in the country.

The measures that should be taken to stabilise interest rates in Uganda

- Fight against inflation.
- Promote the growth of financial institutions or banks.

- Stabilise the bank rate or stabilise the rate of interest on government borrowing.
- Encourage savings.

Fisher's quantity theory of money

Irving Fisher's quantity theory of money states that the general price level (P) is determined by the quantity of money (M), assuming that the velocity of circulation (V) and the level of transactions (T) are constant.

Fisher explained his theory in terms of the equation of exchange:

MV=PT OR P=MV

T

Where

M= Quantity of money in circulation.

V= Velocity of money circulation.

P= General price level.

T= Level of transactions.

This equation **shows** that the general price level tends to **varydirectly** with the quantity of money and velocity of circulation but **inversely** with the volume of transactions, multiplied equation equates the **demand for money (PT) to thesupply of money (MV**). The total volume of transactions multiplied by the price level (PT) represents the demand for money. The total supply of money in the economy consists of the quantity of actual money and the velocity of circulation.

Assumptions of the quantity theory of money

- It assumes that M is determined independently of the other 3 variables P, V and
- It assumes that T is given.
- It assumes that V is constant in the short run.
- It assumes that T is constant in the short run.
- It assumes that the interest rate has no role to play.
- It assumes that individuals hold money for transactions only.
- It assumes that V has a constant equilibrium value to which it will return after any disturbance or shock.

Example:

Given that the amount of money in circulation is 400 million Uganda shillings and the velocity of circulation is 10 times and the level of transactions is 80,000; calculate the general price level in the economy.

$$P = \frac{MV}{T}$$

$$= \frac{400{,}000{,}000 \times 10}{80}$$

$= \textbf{Shs. 50,00}$

Limitations of the quantity theory of money in developing countries

- It assumes that velocity of circulation (V) and level of transaction (T) are constant, which is not true in real life.
- It ignores possibility of barter trade as it assumes that the economy is monetised. Some transactions in the economy are carried out through the barter system.
- It considers only the transactions motive for holding money and ignores other motives for holding money for example precautionary and speculative motives.
- It only attempts to explain changes in the value of money but not how money value is determined.
- It ignores the influence of the rate of interest on money supply and money demand. The theory cannot be complete without reference to the rate of interest.
- It ignores demand for money and only looks at money supply.
- Government influence or control of prices using maximum and minimum price legislation is not covered by the theory.
- Where marginal propensity to save (MPS) is high, the theory may not work; because an increase in money supply may result into high savings which reduces the velocity of circulation of money (V), leading to a fall in prices.
- It assumes full employment, which is unrealistic because where a country has many unemployed resources, an increase in money supply leads to an increase in output of goods and services which makes prices to fall or not change at all.
- There is no general price level as assumed by the theory but rather a series of prices for different commodities.
- It does not take into account other causes of price increase or inflation for example cost push and demand pull inflation.
- Haggling or bargaining between buyers and sellers to reach an agreeable price is

not taken into account.

- The four variables M, V, P and T are not independent of one another because a change in one induces a change in others for example an increase in M may increase P but T may also increase due to increase in aggregate demand.
- It is a truism or fact but not a theory as there is nothing testable in the equation. It merely shows that M, V, P and T are related.
- The theory assumes that velocity of circulation (V) and level of transaction (T) are constant which is unrealistic.

Demand for money (liquidity preference)

Demandfor money or liquidity preference refers to the desire by individuals hold assets or wealth in form of **cash or near cash form** (rather than investing it).

Motives for holding money

According to **Lord John Maynard Keynes**, money is held in liquid form due I the following motives:

- Precautionary motive for money demand. The desire by individuals to hold money to finance events of more uncertain nature.
- Transaction motive for money demand. The desire by individuals to hold money to finance the day to day expenditures.
- Speculative motive for money demand. The desire by individuals to hold money as a store of wealth, that is, individuals old money for speculative purposes to avoid risk due to fluctuating prices of financial assets.
- Finance motive for money demand. The desire by individuals to hold money to finance those ongoing projects in which money has already been injected in form of sunk costs.

Factors that determine the demand for money or level of liquidity preference in a market economy

- Rate of interest. A high rate of interest on government securities leads to low demand for money and a low interest rate leads to greater the demand for money.
- Level of speculation. A high level of speculation results into high demand for money while a low level of speculation leads to low demand for money.
- Level of transactions. A high level of transactions leads to high liquidity preference but a low level of transactions limits the liquidity preference.
- General price levels. An increase in the general price levels leads to high level of

liquidity preference and a decrease in the general price level leads to a decrease in the demand for money.

- Degree of uncertainty. A high level of uncertainty about the future and future opportunities leads to high level of liquidity preference while a low degree of uncertainty about the future limits the level of liquidity preference.
- Knowledge of banking facilities. Awareness of banking facilities leads to lower demand for money while ignorance of banking facilities leads to greater demand for money.
- Level of development of financial institutions for example stock exchange and commercial banks. Well-developed financial institutions lead to low liquidity preference while underdevelopment of financial institutions leads to high demand for money.
- Level of monetisation. A high level of monetisation leads to high level of liquidity preference but low level of monetisation leads to low liquidity preference.
- Current prices of financial assets like treasury bills. High prices of government securities leads to low demand for money while a decrease in price of financial assets makes more individuals to hold only money.
- Level of income. A high level of income leads to lower demand for money while low levels of income leads to high level of liquidity preference.

Reasons for high liquidity preference in developing countries

- Low level of income.
- High level of speculation.
- High rates of inflation or high price level.
- High degree of uncertainty.
- Low level of development of commercial banks and other financial institutions.
- Low interest rates on financial assets.
- High level of illiteracy.
- Limited knowledge of services provided by commercial banks.
- Stringent requirements for opening and operating bank accounts.

Reasons for low liquidity preference in developing countries

- High level of income.

- Low level of speculation.
- Low rates of inflation or high price level.
- Low degree of uncertainty.
- High level of development of commercial banks and other financial institutions
- High interest rates on financial assets.
- High level of literacy.
- Increased awareness or knowledge of services provided by commercial banks,

Some important concepts

Liquidity is the ease with which a certain asset can be converted into cash.

Liquid money refers to that money which is in circulation among the public consisting of coins and notes.

Money in circulation refers to coins and paper notes in the hands of the public plus money deposited in banks.

Velocity of money circulation refers to the number of times money changes hands.

Commodity money refers to money in form of tradable goods like gold, salt among others.

OrCommodity money is money whose value comes from a commodity of which I made. Commodity money consists of objects that have value in themselves as well as value in their use as money.

Paper money refers to paper currency that is circulated for transaction-related purposes. The printing of paper money is typically regulated by a country central bank or treasury in order to keep the flow of money in line with monetary policy.

Gold standard is a monetary system where a country's money was convertible into a fixed quantity of gold.

Hard or convertible currency refers to currencies that can easily be exchanged into other currencies without restrictions, for example, euro, British poundsterling, Us dollar and Japanese yen.

Substitute money refers to a medium of exchange in form of an instrument of credit that can perform the functions of money but are not money themselves, for example, cheques, credit cards, bank draft, bills of exchange and promissory notes.

Fiat money is money printed by the central bank on government orders and backed by government securities.

Fiduciary issue is money issued by the central bank at its discretion and is not racked by gold or foreign reserves.

Token money is one whose metal value is less than its face value.

Intrinsic money is one whose metal value is equal to its face value.

Demand deposit refers to a type of account held at commercial banks that may be withdrawn at any time by the customer.

E-money refers to all types of money which people deal with electronically, far from the traditional ways of payment like banks, cheques, paper money and coins.E. money allows users through internet or wireless devices to pay the charges of tier purchases directly from their bank accounts by electronic ways such as smart cards, digital wallets and micro payments.

Legal tender refers to coins and paper notes issued by the central bank of a country for use in discharge of debts and other financial obligations.

Irving Fisher's quantity theory of money. Irving Fisher's quantity theory states that the general price level (P) is determined by the quantity of money (M) assuming that the velocity of circulation (V) and the level of transactions (T) are constant.

Expansionary monetary policy is the deliberate government policy through the central bank to increase the supply of money in circulation so as to expand/increase demand expenditure to achieve government development objectives like attaining high GDP and high employment levels.

Restrictive monetary policy is the deliberate government policy through the central bank to reduce the supply of money in circulation so as to limit demand expenditure to achieve government development objectives like attaining price ability.

The relationship between cash ratio, bank deposit and credit creation capacity of commercial banks

The relationship is such that the size of the cash ratio determines the fraction of bank deposits that can be loaned; and the level of loans in turn determines the level of credit creation.

Or

Given cash ratio, increase in deposits leads to increased credit creation.

Given cash ratio, decrease in deposits leads

The relationship between cash ratio, bank deposit and credit creation capacity of commercial banks.

The relationship is such that the size of the cash ratio determines the fraction of bank deposits that can be loaned; and the level of loans in turn determines the level of credit

creation.

Or

- Given cash ratio, increase in deposits leads to increased credit creation.
- Given cash ratio, decrease in deposits leads to decreased credit creation.
- Given deposits, increase in cash ratio leads to decreased credit creation
- Given deposits, decrease in cash ratio leads to increased credit creation

A **treasury bill** is a certificate which acknowledges a short -term investment person or a firm in a government security.

Or

A treasury bill is an instrument of short term borrowing by the government normally having a life (maturity period) of 91 days. (**Source; an introduction to modern economics 5th edition 1999; 436 by Philip Hardwick et al)** Ch¬it is a security sold by the government through the central bank to the public with a short term maturity period to which interest is paid.

Limitations to the marketability of treasury bills in Uganda is thus;

- Ignorance of the public
- Low incomes of the majority of people
- Poor distribution of commercial banks / under-developed money markets
- Poor publicity of treasury bills
- Government failure to honour the treasury bills at their maturity date.
- Persistent inflation that lowers the value of money (economic uncertainties)
- High level of liquidity preference among the rich people.

A **bank deposit multiplier** is the number of times by which an initial ban de multiplies itself to generate / give a final change in the deposit.

OR credit created.

It is the number of times an initial bank deposit multiplies itself to give total deposit or total

Given that total deposits in a bank amount to Shs 50,000 and the cash ratio 20%, determine the initial deposit.

Initial deposit= Total deposit ÷ Bank deposit multiplier

= Total deposit ÷ 1/ cash ratio

Liquidity ratio is the proportion or percentage 1 commercial bank (total) deposit that is (must be) kept in cash and / or near cash form.

Cash ratio refers to the percentage /fraction of commercial banks deposit that must be kept/ remain in the bank in cash form to meet the cash demand of depositors.

Or

Is the proportion (fraction) of a commercial bank deposits which is kept in cash form to cater for the day to day cash withdraw needs of the depositors and it is not lent out to borrowers.

Reserve ratio is the percentage /fraction of commercial banks total deposits why by law must be kept with the central bank.

Two reasons why the reserve ratio may be increased are;-

- To control inflation/reduce amount of money in circulation
- To restrict credit creation by commercial banks
- To protect the interest of depositors in times of crisis and financial instability
- To reduce liquidity level of the bank
- To safe guard commercial banks against uncertainties during periods of economic depression.

Credit multiplier-is the number of times by which an initially a given bank deposit multiplies itself to generate a final change in deposit.

Or

The number of times initial deposit in a bank is multiplied to give total credit created /total deposit

The term value of money refers to the amount of goods and services a unit of money can buy OR

Value of money refers to the purchasing power of a unit of money

The factors that influence the value of money

- The quantity of money in circulation of money/monetary policy
- The velocity of money circulation of money
- Government policy of devaluation/revaluation
- Availability of goods and services /innovations
- The price level /rate of inflation

Money market- is one in which short term financial assets or securities are exchanged,

While

Capital market -is one where long term securities are traded

OrIs one in which long term financial assets or long term loans are traded.

Functions of capital markets in Uganda

- Mobilising of savings.
- Encouraging investment.
- Regulating the price of financial assets.
- Promoting the ease of convertibility of assets e.g. from near cash to a form.

Reasons for the underdevelopment of capital markets in Uganda

- Low savings or low incomes of the population.
- Low levels of commercialization of the economy.
- Conservatism.
- Poor performance of private enterprises.
- Limited knowledge of the existence and benefits of trading in financial assets
- Poor attitude towards joint ownership of enterprises.
- Poorly developed commercial banks and other financial institutions.

Revision questions

a. State four characteristics of good money.

b. (i) Define the term barter trade.

ii. State three problems of barter system of exchange in an economy.

a. i. Define the term money supply.

ii. Mention three determinants of money supply in an economy.

c. Define the term liquidity.

Mention any three motives of holding money.

State Irving Fisher's quantity theory of money.

Give any two assumptions of the quantity theory of money.

Distinguish between banking financial intermediaries and non-bank financial intermediaries.

Mention any two merits of non-bank financial intermediaries in your country
What is meant by "monetary policy?"

Mention any three objectives of monetary policy in your country.

Distinguish between expansionary monetary policy and restrictive monetary policy.

Give any two objectives of expansionary monetary policy in your country.

What is meant by "tools of monetary policy?"

Mention any three tools of monetary policy.

What is a central bank?

State any three functions of a central bank in an economy.

Define the term 'monetary policy.

State any three instruments of monetary policy in your country.

What is meant by the term "bank deposit multiplier?"

Given that the initial deposit in the bank as 10 million shillings, cash ratio as10%, calculate the final credit created.

Distinguish between cash ratio and credit multiplier.

What is the relationship between cash ratio and credit multiplier?

Show the relationship between cash ratio and credit creation capacity of commercial banks.

Given that the cash ratio is 20% and the initial deposit is shs. 50,000/=, calculate the total deposit created.

Show the relationship between cash ratio, bank deposit and credit creation capacity of commercial banks, Ie the term liquidity ratio.

Calculate the total credit created if the initial deposits amount to €50,000, cash is 10% and four banks are involved.

Define the term "credit creation".

State any three factors that limit the process of credit creation in your country. Giveany four liabilities of a commercial bank.

Banking

A bank is an institution which carries out certain types of financial businesses. The basic functions of a bank include the following:

1. The collection and safeguarding of the surplus funds or money from the general public.
2. The lending of such funds in return for interest and security in form of overdrafts and loans.
3. The transfer of the funds from one person to another by means of credit transfer and cheque systems.

Commercial banks

A **commercial bank** is a **financial institution** that carries out the duty of accepting and safeguarding deposits from the general public and making the money available to the true owners on demand.

OrIs a **financial institution** that receives deposits from customers, gives out mainly

Commercial or short-term loans at high interest rates and create credit.

Is a **financial institution** established to safely keep deposits / money and give / lend money to borrowers with the aim of making profit.

OrCommercial banks are mainly joint stock companies that are established either by the government or private individuals with the aim of making profits.

Commercial Banks are authorised institutions and perform four key functions.

They accept deposits, make loans, arrange payment of bills and provide a number of customer services.

Other Services

Banks have cash points; exchange foreign currency and issue travellers' cheques; provide night safes and store valuables; execute (carry out) wills and trusts; and factor (collect) debts.

Types of Bank Account

Banks provide different types of account for different needs. Customers can open.

- A current account which provides a cheque book but usually pays no interest. Current accounts are mainly used to pay bills.
- A deposit account which does pay interest but money can only be taken out by visiting the bank. Deposit accounts are mainly used for short term saving.
- An investment or savings account which pays a higher rate of interest but written notice of withdrawal must be given. Accounts of this type are used mainly for long-term saving.

Types of Bank Loan

- An overdraft is when the bank allows a customer to take out more money than is b] his account. Overdrafts are up to an agreed limit, and must be paid off whenever the bank asks. Interest is charged daily on any outstanding balance.
- A loan account is when a customer borrows a fixed sum of money to be repaid in monthly installments over a number of years. A fixed rate of interest is charged.

Assets of a commercial bank

These are the possessions of a commercial bank plus its claims on o institutions.

Or what a commercial bank owns.

Examples include:

- Cash in form of coins and paper notes.
- Deposits with other banks.
- Advances and loans to customers such as overdraft facilities.
- Special deposits or supplementary reserves with the central bank.
- Investment in securities of a short term and long term nature for example treasury bills and bonds.
- Reserves (legal) with the central bank.
- Long term investments in other institutions or business ventures.

- Fixed assets like buildings and land.

Liabilities of a commercial bank

These are claims against the assets of the commercial bank by creditors or depositors.

Examples include:

- Share capital.
- Reserves payable to the central bank.
- Deposits by the customers, government and other commercial banks.
- Dividends payable to the shareholders.
- Bills discounted with the central bank.

Functions of commercial banks in developing economies include:

- Accepting deposits. A commercial bank is an institution which accepts money m the public in form of deposits. Deposit is the basis of commercial banks' activities. In order to attract the general public to deposit their surplus money in the bank, the bank offers to deposit money in either a fixed deposit account or current account or savings account.
- Advancing loans. Commercial banks lend money to their customers (individuals, businessmen and government bodies) through the loaning system and overdrafts. The loans are granted out of deposited money.
- Act as custodians of their customers valuables. Commercial banks provide locker facilities to its customers for safe custody of jewellery, shares, securities ire other valuables.
- Issue various instruments of credit for example cheques and drafts. This helps consumers when they are transferring large amounts of money from one area to another.
- Issuance of letters of credit and acts as referees. Commercial banks issue letters of credit on behalf of their customers to facilitate foreign trade. Commercial banks also answer reference letters regarding the financial standing and business reputation of customers.
- Mobilise savings. Commercial banks mobilise savings from both rural and urban areas by enabling a number of individuals save part of their income. This is acne through opening different branches in the country.
- Implement monetary policies. Commercial banks help the central bank to implement monetary policies that are pursued in the interests of the economy.

This helps to regulate money supply in the country hence attaining development objectives of price stability, full employment among others.

- Provide advice to potential investors. Commercial banks collect and provide trade information and tender advice to its customers about financial matters.
- Provide agency services on behalf of listed companies. Commercial bank sometimes acts as an agent on behalf of its customers at home and abroad in dealing with other banks or financial institutions.
- Regulate money supply by helping government to implement the monetary policies of the Central Bank, for example, by avoiding excessive lending to individuals in times of inflation.
- Underwrite shares and debentures of companies. Commercial banks underwrite shares of companies. This helps the companies to raise their capital.
- Finance both internal and external trade. Commercial banks provide foreign change and accept foreign bills of exchange for businessmen who are engaged in international trade.

Methods employed by commercial banks to transfer money or make payment

- Credit transfer system. This is an instruction by the customer which authorizes the bank to pay a specified amount to each named person on a given list. It is used for making single payments and when large numbers of different payments are being made at the same time, for example, paying salaries / wages from the bank account of an organisation into the bank accounts of employees.
- Cheques. This is an instruction from the account holder (drawer) to the bar., (drawee) to pay a stated amount of money to the person named in the document or his order.
- Standing orders. This is a facility that enables a bank customer to make regular-payments to a named payee. Private or business account holders may ask their banks to make regular payments automatically on their behalf for fixed amount of money. They are used to pay for long-term loans, such as mortgages, regular bills like rent, or to make payments to insurance companies.

  OrIt is an instruction by a customer to pay specified amounts of money to specified person(s) on a regular basis for a specified period.
- Bank draft or bankers' draft. This is a cheque drawn by the bank on it guaranteeing payment of the amount indicated on it. The bank will issue the draft only when the person requesting it has paid the money to the bank or if is the required amount on the account.
- Credit cards. This is a document issued by the bank to its customers allowing

them to purchase goods and services on credit up to stated amounts and pay them later. The card is presented to pay for the goods and the seller collects payment from the company that issued the card. Credit cards customers have a special card (eg Visa or Access) which can be used to buy goods. Cardholders receive a statement every month and no interest is charged if the account is settled in Interest is changed monthly on any outstanding balance.

- Travelers' cheque. This is a written instruction issued to a customer of a bank who is travelling within or outside the country but fears to move with large of money.
- Direct debit scheme: this is where an account holder gives an organization or individual permission to withdraw money directly from the account for a period of time (at regular times).
- Debit card: this is a card that usually has an amount printed on it showing maximum amount that can be paid using it. It is commonly used in retail outlets to pay for items as an alternative to cash or cheques.
- Automated teller machines (ATMs). This is a facility that allows account holders to withdraw and deposit cash 24 hours a day. To withdraw money, the account holder must insert his / her debit / card into the ATM and enter his personal identification number (PIN). The ATM will dispense the money requires by the account holder.

Roles of commercial banks in development process of uganda

The role of commercial banks in development includes:

- Invest in directly productive activities. Undertake investment in other fields for example buildings and agriculture leading to increase in output hence economic growth.
- Mobilise savings which promotes investment in future.
- Provide employment opportunities. They offer more employment opportunities leading to higher incomes of the people.
- Implement monetary policies. They assist the government in implementing monetary policy to avoid price instabilities.
- Lend money for investment. By lending money, they promote investment, production and availability of goods.
- Provide revenue to the government. They are a source of revenue to the government in form of taxes.
- Provide covering letters to local investors and act as referees in international

Bade. They give covering letters to potential investors and act as referees, that is, finance trade.

- They contribute to investment capital in a country by buying shares from various companies.
- Discount bills of exchange. By discounting bills, they operate as money markets which are a source of short term finance for development. Commercial tacks provide short term loans to the businessmen by discounting bills of exchange.
- They offer diversified and specialised services that are highly necessary for peoples' welfare and development for example night safes and issue of travelers cheques.
- Provide advice to potential investors. They assist potential investors by giving them advice on trade and investment matters.
- Develop infrastructure through construction of buildings, housing estates for the poor and so on.
- Mobilise savings from the public hence promote investment.
- Acts as trustees. The banks act as trustee to manage trust property as per instructions of property owners.
- Provide strong rooms. Commercial banks provide locker facilities to its customers for safe custody of jewellery, share securities and other valuables.
- Issue travelers cheques. Banks issue traveler's cheques to the customers traveling in and outside the country.

Problems faced by commercial banks in developing countries

Problems faced by commercial banks in developing countries include:

- Poor banking habits. Majority of the citizens especially in rural areas have a poor attitude towards the banking sector.
- High liquidity preference. Many low income earners in the country prefer to hold their wealth in cash form other than saving it in banks. This leads to low deposits in the commercial banks.
- Conservatism. There is a high level of conservatism among the population. This limits the amount of deposits in commercial banks which thus, lowers the ability of banks to give out loans.
- Poor infrastructure like inadequate power and poor roads. The poor roads n some pails of the country making it difficult to mobilise savings by the office of commercial banks.

- Corruption. Some bank officials misuse he customers' deposits for persona gratification thereby causing huge losses to commercial banks.
- High rates of inflation. The high rates of inflation make people to fear to deposit money in banks for fear of loss of value which leads to low level deposits with the commercial banks.
- Political interference. There is a high level of political interference in the activities of national commercial banks especially in appointment of tap managers.
- High levels of insecurity or political unrest. Political unrest in some pans of the country in form of riots, demonstrations and walk to work campaigns scare bank officials thereby causing the suspension of activities during such unrest.
- Few credit worthy borrowers. Many of the borrowers access loans and fad to pay back which increases the bad debts in the banking sector and impacs negatively on banking performance.
- Limited collateral security. The many would be borrowers do not have ne collateral security required by the bank, for example, land title and thus they fail to obtain loans leaving the surplus funds (deposits) idle in the commercial bank.
- High operational costs, for example, high taxes, insurance cover for loans, heavy wage bill and rent. These reduce the profits of the commercial banks.
- Interference by the central bank. The central bank sometimes interferes in the operation of commercial banks when implementing the restrictive monetary policies, for example, charging high interest rates. This aims at lowering ire money supply in the economy but at the same time impacts negatively commercial banks by lowering their lending capacity.
- Ignorance of people about banking services. There is a high level ignorance among the population regarding the facilities and services offered commercial banks. This results into low deposits and limited borrowing from commercial banks.
- Stiff competition with other financial institutions most especially micro-finance institutions. This has reduced on the client base of the commerce banks.

Measures that can be taken to promote commercial banking in Uganda

What measures can be taken to promote commercial banking in your country?

- Encourage savings. Commercial banks can mobilise savings from various individuals especially in schools and rural areas to encourage them deposit surplus money in the banks. This can help increase the operating capital of the banks.

- Control inflation / Attain and maintain price stability. Measures can be taker to fight inflation that usually erodes the value of deposits. This can greatly increase on the use of commercial banks by surplus spending units.

- Fight corruption. This can be done through designing a computerized system that can easily detect cases of fraud and embezzlement of bank deposits by employees and the public, for example, installation of cameras at ATMs.

- Stabilise the political climate. This can encourage many people to take on production activities and also give them confidence to deposit their money in the banks.

- Improve infrastructure. The government can improve on the road network to allow the commercial banks access the potential savers in different parts of the country.

- Sensitise the population about the importance of banking / sensitisation of the population on the benefits of savings. Programmes should be designed on radio stations, televisions and in newspapers to educate the public about the banking industry in the country, and the importance of saving with the banks.

- Develop commercial banks and other financial institutions. The government through the Central Bank should encourage the setting up of various commercial banks to meet the development needs of the country. This can be done through having appropriate legislation in place.

- Use of modern technology. The commercial banks can introduce modern technology in banking activities, for example, computerisation of banking activities to make handling of money easier and faster as well as use of ATMs to reduce congestion in banking halls.

- Close supervision of banks by the Central Bank. Bank of Uganda should strengthen her supervisory role of commercial banks and can enforce closure of those which do not conform to regulations.

The role of foreign commercial banks in economic development of uganda

The role of foreign commercial banks in economic development of my country includes:

Positive role:

- Mobilise savings (funds) for investment by receiving deposits from the public thereby leading to the development of the banking sector.

- Leads to high capital inflow in form of increased remittance of foreign money.

- Promotes cordial international relationships.

- Promotes international trade through encouraging financial transactions with other countries.

- Promotes a competitive spirit with locally owned banks resulting in high levels of efficiency in the banking sector.
- Safeguard or keep deposits from the public.
- Give out loans to borrowers for carrying out investment. Foreign commercial ranks promote growth of enterprises through lending.
- Contribute towards government revenue through paying taxes.
- Provide employment opportunities.
- Contribute to economic growth through facilitating production of goods and services. Foreign owned commercial banks invest in productive activities in lead to increase in output hence economic growth.
- Improve the skills of local labour in the field of management and banking through training. Foreign commercial banks enable labour to acquire management skills through training.
- Finance consumption hence improving consumer welfare.
- Promote transfer of foreign capital hence closing the savings-investment gar
- Help implement monetary policies, for example, contractionary policies for fighting inflation.
- Negative role:
- Increase income inequality.
- Promote regional imbalances because of concentration of activities in urban areas.
- Limited employment creation because of automation in banking (use of capital intensive technology) and discrimination in employment of high level management.
- Encourage capital outflow in form of profit repatriation. Foreign commercial banks are vehicles for repatriation by foreigners hence perpetuating the pro": of capital flight. :
- Charge high interest rates on borrowers and give low interest rate-depositors (savings).
- Discriminate in their lending policies.
- Encourage economic dominance by foreigners.

- Limit the effective implementation of monetary policy of the central because they have excessive liquidity.
- Their existence increases economic dependence by increasing reliance foreign investment.
- They limit government tax revenue because of tax concessions or tax holidays given to them.
- Increase the problem of rural urban migration and its negative effects on economy because of their concentration in urban areas.
- Outcompeting the locally owned commercial banks and other fins institutions.

Financial intermediaries

These are bodies that bring together surplus and deficit spending units.

Banking financial intermediaries refers to the financial institutions w receive deposits from the public, give out mainly short term loans and they create credit or create new deposits, for example, commercial banks.

Features of banking financial intermediaries (commercial banks) in Uganda

- They are mainly urban based.
- They charge mainly high interest rates.
- Mainly operate on small scale.
- Fewbut growing number of firms in the industry / there are few participants in ne industry.
- They deal in a limited variety of financial assets.
- They are mainly privately owned.
- Dominated by foreign commercial banks.
- Most of the commercial banks use capital intensive methods.
- Mainly aim at profit maximisation.

Non-bank financial intermediaries- are financial institutions that receive deposits, give out loans but do not create credit.

Examples include; development banks, post bank, insurance companies, -vestment banks, building societies, cooperative banks, and savings and credit schemes.

NB.Non-banking financial institutions are those financial intermediaries which accept peoples deposits give out long term loans but they don't create credit or new deposits

Role of non-bank financial intermediaries in my country include;

- Promote savings.
- Encourage investment through provision of long term loans.
- Provide more employment opportunities.
- Develop/ increase labour skills through training of manpower.
- Contribute revenue to government through taxation.
- Develop infrastructures.
- Promote entrepreneurship.
- Encourage production hence economic growth.
- Monetise the economy.
- Facilitate industrial development in the economy.
- Facilitate rural transformation and development.

Differences between banking and non-banking financial

Intermediaries

Banking financial intermediaries	**Non-banking financial intermediaries**
Lend credit	Lend long term.
Create credit	Do not create credit
Charge higher interest rates	Charge lower interest rates on loans
Generally maintain current or short-take deposits	Maintain time or fixed deposit account
Undertake lower investment risks	Undertake greater investment risks
Provide cheque facilities to current account holders	Do not have cheque facilities.

The contribution of banking financial intermediaries

Examine the contribution of banking financial intermediaries in tin development of an economy.

Suggested answers

Positive contribution:

- Mobilise savings (funds) for investment from the public.
- Safeguard or keep deposits from the public.
- Provision of credit facilities. Banking financial institutions give out loans borrowers for carrying out investment.
- Contribute towards government revenue through paying taxes.
- Provision of employment opportunities.
- Encourage the development of infrastructure.
- Development of local skills. Banking financial institutions enable labour to acquire skills through training.
- Encourage both local and foreign trade. Foreign banking financial institutions facilitate the process of international trade through availing foreign exchange and advice.
- Facilitate investments.
- Facilitate development of entrepreneurial skills.
- Help in implementation of monetary policies.
- Encourage technological development and transfer into the country, for example, Automated Teller Machines (ATMs).
- Encourage monetisation of the economy.
- Contribute to economic growth through facilitating production of goods and services.

Negative contribution:

- Increase income inequality.
- Promote regional imbalances because of concentration of activities in urban areas.
- Limited creation of employment opportunities. Banking financial institutions increase unemployment because of use of capital-intensive technology.
- Charge high interest rates on borrowers and give low interest rates ondepositors (savings).
- Discriminate in their lending policies.
- Lead to rural-urban migration and its related problems since they are urban

based.

- They worsen the balance of payment position (deficit) because of increase profit repatriation.

- Limit the effectiveness of monetary policies at times. They limit the operation of the monetary policy by not co-operating with the central bank.

Objectives of commercial banks

Commercial banks aim at achieving the following objectives:

1. Profit motive.

2. Liquidity motive.

3. Security (safety) motive.

How commercial banks achieve the objective of liquidity:

- Maintaining the cash ratio.

- Maintaining near liquid assets that can easily be turned into cash for example treasury bills, money at call and short notice or mortgaging fixed assets.

- Pursue short term lending policies/Lending short term / avoiding long termlending.

- Credit squeeze i.e. a policy of limiting lending or phased lending.

- Maintaining a high minimum balance.

- Regulating the volume and frequency of withdrawals, say in the case of savings account.

- Maintaining special deposits with the central bank.

- Borrowing from other financial institutions, that is commercial banks and the central bank.

How commercial banks achieve the objective of profitability:

- Advancing loans and overdrafts at fixed rates of interest.

- Investment in profitable projects/ ventures.

- Discounting bills of exchange, promissory notes and underwriting shares for commissions.

- Charging fees services rendered to customers.

- Investing in / buying government securities.
- How commercial banks achieve the objective of safety:
- Investing in sound projects especially purchase of government securities such as rends and treasury bills.
- Determining the credit worthiness of borrowers before advancing loans.
- Maintaining a high liquidity-assets ratio.
- Margin requirement measures.
- Obtaining collateral security.
- Supervising / monitoring the projects funded by the bank.
- Regulating the amount and frequency of loan release.

Development banks

meaning

A **development bank** is a **financial institution** set up to finance long-term envelopment projects in the country.

OrIs a **non-bank financial institution** that receives deposits, gives out long term loans at low interest rates for development but do not create credit.

Functions of development banks

- Finance small and large scale projects in the country by giving them loans both in cash and physical assets. Loans can be on a short term or long term basis and can be used by the firms to increase production.
- Encourage production of goods for export, for example, flowers and vegetables hence increasing foreign exchange earnings.

The central bank

A **central bank** is a **financial institution** set up by the government to control the monetary system in the country and to control the activities of all the financial institutions to ensure macro-economic stability.

The central bank is the apex institution of a country's monetary system, design and control of the country's monetary policy is its main responsibility.

Functions of the Central bank include:

- It issues the country's currency. It has the sole authority of printing currency notes and minting coins.

- It is a banker to the government by keeping government funds and foreign exchange reserves like gold and US dollars.
- It acts as a fiscal agent and advisor to government in formulating budgets taxation and economic policy.
- It is a banker to commercial banks and other financial institution. All commercial banks are required by law to keep a certain percentage of deposits with the central bank (legal reserve requirement).
- It controls and regulates the operations of commercial banks. Commercial banks are directly controlled in their operations by the central bank.
- It is a lender of last resort to commercial banks. The commercial banks borrow money from the central bank after failing in other sources.
- It is a banker to international institutions working in the country such as I.M.F., F.A.O. and Red Cross. The central bank maintains close relations these international institutions.
- It is a clearing house for all commercial banks. All commercial banks: their indebtedness through the Central bank.
- It manages the public debt. The central bank negotiates on behalf of the government for government loans, keeps debt records and monitors the repayment of the debts.
- It regulates / controls foreign exchange rates. The central bank intervenes foreign exchange market whenever there is an appreciation or depreciation of the local currency to maintain stability.
- It manages the country's monetary policy. The central bank uses various tools of monetary policy for controlling the volume of money in circulation.

How the Central bank controls credit creation:

This is mainly done through manipulation of monetary tools; thus

- Through the Bank rate. This is the charge by the central bank on loans given to commercial banks. An increase in the bank rate by the central bank discouraging the commercial banks from borrowing money. The commercial banks therefore increase the interest rate on the loans given to the customers/ borrowers thereby reducing money supply in circulation. However, to increase money supply in circulation, the central bank lowers its bank rate so that the commercial banks are able to lower the interest rate charged on the customers/ borrowers, for them take on loans.
- Open market operations. This refers to the selling and buying government

securities like treasury bills and bonds. To increase money supply circulation, the central bank buys the securities from the public thus leaving money with the people. However, to decrease money supply in circulation, the central bank sells securities to the public and withdraws money from circulation.

- Selective credit control. This refers to a situation where the central bank encourages commercial banks to give loans to some specific sectors of importance/priority and denying other sectors from acquiring loans to reduce money supply in circulation. However, when the central bank wants to increase money supply in circulation, it tends to relax the tool of selective credit control.

- Use of special deposits. These are deposits the central bank demands from the commercial banks

- on top of legal reserve requirement. To reduce money supply m circulation, the central bank puts in place a special deposit on top of the legal reserve requirement. However, to increase money supply in circulation, special deposits are not required.

- Moral suasion. This is a way of persuading/ advising the commercial banks and the public about the dangers of too much money or too little money in circulation. The commercial banks are persuaded to follow the policies, which the central bank believes to be in the interests of the country.

- Regulation of margin requirements. Margin requirement refers to the difference between the amount of the loan advanced and the value of the collateral security pledged. Margin requirement is increased to discourage people from borrowing money from commercial banks so that money supply is limited while the central bank lowers the margin requirement to encourage people to borrow money so that money supply in circulation is increased.

- Rationing of credit. The central bank regulates the amount of money to be lent to commercial banks. To reduce money in circulation, the central bank lends less money to commercial banks which limits the process of credit creation. However, when there is need to increase money in circulation, the central bank increases the amount of money, which is lent to commercial banks hence availing more funds for credit creation.

- Use of minimum legal reserve requirement. This refers to the percentage of commercial banks' total deposits that is kept with the central bank according to law. To increase money supply in circulation, the central bank lowers the legal reserve requirement so that the commercial banks are left with enough money for ending. However, when the central bank wants to reduce money supply in circulation, it increases the legal reserve requirement so that the commercial ranks have limited amount of money to lend out to the public.

- Currency reforms. This is a tool applied when there is too much money in circulation resulting into total loss of money value and loss of confidence in the local currency. The government through the central bank orders for the replacement of the currency with a new one as a step of reducing money supply in circulation.

- Cash ratio. This refers to the proportion or percentage of the commercial ranks' total deposit that is kept in cash form to meet the daily demands of the customers. To increase money supply in circulation, the central bank lowers the cash ratio and to reduce money supply in circulation, the central bank increases re cash ratio.

How the central bank limits the ability of commercial banks to give loans or create credit

- By selling government securities. The central bank embarks on selling treasury bills to the public. Individuals who buy the treasury bills write out cheques through their commercial banks paying the central bank. This reduces money available in commercial banks and finally their lending capacity is reduced.

- Instructing commercial banks to raise the cash ratio. The central bank can direct commercial banks to raise their cash ratio. When cash ratio is increased, the volume of money available for lending is reduced. This forces commercial banks to lend less money to the public.

- By raising the bank rate at which commercial banks borrow from the central bank. An increase in the bank rate by the central bank results into an increase in the interest rate on commercial bank loans. This increases the cost e borrowing. The public is discouraged from getting loans from commercial bank hence their capacity to lend is reduced.

- Commercial banks may be required to make special deposits with the central bank. These special deposits reduce the amount of money for lending in commercial banks.

- By using the tool of selective credit control. Commercial banks are required give loans to only selected or priority sectors or projects in a country. This reduces massive or excessive lending of money to the public by the central bank.

- By using moral suasion. The central bank appeals to or politely requests commercial banks to refrain from excessive lending. Letters and circulars are sent by the central bank to commercial bank persuading them to reduce lending in order to fight or check inflation.

- By instructing commercial banks to increase the margin requirement. High margin requirement scares the public from applying for loans from commercial banks. This reduces the capacity of commercial banks in giving out loans to the public.

Credit / bank deposit multiplier

This is the number of times initial deposit in a bank is multiplied to give the tea credit created (total deposits or final deposits).

OR

It is the number of times by which an initial bank deposit multiplies itself togenerate a final change in deposits.

OR

The number of times by which a given bank deposit multiplies itself to generate a final change in deposits (total credit created)

OR

The measure of change in bank deposits in comparison to change in initial deposits made in the bank.

It is given by the formula:

$$\text{Bank deposit multiplier} = \frac{\text{Final deposits}}{\text{Initial deposits}}$$

$$\text{Bank deposit multiplier} = \frac{1}{\text{Cash ratio (CR)}}$$

Example :A commercial bank that maintains a uniform cash ratio of 0.2% receives a new deposit of Shs 1,000,000. Calculate the total credit created in the bank system. Solution:

Step 1: Find the bank credit multiplier

$$\begin{aligned}\text{Bank deposit multiplier} &= \frac{1}{\text{Cash ratio (CR)}}\\ &= 1/0.2\%\\ &= 1/0.002\\ &= 500 \text{ times}\end{aligned}$$

Step2: Find the total credit created

Total credit created = Initial bank deposit x Bank credit multiplier

= Shs 1,000,000 x 500

= Shs 500,000,000

Factors that influence the bank / credit multiplier

- The willingness of the people to borrow.
- The cash ratio.
- The rate of interest.
- The liquidity ratio.
- The level of savings.
- The economic climate / rate of inflation.
- Government policy as regards lending.

Exercise

1. Given that the cash ratio is 10% and the initial deposit is shs 5.000,000/=, determine the value of total deposits that can be created.
2. Given an initial deposit of shs 1,000,000 with a cash ratio of 20%, calculate the credit that will be created when four banks are involved.

3. Given that the initial deposit is shs. 10,000/= and the total deposits created amount to shs. 200,000/=, calculate the cash ratio.

4. Given a cash ratio of 0.2% and the total deposit created is Uganda 200 million, calculate;

Credit multiplier.

Initial deposit that was available in the bank.

5. Given a cash ratio of 0.1% and initial deposit of shs 250,000, determine:

Credit multiplier.

Total credit created.

6. Given that the initial deposit is shs. 10,000 and the total deposit created amount to shs.200,000, calculate the cash ratio.

7. Calculate the total credit created if the initial deposit amounts to 50,000, cash ratio is 10% and four banks are involved.

8. Given that the initial deposit in a bank is Uganda shs. 10 million and cash ratio is 20%, calculate the total amount of credit that will be created in a multi-bank system.

Credit creation process

Credit creation is the process by which part of the deposit received by commercial banks is lent and it expands into greater volumes of credit.

Or

Is the process by which commercial banks generate or create new deposits out initial deposits made by customers.

Or

Refers to the process by which commercial banks create deposit money in excess of the initial cash deposits they hold.

Assumptions of the process of credit creation

- The banks maintain a fixed cash ratio. This is usually decided by the central bank.
- Transactions in the economy are carried out by use of the cheque system.
- Assumes a multi-bank system, that is, there are several banks in the economy that participate in the process.
- People or individuals in the economy are willing to save and keep their mc in the banks.
- The public is willing to borrow from commercial banks and commercial bar are willing to lend the public.
- The money lent out by one bank is deposited in another bank for the processes continue.

Example 1

A description of the credit creation process by commercial banks

Commercial banks in Uganda create credit by:

- Receiving deposits from customers. For example an initial deposit of 100,000
- Keeping percentage of deposits as cash ratio, that is, without lending it out. For example, 20% of shs 100,000 = shs 20,000
- Lending out to borrowers / Advancing loans to borrowers out of deposits received. For example, shs 100,000 - 20,000 = shs 80,000
- Accepting money lent out as new deposits by another bank. For example, shs800,000
- Retains percentage as cash ratio/ reserves. For example, 20% of 80,000 = shs: 800,000
- Lends out part of the new deposit again to borrowers through another bank. For

example shs 80,000 -16,000 - shs 64,000

- And the process continues till the initial deposit defuses in the system i.e. process continues till amount to be lent is negligible.

Value of total deposit or total amount created = initial deposit x bank multiplier But,

$$\text{Bank deposit multiplier} = \frac{1}{\text{Cash ratio (CR)}}$$

$$\text{Hence final deposit} = \text{shs } 100{,}000 * 1/20\%$$

$$= \text{shs } 500{,}000$$

Sample question: Describe the process of credit creation by commercial banks in an economy.

Example 2

Calculate the credit created where initial deposits amount to Uganda shillings 10,000, cash is 5 % and four banks are involved.

BANK	**NEW DEPOSIT SHS.**	**CASH RATIO 5% SHS.**	**LOANS OR ADVANCES SHS.**
A	10,000	500	9,500
B	9,500	475	9,025
C	9,025	451,25	8,573.75
D	8,573.75	428,69	8,145,06

Therefore, total credit created = 10,000 + 9,500 +9025 + 8573.75 = Shs 37,098.75

EXAMPLE 3 on describing the process of credit creation given an initial deposit and cash reserve:

Question:

Describe how credit is created by a commercial bank using an initial depose of shs 1,000,000 and a uniform cash ratio of 20%.

N.B: A commercial bank creates credit by accepting an initial deposit of shs 1,000,000 and lending part of it.

Receiving of the initial deposit of shs 1,000,000 by the first bank (Bank A), thai is, the bank receives a deposit of shs 1,000,000 from a client (depositor) Keeping of percentage of the deposit as a cash reserve by **Bank A.** Hence **Bank** A keeps 20% of shs 1,000,000 = shs 200,000 as cash reserve. Lending the balance to a credit worthy borrower. For example, the amount Bank A lends out as loans = Deposit - cash reserve.

(Shs 1,000,000 -shs 200. -shs 800,000)

Receiving the new loan of shs 800,000 as a deposit in another (second)bank (Bank B).

Keeping of a percentage of the deposit in **Bank B** as a cash reserve. In this **Bank B** keeps 20% of shs 800,000 = shs 160,000 as a cash reserve. **Bank B** lending the balance of shs 640,000 (shs 800,000 - shs 160,000) credit worthy borrower.

The process continues till the initial deposit diminishes (defuses) in the b system.

At the end of the process of the process, the total credit created is equal to:

Total credit created = Initial deposit x 1/cash ratio

= Shs 1,000,000 x 1/0.2

= Shs 1,000,000 x 5

= Shs 5,000,000.

Factors that influence the process of credit creation

Factors that influence the process of credit creation in Uganda include:

- Level of interest rate. High interest rate on loans discourages borrowing thus limiting credit creation by commercial banks, low interest rate on 1 encourages borrowing, and this leads to high credit creation.
- Size of the initial bank deposit. The higher the initial bank deposit, longer the process thereby resulting into more credit created but low initial deposit limits the process of credit creation.
- Central bank interference through monetary policy. Expansionary monetary policy encourages giving out of loans to borrowers by the commerce banks hence encouraging credit creation while a restrictive monetary policy of the central bank discourages the process of credit creation by making loan acquisition expensive to investors.
- Level of liquidity preference. High levels of liquidity preference in an economy leads to low rate of credit creation because most people prefer keeping their wealth in cash form without depositing it in banks hence limiting the capacity of banks to have loanable funds. However, a low level of liquidity preference implies an increase in bank deposits as more people are willing to use the banking system which avails more funds for borrowing hence increase in credit creation.
- Distribution of commercial banks. Increased concentration of commercial ranks in urban areas implies that many people in rural areas do not get access to banking facilities for making deposits and borrowing hence limiting the process the credit creation however, when banks are well distributed in the country credit

creation is likely to be high due to increased access to depositors and people interested in borrowing.

- Availability of credit worthy clients. Lack of creditworthy borrowers leads to low rates of credit creation since banks fear to give out loans to borrowers who are not credit worthy because they may fail to pay back the borrowed money. However, presence of enough credit worthy borrowers leads to a high rate of credit creation since commercial banks will have security against a loan advanced.

- Possession of collateral security. Presence of enough collateral security leads to high rates of credit creation because collateral security avails many individuals with the capacity to borrow from banks while the lack of collateral security leads to a low rate of credit creation as banks become fearful in lending to such individuals.

- Degree of uncertainties. High levels of uncertainties in the economy in form of high rates of inflation, makes banks keep many liquid assets, reduces deposits made in the banking sector as well as discouraging banks from lending to borrowers which leads to a low rate of credit creation. However, a low level of uncertainties in form of stable prices, encourages high level of banking activities lending to high level of credit creation.

- People's knowledge and popularity of loans. The ignorance about banking and the unpopularity of loans among many people in the country makes it difficult for commercial banks to create credit since borrowing is limited. However, where individuals have knowledge about the banking system and loans are popular, there is a high rate of credit creation.

- Degree of accountability. High levels of corruption (low levels of accountability) by the bank officials discourages saving and scares the would be Borrowers form the commercial banks which results into low levels of credit creation. However, low levels of corruption (high level of accountability) leads to high level of credit creation as many people are more willing to deposit funds in and borrow from the banking system.

- Level of cash ratio or reserves. A high cash ratio discourages the process of credit creation because it leaves the commercial banks with limited amounts of funds for lending out to people but a low cash ratio leads to high rates of credit creation because commercial banks have a greater ability to lend to many people.

- Level of investment. Increased investment leas to a high demand for loans replying greater credit creation while low levels of investment leads to limited .Demand for loans thus low level of credit creation.

- Political climate. Poor political climate in a country discourages investment ire reduces borrowing from commercial banks due to the high risks involved in ending hence resulting in low level of credit creation. However, a stable political c .ornate gives people confidence to borrow and invest which increases the demand for bank loans hence encouraging the process of credit creation.

Factors which limit credit creation by commercial banks

The factors which limit credit creation by commercial banks in my country are:

- High cash ratio. This limits the amount of new deposits/loans (lending ability of commercial banks) and this limits the process of credit creation.
- Lack of collateral security. Many people do not possess the required collateral security and therefore cannot access credit facilities and this limits ability of commercial banks to create credit.
- Few credit worthy borrowers. Commercial banks fear to lend money to people due to their inability to pay back loans as a result of the low income earned by a number of people. This leads to low demand for excess reserves limits the capacity of banks to create credit.
- High interest rate on loans. This discourages the general public formborrowing money from the commercial banks thereby limiting the ability commercial banks from creating more credit.
- High liquidity preference. Many people prefer to keep their assets in cash form in their houses other than saving it in the bank. This limits the amount of funds available to commercial banks to create more credit.
- Unpopularity of loans. Many people have a negative attitude to acquiring credit form commercial banks, thereby limiting the credit creation process.
- Poor accountability or high level of corruption in commercial banks. Corruption by bank officials who lend only to those who bribe them sometimes do limit the volume of deposits for lending, thereby limiting amount of money available to commercial banks for lending to create more
- Low income level of the population. This discourages savings limiting the amount of funds available for borrowing. This limits the ability of commercial banks to create credit.
- Low savings. Low savings in an economy lead to low deposits in commercial banks which limit the ability of the banks to give out loan to borrowers hence limiting the credit creation process.

- Poor political atmosphere. Political unrest in some parts of the country scares people from depositing money in banks. This results in low savings: limiting the funds available to commercial banks for the process of credit creation.
- Low level of investment. Low level of investment in an economy results generation of limited incomes. This leads to limited funds available for savings the banking sector hence limiting credit creation process.
- Large subsistence sector. The big size of the subsistence sector in the economy implies that few individuals are using money for exchange purposes. This results in low savings hence low deposits in banks which limits the process of credit creation.
- Limited knowledge about services offered by commercial banks. Many people are ignorant about the availability of banks, use of cheques and other banking services. This leads to limited borrowing by the people and low creation.
- Economic uncertainty in Uganda. This discourages the public borrowing money from the commercial banks thereby limiting the ability of the commercial banks to create credit.
- Few and mainly urban based commercial banks. The commercial banks through which the process operates are poorly distributed, concentrating in urban areas and this leads to limited borrowing and lending of money in rural areas thus limiting the process of credit creation.
- Restrictive or contractionary monetary policy by the Central bank or government.
- A restrictive monetary policy involving raising of the bank rate and cash ratio reduces the capacity of commercial banks to lend because it avails less funds for lending. This limits the process of credit creation.

Question

a. Explain the factors that influence the level of credit creation in your country.

b. Account for the low credit creation by commercial banks in your country.

The reasons for the control of credit creation

The reasons for the control of credit creation in an economy;

- To create employment opportunities.
- To establish prices / to control inflation.
- To improve the balance of payments position.
- To increase economic growth rate.

- To increase the level of investment.
- To stabilise exchange rates.
- To ensure growth and stability of the banking/financial sector
- To manage the (internal) public debt.
- To ensure safety to customers deposits.

Measures used to control credit creation

- Use of the bank rate
- Special deposits
- Use of variable reserve requirements
- Using the margin requirements
- Moral suasion
- Open market operations
- Size of the initial deposits
- Selective credit control
- Rationing of credit

Measures being used to reduce credit creation

Question:

What measures are being used to reduce credit creation in your country?

Measures being used to reduce credit creation in Uganda are thus:

Tense; strictly use the present continuous tense / now tense

- Sale of government securities, for example, treasury bills
- Increasing the bank rate
- Increasing the variable reserve requirement / increasing the cash ratio and liquidity ratio.
- Increasing the minimum legal reserve requirement

- Increasing the margin requirement
- Increasing the special deposits
- Implementing a selective credit control policy (system)
- Persuading commercial banks to restrict lending / embarking on moral suasion.
- Rationing of credit

Monetary policy

Monetary policy is the deliberate government policy through the central bank of **regulating** (increase or decrease) the volume of money in circulation in order attain desired macro-economic objectives such as full employment, economic growth rates, price stability, balance of payment stability among others.

Or

Is the **deliberate** government policy through the central bank to regulate(control) money supply in circulation so as to influence demand expenditure the level of economic activities to achieve various objectives, for example, price stability, exchange stability, increasing rate of economic growth among others.

Objectives of monetary policy in uganda

Objectives of monetary policy in my country:

- To attain full employment / to increase the level of employment. A decline in short- and long-term interest rates makes it cheaper to borrow, so ho are more willing to buy goods and services and firms are in a better position to purchase items such as property and equipment to expand their businesses. Firms respond to these increases in total household and business spending by hiring more workers.
- To attain high levels of economic growth / to increase economic rates. A fall in interest rates leads to increase in consumption which gives entrepreneurs confidence to invest. This encourages producers to expand output thus increasing the productive capacity of an economy.
- To improve Balance of payments position / to reduce Balance of Payments deficits. The expansionary monetary policy lowers the exchange rate and makes the country's exports relatively cheaper and imports become relatively more expensive hence improving the balance of trade. However, a restrictive monetary policy raises the exchange rate and makes the country's exports relatively more expensive and imports become relatively cheaper hence leading to unfavorable the balance of trade.
- To attain and maintain price stability / to control inflation. Raising interest rates

and reducing bank lending lowers investment and reduce consumer spending thereby controlling demand-pull inflation.

- To ensure growth and stability of the financial sector. The primary a -monetary policies is to lower the longer term interest rates, thereby improving financial conditions. This can be achieved through the lowering of the Central Bank Rate (CBR) to commercial banks. This enables commercial banks to reduce their commercial lending rate to the private sector hence boosting the growth of the financial sector.

- To stabilise the foreign exchange rate. The central bank at times tries to influence the market rates under the floating exchange rate system to attain exchange stability, for example, central bank adjusts the interest rates to influence the flow of funds into and out of the country.

- To promote or influence investment. A decline in short- and long-term merest rates makes it cheaper to borrow, so households are more willing to buy goods and services and firms are in a better position to purchase items such as property and equipment to expand their businesses. Firms respond to these increases in total household and business spending by boosting production and investment. However, a fall in the money supply raises the interest rate which increases the cost of borrowing. This reduces the demand for loanable funds which reduces investment.

N.B. Explain the objectives of monetary policy with the help of the tools or instruments clearly bringing out how expansionary or restrictive monetary policies can help attain a given objective.

Uses / importance of monetary policy in economy

- Ensures attainment of full employment / increases the level of employment

- Ensures attainment of high levels of economic growth.

- Results in improvement in Balance of payments position / reduces Balance of Payments deficits.

- Helps to attain and maintain price stability / controls inflation.

- Ensures growth and stability of the financial sector, stabilises the foreign exchange rate.

- Promotes or influences investment.

Tools of monetary policy

Meaning: **Tools of monetary policy** are those planned and **deliberate actions** undertaken by the government through **the central bank** to **control the amountof money in**

circulation with an aim of reducing inflation.

Broadly defined, tools of monetary policy refers to **guidelines or weapons or instruments** employed by the central bank to increase or reduce the money apply in circulation so as to achieve development objectives such as attainment it rail employment, price stability and so on. They are basically used as methods of credit control.

These **tools** are listed below

- Open market operations
- The bank rate
- The legal reserve requirement/Minimum legal reserve requirement.
- Special deposits from commercial banks.
- Selective credit control.
- Moral Persuasion/ Moral suasion
- Variable reserve requirement (cash ratio and liquidity ratio).
- Margin requirement
- Rationing of credit by the central bank.
- Currency reforms.

N.B. Expansionary monetary policy is the deliberate government policy through the central bank to increase the supply of money in circulation to expand/increase demand expenditure to achieve government development objectives like attains high GDP and high employment levels.

While

Restrictive monetary policy is the deliberate government policy through the central bank to reduce the supply of money in circulation to limit demand expenditure to achieve government development objectives like attaining price stability.

1. Open market operation: This refers to the central bank action of buying and selling government securities. In order to reduce money in circulation, the centralbank sells government securities to the public. However, to increase the volumeof money in circulation, the central bank buys government securities from the public hence injecting more money in circulation
2. The bank rate. Bank rate is a charge, which is fixed on loans that the central bank gives to commercial banks. It is the central bank lending charge. An increase in the bank rate causes an increase in the interest rate charged by commercial banks on

loans advanced to the public. An increase in interest rate discourages borrowing from the commercial banks and this reduces the volume! money in circulation. However, a decrease in the bank rate makes commercial banks to reduce their interest rate on loans. The public is encouraged to borrow from commercial banks and this increases the volume of money in circulation

3. Legal reserve requirement: This is a minimum amount of money, which every commercial bank is legally required to keep with the central bank. When the legal reserve requirement is increased by the central bank, the commercial-banks are left with less money for lending. This reduces the amount or volume ofmoney in circulation and inflation is checked.

4. Special deposits. The central bank may instructor order commercial banks n» make a special deposit in addition to the legal reserve requirement. When commercial banks make this special deposit the cash available for lending to in-public is reduced. This reduces the volume of money in circulation and inflation is checked in the country.

5. Selective credit control: The central bank from time to time can instruct commercial banks to advance loans to only important or priority sectors of the economy like agriculture and industry. This helps to reduce massive or excessive lending by commercial banks. The volume of money in circulation is reduced andinflation is controlled. However, when the central bank wants to increase lending, abolishes the policy of selective credit control.

6. Moral Suasion. This tool involves the central bank politely appealing to (persuading) commercial to limit or restrict lending to the public in order to -educe money in circulation and check inflation. The central bank does this by writing letters or circulars to commercial banks encouraging them to reduce ending to the public.

7. The cash ratio. Cash ratio is the proportion or fraction of commercial bank deposits which is kept in cash form to cater for the cash withdraw needs of the customers. By keeping a high cash ratio, commercial banks set aside little money for lending to the public. However, by keeping a low cash ratio, commercial banks set aside more money for lending to the public.

8. Margin requirement. This is the difference between the value of collateral security and the value of the loan to be advanced to a borrower by a commercial. For example, if one wants to borrow shs 10 million but he is required to rare-sent collateral security worth 12 million, then the margin requirement is shs 2 million.

   Commercial banks increase margin requirement in order to discourage borrowing arc they reduce the margin requirement to encourage the public to borrow from them.

9. Rationing of credit by the central bank. The central bank regulates the amount of money to be lent to commercial banks. To reduce money in circulation, the central

bank lends less money to commercial banks. However, when there is need to increase money in circulation, the central bank increases the amount of money, which is lent to commercial banks.

Factors influencing the implementation of monetary policy

The factors that influence the implementation of monetary policy in my country;

- The location of commercial banks / the level of development of commercial banks.
- The degree of conflict in government objectives
- The degree of liquidity preference by public
- The level of liquidity in commercial banks
- The knowledge level of awareness of the population of open market operations
- The degree of political interference
- The level of control of the economy/ dominance of foreign owned commercial banks
- The level of accountability by ban (king) officials.
- The level of development of capital markets.
- The intensity in the use of commercial banks due to;

➢ The level of incomes.

➢ The degree of ignorance by the public of the services offered commercial banks.

➢ The level of illiteracy.

➢ The popularity of loans.

➢ The degree of conservatism.

➢ The size of the subsistence sector.

➢ The credit worthiness of borrowers.

N.B. Generate explanations to these factors.

Limitations to the operation of the monetary policy in Uganda

Factors limiting the operation of the monetary policy in Uganda include:

➢ Poor lending and borrowing habits due to limited collateral security m few credit worthy borrowers. Credit creation by commercial banks is very limited due to limited effective use of banks and inadequate collateral security from the public. Hence, there is no need of any monetary tool aimed at controlling credit.

- Dominance of defiant foreign owned commercial banks. Many of a foreign banks have cash at their disposal from their foreign headquarters and can easily avoid any monetary tool which may be used to reduce their business activities.

- Poor distribution of commercial banks; this is mainly due to their concentration. Commercial banks are mostly based in urban areas leaving out the rural areas. This makes it difficult to effectively implement monetary policies aimed at controlling credit creation.

- Excessive liquidity in the commercial banks. Commercial bank-developing countries enjoy excessive liquidity. Therefore, it is very rare for l to borrow money from the central bank. Consequently, use of the bank rate monetary policy becomes ineffective.

- Conflicting objectives of government. Sometimes the government orders the printing of money and issuance of currency in the economy in the name financing emergencies which leads to increase in money supply in circulation centrally to the central bank policy of reducing money supply to control inflation.

- Corruption by bank officials in the implementation of some of instruments especially in the use of selective credit control. There is widespread corruption and bribery in developing countries such that selective credit control as a monetary tool is almost rendered unworkable.

- High liquidity preference among the population or public. Most people in developing countries do not keep their money with commercial banks, makes it difficult on the part of the central bank to control money which is outside the banking system.

- Political interference. Politicians usually interfere in the operations of the central bank, making it difficult to control money supply. This may be in the form of giving political directives regarding lending to politically connected individualor funding certain government programmes outside of the budgeted amount centrally to the interests of the country.

- Persistent inflation. The persistent inflation makes it difficult for the central bank to implement some of the tools of monetary policy. This is due to the limited use of commercial banks and the loss of confidence in money as a medium of exchange.

- Large subsistence sector resulting in limited use of the commercial banks. There is a big subsistence sector in developing countries therefore; monetary policies may not be effective in controlling money supply since the bigger part of the economy uses barter.

- Underdeveloped money and capital markets. In most developing countries like Uganda, the money market for short-term loans and the capital market for long-term securities are poorly developed making it difficult to control money supply.
- Ignorance of the public about the facilities offered by commercial banks, for example open market operations. They therefore, do not buy government bonds and securities whenever they are declared. This makes this tool ineffective. Also, people are ignorant about the availability of credit facilities. Thus, tools like selective credit control favouring a priority sector like agriculture may not be utilized
-

Question 1

a. What is the difference between a Central Bank and a Development Bank?

b. Explain the role of Bank of Uganda (BOU) in the economic development of your country.

Question 2

a. Distinguish between a development bank and a central bank.

b. Explain the functions of Bank of Uganda.

Question 3

a. Describe the functions of a central bank in an economy.

b. Explain the instruments used by a central bank to regulate money supply in an economy.

Question 4

a. What is a non-bank financial intermediary?

b. Explain the factors that influence the development of non-bank financial intermediaries in your country.

Question 5

a. Describe how commercial banks create credit.

b. Examine the factors influencing the level of bank credit creation in developing countries.

Question 6

a. How do commercial banks achieve profitability and liquidity objectives?

b. Discuss the problems faced by commercial banks in developing economies.

Question 7

a. Explain the objectives of monetary policy in an economy.

b. What are the factors that limit effective implementation of monetary policies in developing economies?

Question 8

a. What are the functions of commercial banks in your country?

b. Discuss the problems faced by commercial banks in your country.

Question 9

a. Explain the functions of the central bank in market economies.

b. Discuss the methods used by the central bank to influence the level of money supply in market economies.

Question 10

a. Differentiate between "commercial bank" and "development bank"

b. Discuss the contribution of foreign owned commercial banks to the development of developing countries.

Question 11

a. Explain the quantity theory of money according to Irving Fisher.

b. What are the limitations to the applicability of the theory of money to a market economy?

Question 12

a) How do commercial banks achieve:

i. Profitability objective.

ii. Liquidity objective.

(iii) Safety objective.

b) Discuss the factors limiting commercial banks in your country achieving their objectives.

Question 13

a. Explain the Fisher's quantity theory of money.

b. What are limitations of the quantity theory of money in develop countries?

c. Explain the role of money in an economy.

Question 14

(a) Explain the relationship between the following:

(i) Bank deposit and Credit creation,

(ii) Cash ratio and Credit creation.

b) Suggest the measures that should be taken to increase the volume of credit created by commercial banks in your country.

Question 15

a) A commercial bank that keeps a uniform cash ratio of 0.25% receives initial deposit of shs 500,000. Calculate the:

(i) Bank credit multiplier,

(ii) Total credit created.

b) Examine the factors that affect credit creation in an economy.

Question 16

a. Calculate the total credit created by the first four banks in the system where an initial deposit of shs 100,000 is received and a uniform cash ratio 0.4 is in use.

b. Assess the impact of foreign owned commercial banks in the economic development of your country.

TOPIC 8: INFLATION

Inflation refers to the **persistent increase in the general price level of goods and services in an economy in a given period.**

State of inflation refers to the speed or rate of increase in the general price level in a given period.

Type of inflation refers to the nature or cause of the increase in the general price level.

Classification of inflation

Inflation can be classified using the criteria below;

1. According to the degree of intensity i.e. the speed at which prices are rising.
2. According to its cause i.e. what is causing it.

Classification of inflation according to the degree of intensity

In this classification, we consider the speed or rate or percentage at which the general price levels increase in a given period. It is measured by the consumer price index or the national income deflator. In this classification, we have:

Mild / creeping / gradual inflation: this is where the persistent increase in general price level proceeds at a slow rate usually not exceeding 10%.

Effects of creeping or mild inflation include:

- Promotes entrepreneurship.
- Encourages investment.
- Encourages effort and hard work.
- Encourages creativity and innovativeness.
- Encourages forced savings.
- Encourages productivity / Leads to growth in GDP.
- Facilitates exploitation of idle potentials, hence optimum use of available resources.
- Leads to more employment due to higher level of resource utilisation.
- Earns more revenue to the government in form of taxes.
- Helps commercialise the economy or reduces the subsistence sector.

Hyper / runaway / galloping inflation: this is where the general price level increases at a **veryhigh rate**, the increase taking place within hours, days or within few weeks, usually exceeding 20%.

Effects of hyper inflation

- Discourages savings.
- Leads to loss of confidence in local currency.
- Worsens the balance of payments position.
- Leads to high costs of production.
- Makes the government in power unpopular.
- Discourages both local and foreign investment.
- Leads to unemployment problem.
- High crime rates.
- Leads to brain drain.
- Makes planning difficult.
- Discourages borrowing due to high interest rates.

Decline in Gross Domestic Product (GDP) or economic growth due to decline investment.

- Declining government revenue.
- Generates industrial and social unrest due to competition for higher incoir -

Classification of inflation according to the causes

In this classification, we consider the initiating causes of the increase in general price level. The causes or types of inflation include:

Structural or bottleneck inflation is the persistent increase in general prices due to supply rigidities in an economy that result into shortages of goods on the market.

Or

Is the type of inflation that arises out of supply rigidities.

Or

Occurs when prices are pushed up by supply rigidities making it impossible for supply of goods to meet demand.

Causes of structural inflation

- Breakdown of infrastructure.
- Unfavourable natural factors causing failure in the agricultural sector.
- Political turmoil / instability.
- Breakdown of industrial sector.
- Shortage of inputs / raw materials to the agro-based industries.
- Speculation by businessmen.
- Foreign exchange bottlenecks.

Measures that are being taken to control structural inflation

- Improving basic infrastructure.
- Ensuring political stability.
- Undertaking agricultural modernization.
- Privatization of public enterprises.
- Further liberalization of the economy.
- Encouraging production through offering investment incentives.
- Importing raw materials from cheaper sources.
- Improving the system of marketing and distribution of goods to market places
- Conducting regular repairs and replacement of worn out industrial machines.

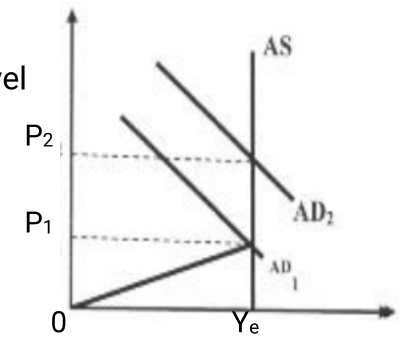
Measures that have been taken to control structural inflation

- Construction or rehabilitation of infrastructure.
- Liberalisation of the economy.
- Further privatisation drive.
- Ensure political stability / Reduction in political turmoil.
- Provisions of incentives to producers for example extend affordable credit to producers.
- Embark on efforts aimed at modernizing agriculture.

Demand-pull inflation is persistent increase in general price level arising of excess aggregate demand over aggregate supply at full employment of resources.

Illustration

Price level



Real GDP(output)

From the diagram above, an increase in aggregate demand from AD1 to AD2, occurring at full employment level of real national income results in an increase in general price level from OP1 to OP2.

Causes of demand pull inflation

- Excessive government expenditure.
- Excessive issuing of currency.
- Excessive inflows of income s from abroad.
- Uncontrolled credit creation by commercial banks.
- Increasing demand for our exports in other countries like Democratic Republic of Congo and Southern Sudan.

Possible solutions / remedies to demand pull inflation

- Increase direct taxes / increase taxes on income to reduce the consumer's disposable income.
- Reduce government expenditure.
- Increase interest rates on loans.
- Provide investment incentives to producers to encourage more domestic production.
- Adopt a restrictive monetary policy aimed at reduction of money supply in circulation.

- Reduce or controlling exports.

Imported inflation is where the persistent increase in general price levels arise from importation of goods from inflation prone countries, resulting into price increase in the domestic economy. Or

Is a type of inflation that is caused by buying of goods from a country experiencing inflation, which results into price increments in the domestic economy.

NB: When such goods are brought into the country, the importers have to sell them expensively thereby creating imported inflation.

Causes of Imported inflation

- Importation of commodities from a country experiencing inflation.
- Rising prices in the international market for example prices of petroleum products.

Possible solutions to imported inflation

- Encourage establishment of import substitution industries.
- Encourage import restriction through fixing a total ban.
- Importing goods from cheaper sources.
- Fighting the depreciation of local currency.

Cost-push inflation refers to the persistent increase in the general price level due

to a persistent increase in the average cost or costs of production.

Or

Is a type of inflation that arises as a result of increase in the costs of production.

Causes of cost push inflation

- Rising costs of raw materials / inputs.
- Rising wages by employers due to trade union pressure.
- Rising costs of energy or fuel.
- Rising rates of rent.
- Rising costs of borrowing due to increase in interest rates charged on loans by commercial banks.
- Rising rates of indirect taxes on industrial inputs.

- Rising costs of transport.
- Rising costs of improving working conditions due to trade union pressure.

An explanation of the causes of cost pushinflation

- Rising wages and salaries, Rising wages and salaries causes. Inflation when money wages rise more than labour productivity. Powerful trade unions demand for wage increases, in excess of labour productivity thereby increasing the average cost of production, employers in turn raise prices of final -products, thereby causing inflation.
- Rising cost of raw materials. An increase in prices of domestically produced or imported raw materials used as Inputs in the production of final -products leads to Inflation, increase in the price of raw materials leads to rising average costs of production. Producers offset the rise In production costs by continuously raising prices of final products thereby causing Inflation.
- Rising cost of transport. Most developing countries have poor infrastructure and units of carriage. This pushes up transport costs for raw materials, final -products and transport services. Rising transport costs
- Increase the average costs of production leading to persistent increase in the prices of final products in the market thereby causing Inflation.
- Rising cost of borrowing from banks. Due to high interest rates on capital borrowed, average costs of production persistently rise leading to rising prices of final products thereby causing Inflation.
- Rising costs of fuel. Developing countries depend on oil products and to a lesser extent electricity and solar power for energy needs. The continued dependence on imported petrol and other petrol products whose prices continuously increase leading to rising production costs. Consequently, persistent increase in the general price level.
- Rising advertisement costs. Firms usually expand their share of the market through massive advertisements (sales promotion). Resources used by firms to Increase sales, Increase production costs. The costs of sales are shifted by producers onwards to consumers in form of rising prices for the products prince Inflation.
- Rising indirect taxation. Governments In developing countries usually impose heavy taxes on Industrial Inputs as a way of raising more revenue. The increased tax rates lead to increased average costs of production. Producers shift the burden of indirect taxes onwards to consumers in form of increased prices for the products to maintain their profit margins hence continuous increase in the general price level.

- Rising rent rates. Producers hire premises to carry out production at rising rates hence rising production costs. To recover their production costs, producers persistently increase prices of final products leading to inflation.
- Rising costs of Improving working conditions due to trade union pressure. Trade unions pressurize employers for better conditions of work such as shorter working hours, better working environment, increased health, housing and other allowances. This increases production costs leading to rising prices of final products hence inflation.

Policy measures that should be taken to control cost push inflation

- Wage control; for example, reduce the work force in order to reduce costs on wages.
- Government can construct fuel reserves in the country to serve the country in times of shortages.
- Subsidisation of producers, for example, subsidise the cost of electricity supplied to industries or manufacturing firms.
- Control of interest rates, for instance, reduces interest rates on loans advanced by commercial banks.
- Reduce indirect taxes levied on industrial raw materials and spare parts.
- Non-monetary rewards to labour.
- Provision of tax holidays.
- Price control of raw material inputs.
- Rent control.
- Develop cheaper sources of energy.

Forms of cost push inflation

Wage-wage inflation refers to a situation where prices in the economy increase due to inter firm or inter sectoral comparison of wages between the workers of these different firms. The high demand for wage increase by the workers of one firm will force other workers in other firms to demand for a wage increment. This leads to increase in the cost of production in the different firms forcing them to increase the prices of their products.

Wage - price inflation refers to where increase in the demand for high wages by the workers of a firm leading to increased cost of production by the firm thus making the producer to increase the price of the final product. The increase in the price by the producers leads to increase in the cost of living, which causes the workers to demand for increase in their wages again.

Price- wage inflation refers to a type of inflation, which occurs when an increase in commodity prices leads to workers demanding higher wages resulting into a rise in prices of other commodities.

Or

A persistent increase in the general price level due to increase in the general price level that leads to persistent demand for wage increments (hence increased costs of production, increased price level and demand for wage increments again).

Measures that should be taken to control price-wage inflation in developing economies

- Maximum wage legislation.
- Maximum price legislation.
- Subsidisation of firms.
- Provision of tax incentives to firms.

Some key concepts

Headline inflation is one which is caused by rising prices of food items on the market in a given period of time.

Underlying inflation is one which is caused by rising prices of non-food items like manufactured goods, metered water, electricity etc.

Theories of inflation are the ideas developed about inflation by different economists according to the causes of inflation. They include the following

- Demand pull theory. This theory explains that inflation occurs when there is persistent excess aggregate demand over the aggregate supply of the available goods and services in an economy causing suppliers to continuously adjust prices for their products and services upwards.
- Cost push theory. This theory explains that inflation is a caused by rising production costs due to increase in wages, interest rates, indirect taxes, energy and fuel costs, prices of raw material inputs, transport costs and rent.
- Scarcity / bottleneck inflation theory. This theory explains that inflation occurs when scarcity of inputs leads to excess capacity in production hence deficiency in aggregate supply in relation to aggregate demand.
- Speculative inflation theory. Inflation that occurs when consumers expect increased prices or short falls in supply of goods in the near future thus scrambling for goods leading to shortage in aggregate supply relative to aggregate demand hence rising prices.

- Imported inflation theory. Inflation caused by importation of final and intermediate products from a country experiencing inflation. This is reflected in high prices of final products in the domestic economy.

- Structural inflation theory. Inflation caused by supply inelasticities and structural rigidities in the economy.

Open inflation is a situation in which excess aggregate demand over the aggregate supply leads to inflation due to absence of government interference with the price mechanism in resource allocation.

Suppressed inflation is a situation where demand exceeds supply but the effect of this on prices is minimised by price controls and rationing.

Or

Is one in which aggregate demand exceeds aggregate supply but the general price evel does not rise due to state interference in market mechanism through measures such as price control and rationing.

Effects (costs) of suppressed inflation

- Leads to misallocation of resources. Resources are allocated from essential goods industries whose prices are controlled to no-essential goods industries.

- Leads to malpractices such as black marketing, corruption and hoarding.

- Controls speculation in the economy.

- Discourages enterprise/ entrepreneurship.

- Leads to rising unemployment levels. There is rising unemployment due to producers laying off workers to cut costs when maximum price legislation exists.

- Discourages investment. Reduces incentive to invest due to low profits when maximum price legislation exists.

- Rising prices of uncontrolled commodities when prices of essential goods are controlled and non-essential goods are not subject to price control.

Deflation refers to persistent decrease or fall in prices of goods and services in a country.

Or

It is a situation where prices fall along with a decline in the level of output and employment.

Costs or disadvantages of deflation

- Leads to unemployment because profits fall and many firms close down due to die inability to cover production costs.
- Reduces investment because of falling prices and profits.
- Decline in government revenue from both direct and indirect taxes. This is caused by declining economic activities as firms' performance declines.
- Low rate of economic growth because of a decline in output due to declining prices and profits.
- Debtors lose because they pay back the same amount of money borrowed yet the purchasing power has increased.

Advantages of deflation

- Creditors gain because they receive back in real terms more than what was lent out due to decrease in the value of money.
- Fixed income earners gain because the value of money increases with falling prices. With the same amount of money income, one can buy more commodities

Control of deflation

Detlation can be controlled by adopting the following policies:

- Use of expansionary monetary policy which includes a reduction in bank rate, reduction in margin requirement, buying securities from government among others. These policies increase the amount of money in circulation, increase aggregate demand and stimulate economic growth.
- Use of fiscal policies like increasing government expenditure, reducing direct taxes and increasing government borrowing. These policies lead to increase in aggregate demand, investment and output.
- Increase the volume of exports.
- Reduce imports.
- Undertake minimum price legislation.
- Provision of a condusive investment climate to attract investors.

Stagflation refers to a situation where there is coexistence of high rates of inflation and high rates of unemployment in an economy. It is common in developing countries with structural rigidities like failure of investment to have desired effects such as increased output and increased employment.

Causes of stagflation

- Rapid increase in wages. This increases cost of production and forces producers to reduce output.
- Increased imports. This reduces demand for local output leading to unemployment.
- Reduction in exports. This discourages domestic production leading to unemployment.
- Increase in prices of raw materials. This increases prices of final products which are domestically produced thus reducing aggregate demand, output and employment.
- Increasing direct taxes which leads to reduction in disposable income thus decline in aggregate demand.

Adverse effects (costs) of stagflation

- Reduced savings.
- Decline in investment.
- Decline in production and thus employment levels.
- Increasing cost of living.
- Decline or fall welfare due to decreasing purchasing power.
- Worsens problems of income inequalities.
- Increased social evils.
- Increased social distress or tension.
- Reduced production in general thus low growth rates.
- Leads to balance of payment problem due to stagnant output.
- Erosion of confidence in the country's currency.

Measured aimed at reducing stagnation.

- Reduction in taxes to increase disposable income to encourage investment.
- Relaxed/ liberalized monetary policy for example reduced interest rate on capital.
- Reduction in factor input costs so as to increase output or GNP.
- Increased government expenditure so as to encourage production.

Reflation refers to a deliberate government policy to force prices upwards to recover from a depression.

Instruments of reflationary policy.

- Tax reduction/reduce taxes.
- Increase in government expenditure.
- Encouraging exports.
- Increase in wages.

Credit squeeze is where the central bank use various measures to influence economic activities by limiting the amount of money in circulation for example increasing the bank rate, selling of government securities, calling for special deposits, moral suasion etc.

Inflationary spiral refers to a situation where a persistent rise in general price levels causes a demand for higher wages to be made, which increases the cost of production leading to a rise in prices which again leads to a demand for higher wages, which induces further price increase to offset rising labour costs and to earn higher profits.

Or is refers to a situation in which a persistent rise in the general price level leads to a persistent demand fro higher wages which increases costs of production leading to increase in prices which in turn leads to increased demand fro wages and the situation goes on.

Economic stagnation

This refers to a period of static economic activities characterized by no new investments coming up, No new employment opportunities being created and constant economic growth.

Causes of economic stagnation.

- low levels of income.
- High level of direct taxes which reduces disposable incomes. Low levels of government expenditure.
- Low levels of exportation.
- Heavy debt servicing.
- Political unrest causing a decline in production due to loss of confidence ami - investors.
- High levels of importation.
- Low levels of investment due to poor investment climate in form of limited or no

incentives.

Measures taken to overcome economic stagnation

- Reduction of direct taxes.
- Increasing government expenditure on provision of public and merit goods.
- Increasing exports.
- Providing investment incentives like tax holidays, tax rebates and land allocation in order to encourage investment.
- Reducing imports so as to create demand for local output.
- Adoption of expansionary monetary policy through reducing the bank rate, buying securities from the public and reducing the legal reserve requirement.

Causes of inflation in Uganda

- Breakdown of infrastructure causing a reduction in production activities
- The breakdown of railway and road services gives rise to scarcity of commodities in many areas of the country. This is because it limits effective movement of goods from areas of production to the market. Consequently aggregate demand exceeds aggregate supply thereby causing prices to increase and finally creates inflation.
- Increased demand for exports especially in the neighbouring countries of Democratic Republic of Congo and South Sudan. There is increased demand for goods produced in Uganda in the neighbouring countries. This causes shortage in the local market thereby leading to price increase and finally creating inflation.
- Unfavourable natural factors leading to scarcity of goods. This mostly causes poor performance of the agriculture sector due to supply rigidities. Unfavourable natural conditions like a long dry spell / season, crop pests and diseases and floods greatly lead to fall in agricultural production which reduces supply of agricultural products. This creates a shortage of food items leading to a rise in the prices of food items and this causes headline inflation.
- Desire for excessive profits by business people leading to profit push inflation. Many producers / traders aim at getting abnormal profits and end up increasing prices for their products / goods even when it is not necessary to do so. This increases market prices of goods hence causing inflation in Uganda.
- Rising costs of raw materials or rising costs of production (rising wages, rising rent, rising transport costs, rising electricity bills etc). This forces the producers to react by increasing the prices for their products sold to the final consumers in order to recover money spent during the production process. This causes cost

push inflation.

- Poor political climate in some areas which limits production and destroys productive infrastructure. Political instability scares away investors, disrupts and destructs production in some areas of the country. This limits the level of investment thereby resulting into the low supply of goods and services. The supply of commodities decreases leading to aggregate demand exceeding aggregate supply. This leads to increase in price level and this finally creates inflation.

- Increasing inflow of incomes from abroad. This is in form of external borrowing , foreign investment and income from Ugandans working abroad which leads to increase in the volume of money in circulation, increased incomes and increased aggregate demand without a corresponding increase in supply in the economy thereby causing monetary inflation.

- Excessive issuance of local currency. This leads to excessive money in circulation which is not followed with an increase in production of goods and services. This consequently results into too much money chasing too few commodities. There is excessive demand for goods and services causing the prices to increase which leads to inflation.

- Excessive government expenditure on the provision of services to the people causes a significant increase in the amount of money in circulation.

- This increases the purchasing power and the aggregate demand for goods and services by the people without a corresponding increase in supply, thereby forcing prices to increase. This finally causes inflation.

- Persistent importation from inflation prone countries. As importers get goods from countries experiencing inflation, they also sell the final products in Uganda at increased prices. The importers increase prices of imported goods to recover the heavy costs of importation and to get some profits. This causes local prices to increase thereby causing imported inflation.

- Speculative behavior of businessmen for example hoarding of some goods. Expectations of future price rise or decline in supply leads to hoarding of goods and price hikes by traders as well as a rush to buy consumer goods by the population. This leads to increase in the price level which is inflationary.

Consequences of inflation in uganda

Inflation has both positive and negative consequences or effects in an economy.

Positive consequences (effects of mild inflation)

A low rate of inflation is desirable because of its merits shown below:

- Encourages effort and hard work. People are stimulated to carry out economic activities so as to earn income and be able to buy those goods whose prices are slowly rising, that is, people work hard to get money in order to meet the slowly rising cost of living.

- Promotes entrepreneurship. Mild inflation is associated with a slight rise in profits of traders. This encourages people to become risk-takers and they set up income generating businesses so that they have something to sell and get the profits.

- Encourages investment and production due to high producer profits.

- Mild inflation leads to slight increase in the profits of the producers whose goods ire being sold at slightly higher prices. Consequently, investment and production increase leading to a high Gross Domestic Product (G.D.P.)

- Encourages forced saving. During periods of gradual inflation, the government encourages the public to save using the National Social Security Fund (NSSF) contribution. This enables people to save funds for future use. The aim is to reduce money in circulation and check further increases in prices of goods and services.

- Encourages creativity and innovativeness. More producers become creative and innovative as a way of ensuring generation of maximum profits. This leads to invention of cheaper production techniques so as to lower average production costs and remain in production.

- Creates more employment due to higher level of resource utilisation. Since investors are getting high profits from the gradual inflation, they are able to expand their investments and this promotes the creation of jobs to the people.

- Encourages productivity /stimulates economic growth/ increases the level of output thereby promoting growth in GDP. This comes out of the production of more goods and services by people who want to benefit from mild inflation.

- Generates more revenue to government in form of taxes. As a result of slow increase in prices of commodities, business companies earn profits. Such profits are taxed and the tax revenue generated is used to provide essential services to the people.

- Facilitates exploitation of idle potentials hence optimum use of available resources. Mild inflation promotes investment which leads to increase in production and this makes the businesses to increase on resource use. These resources that are put to use would have remained idle.

- Helps commercialise the economy or reduces subsistence sector. Mild inflation encourages increased production for the market because of the high profits generated by producers. This helps to reduce the size of the subsistence sector.

- Leads to high business profits. High profits are realised at the time of mild inflation. This increases the capital base of the producers because parts of the profits are re-invested.

- Debtors (borrowers) stand to gain in real terms. At the time of borrowing, the value of money is still very high and the borrower uses the money to buy more goods from the market. However, by the time the borrower pays back the money, its value will have gone down but he or she would have gained in real terms.

- Encourages labour mobility. Due to the rising cost of living, workers sir to find better paying jobs or occupations. Therefore, they move from the low paying jobs to higher paying jobs which leads to occupational mobility of labour

- Encourages the adoption of import substitution strategy of industrialisation. Domestic industries are developed or set up to increase local production of commodities in order to check imported inflation.

Negative consequences of inflation (effects of hyper inflation)

A high rate of inflation known as hyper inflation is undesirable because of it-demerits shown below:

- Discourages savings due to rapid loss of money value. A rapid loss of money value reduces voluntary savings among people by creating fear of the very high rate at which money is losing value. If money is saved, it is of little use in the future when its value is low.

- Worsens balance of payments problem. This is because a high rate of inflation makes our exports less competitive on the world market and imports become cheap and more competitive in the home market. This reduces the foreign exchange earnings from exports and increases foreign exchange expenditure thus causing a Balance of Payments problem.

- Leads to brain drain as people look for jobs in other countries with low inflation. Highly trained people or professionals migrate from a country with hyper-inflation to look for jobs in other countries where the cost of living or cost of goods and services is lower. This leads into loss of highly skilled manpower from the economy experiencing hyper-inflation to an economy where incomes are higher and stable which slows down the process of development.

- Lending is discouraged as creditors stand to lose. This is because the lender gets back their money from the borrower when it has a lower value than that at which it was borrowed. That is why commercial banks are reluctant to lend money to people. A reduction in lending reduces investment or production.

- Worsens problem of income inequalities. Hyper-in flat ion benefits greatly the businessmen as they earn more income by selling goods at very high prices. Their income becomes higher than of people receiving fixed income. This creates income disparity among people engaged in various occupations.

- Causes unpopularity of government. People during hyper inflationary period blame the government for the socio-economic hardships they are faced with. Hyper-inflation makes the people frustrated because of the rise in value of goods and services on their fixed incomes. This frustration causes political tension and makes the people to take up arms, rebellions and riots against the government hence distabilising peace and security.

- Leads to loss of confidence in the local currency. A very high rate of inflation makes money to lose its function as a store of value and the public resorts o use of barter trade.

- Strains the people due to long hours of work as they strive to cope with the rising cost of living. People tend to forego leisure in order to engage in income generating activities to supplement what they are currently earning. This greatly lowers the welfare of people because they have less time to rest and they become physically and mentally strained.

- Makes planning by government difficult. Due to hyper-inflation the money previously set aside to be used to finance development projects becomes inadequate. This makes the government to abandon the implementation of some development plans hence limiting economic growth.

- Leads to unemployment as firms close down. Due to hyper-inflation production costs rise at a high rate as some firms find it difficult to continue producing hence unemployment.

- Fixed income earners suffer as real income falls. The individuals who earn fixed incomes suffer greatly due to the rising cost of living. They continue to earn the same amount of income yet the price of goods and services are rising at a high rate. Hyper-inflation greatly reduces the purchasing power of their fixed incomes.

- Reduces production or discourages investment due to rising costs. Hyper¬inflation increases production costs at a very high rate. This ultimately reduces investment levels and less goods and services are produced.

- Production and consumption of poor quality goods due to inefficiency of firms. Firms become increasingly inefficient during periods of demand-pull inflation. Since the competitive pressure to improve both product and performance are greatly weakened, many producers simply produce output without paying attention to improvement on the quality of the output. This has a danger of lowering the standards of living of the people.

- Generates industrial and social unrest due to constant demand for high wages.

This arises because trade unions begin to agitate for an increase in wages of their members during periods of hyper-inflation. The trade union leaders may organize sit down strikes to increase wages of their members and this creates industrial unrest.

- Capital outflow is accelerated as foreign investors fear to re-invest their profits in inflation hit country. Hyper-inflation encourages capital flight as foreign investors repatriate their profits to the mother countries. This greatly reduces the multiplier effects of foreign investment.

- Decline in economic growth rate. The high costs of production during periods of hyper-inflation cause production firms to reduce output as some fir may close down. A reduction in production of goods and services greatly lowers the rate of economic growth hence a fall in Gross Domestic Product.

- Encourages speculation. This is because it encourages purchase of real assets by borrowing rather than investment by use of resources in production. It discourages investment in long term projects because of fear of possible government anti-inflationary policies. This prompts business people to demand money to invest in anticipation of economic windfalls rather than business profitability.

- Encourages illegal activities such as corruption, bribery and prostitution leading to a rise in crime and immorality. People look for possible opportunities of supplementing their income through unlawful means so that they get additional money which can make them survive amidst the high cost of living caused by hyper-inflation.

Objectives of fighting inflation in an economy

The reasons why government strives to control inflation or maintain low rate inflation in Uganda are thus;

- To reduce Balance of Payment problem. Inflation makes exports expensive and imports cheap and competitive in the home market which leads to balance of payments problems. Therefore, government strives to ensure stable prices at home in order to encourage a rise in exports and a decrease in imports which ensures improved Balance of Payments position.

- To build confidence in the local currency. During inflation, money loses value within a short time thereby requiring people to carry large sums of money even for small transactions. Therefore, the government tries to control inflation to ensure that money begins to effectively perform its functions as a store of value and medium of exchange hence avoiding loss of confidence in the local currency.

- To encourage savings in the country. By maintaining a low inflation rate, the government aims at avoiding the constant loss of money value overtime which is a disincentive to savings. Therefore, controlling inflation ensures stability in the money value which induces people to save part of their incomes for future use.

- To reduce costs of production so as to encourage production/ investment. This is because a low rate of inflation increases the profits and stabilises the costs of factor inputs for the purposes of increasing investment and the volume of production.

- To reduce income inequality. Inflation erodes the incomes of the salaried or fixed income earners more than the incomes of the traders because the traders have holdings of real income generating assets which appreciate with increase in general price level. Therefore, government tries to maintain a low rate of inflation for purposes of controlling income inequalities between the salaried workers and the businessmen / traders.

- To minimise illegal or evil activities. During hyper-inflation, people indulge in immoral activities because of low incomes and general economic hardships that make people to use unlawful means for survival. Therefore, the government strives to control inflation so as to control social evils like prostitution and malpractices like corruption, smuggling, black marketing and hoarding that are associated with shortages of goods.

- To minimise / reduce / control unemployment. This is because maintaining a low rate of inflation stimulates investment and production as firms are able to meet production costs thereby creating more employment opportunities.

- To minimise / control brain drain. During hyper inflation, skilled labourers of a country migrate to countries where incomes are higher. Therefore, government tries to control the rate of inflation to enable the professional skilled labour to remain in the country and take on the expanded wage employment opportunities.

- To encourage lending by creditors. Inflation is controlled in order to keep interest rates low and stable which avails more funds and increases the rate of borrowing for investment purposes. The stable interest rates increase the profitability of businesses and act as an incentive to increased investment in an economy.

- To make effective planning possible. High rates of inflation make the amount budgeted for planning inadequate due to continuous increase in the general price level. Therefore, government strives to control inflation to ease / facilitate planning because the different sectors or projects become feasible to implement due to the stability in costs of inputs and the possibility of meeting the financial targets.

- To improve the standard of living by increasing consumption. This is because there is increase in aggregate demand for goods due to the stability in prices thereby increasing consumption of commodities in the economy.

- To minimise speculation. This is because there is reduced uncertainty in business activities. As a result, business people are encouraged to invest in long term projects because of their profitability.

- To minimise industrial unrest. High rates of inflation generate industrial and social unrest since there is competition for higher incomes which forces trade unions to ask for wage increases. Therefore, maintaining a low rate of inflation ensures that there is continuity in the production process as labour strikes are avoided due to the low rates of inflation experienced following government intervention.

- To avoid overstraining the people. During high rates of inflation, people stram due to long hours of work under difficult conditions due to need to catch up with the ever rising cost of living. Therefore, government tries to maintain a low rate of inflation to ease the working hours for the people and reduce tendencies of overstraining in terms of long hours of work that are common when high rates of inflation are experienced.

- To make government in power popular to the masses. During periods of hyper-inflation, people blame government for the socio-economic hardships they are faced with which forces some to think of illegal means of removing the current government. Therefore, government comes in to control inflation to reduce cases of frustration, misery and hopelessness among the population, thereby easing mobilisation of people in supporting development programmes in the country.

Circumstances under which inflation may be desirable in an economy

- When it promotes economic growth. The existence of mild inflation encourages producers to increase output in order to sell more goods and service to make higher profits. The increase in output brings about higher levels of economic growth thereby making inflation to be desirable in an economy.

- When it results into the increase in profits of producers. An increase in general prices, during periods of inflation producers earn more profits and this makes inflation to be desirable to producers in an economy.

- When it stimulates invention and innovations through encouraging hard work. During periods of inflation, the cost of living increases. This makes the public to be creative and hardworking so as to receive money and be able to survive amidst inflation. Many people become enterprising and are ready to take on risks in business hence making inflation to be desired.

- When there is need to stimulate investment. Since producers desire to make more profits during periods of inflation, they expand their investment. As a result resources are put to better use thereby making inflation to be desired in an economy.

- When government wants to increase the tax revenue. Inflation is desirable so as to raise more revenue to the government in form of taxes so as to fund her development expenditure.
- When there is need to expand the market or demand for goods and services or when it stimulates aggregate demand. As people expect prices to continue rising in the future, they buy more goods during the current period. This increases the aggregate demand for goods. Producers are able to increase the volume of sales and they earn more profits thereby making inflation desirable in an economy.
- When it encourages labour mobility in an economy. Due to inflation, labour shifts from low paying jobs to higher paying jobs and this gives rise to occupational mobility of labour. In such a situation inflation becomes desirable in an economy.
- When there is need to reduce voluntary unemployment among people. Inflation increases the cost of living and this forces people who would not have taken up jobs to get into active employment because they need to earn income to survive amidst the high cost of living.
- When it is used by the government as a means to increase forced savings. The existence of inflation may compel the government to encourage people to start saving their income thus compulsory saving schemes.
- When it is necessary to revive an economy from a depression or recession or slump. When mild inflation exists in an economy, it encourages producers to increase production. Incomes of producers increase and they are able to undertake more investments. This may pull an economy out of a depression and thereby inflation becomes desirable.
- Where excess capacity or unutilised potentials exist so that it stimulates increased output. This is because a low rate of inflation facilitates use of the idle resources which leads to increased production of goods and services.

Policy measures which are being undertaken to control inflation

Policy measures which are being undertaken to reduce/ control inflation in my country:

- Increasing direct taxes or increasing taxes on incomes. By increasing direct taxes, people's disposable incomes are reduced. Aggregate demand is thereby reduced and this helps to keep the prices stable hence controlling inflation.
- Reducing government expenditure on non-essential goods. Government is trying to implement tight budgetary expenditure controls on non-essential goods. This action is assisting the government to reduce money supply and aggregate demand hence checking inflation.
- Further liberalisation of the economy. Controls on trade are being relaxed by the government. This policy is encouraging investors to produce more goods and

services. As more goods and services become available on the market, inflation is checked.

- Providing incentives to investors or improving investment climate. By providing tax holidays and other incentives to investors, investment is being expanded. As a result more goods and services are being produced in Uganda hence making prices to be stable.

- Developing infrastructure. Improved road network is facilitating the deliver; of goods to market places to eliminate scarcity or shortages. This helps to keep prices stable in the country hence checking or reducing inflation.

- Implementing a restrictive or contractionary monetary policy. The government is embarking on the selling of treasury bills and government bonds w the general public. This is helping government to reduce money supply which finally reduces demand and prices of goods and services are reduced.

- Controlling issuance of currency. The central bank on the instructions of the government is regulating the volume of money in circulation. As a result of the aggregate demand is reduced hence helping to keep prices relatively stable.

- Modernising of agriculture to increase supply of food items in the country. By modernising agriculture, there is an increase in production of food items in Uganda. As food items become available on the market, prices become stable thereby reducing headline inflation.

- Further privatisation of public or state enterprises. Privatization of public enterprises is resulting into increased volumes of goods and services supplied on the market. This is eliminating scarcity of commodities on the market hence making prices to be relatively stable.

- Encouraging importation of goods from cheaper sources. This policy helps to avoid buying goods from countries hit by inflation hence checking imported inflation.

- Improving the political atmosphere or climate. By ensuring political stability, investment in industries, agriculture and other sectors is also promoted or expanded. More goods and services are produced. This reduces scarcity of goods thereby controlling inflation in Uganda.

- Reducing government borrowing from the Central Bank. Money supply is reduced and there is a fall in the people's purchasing power and aggregate demand. This keeps prices stable hence controlling inflation.

- Encouraging the establishment of import substitution industries. These industries are now producing more consumer goods that were formerly imported. This is minimising the possibility of importing goods from countries experiencing inflation since these goods are now produced locally within Uganda.

- Encouraging the use of instruments of credit by the public. The use of instruments of credit like cheques, bills of exchange, and promissory notes is being encouraged by financial institutions to reduce the volume of cash transactions. This reduces the volume of paper notes and coins in circulation. This checks aggregate demand and inflation is reduced.

NB: Instruments of credit are (written or typed) financial documents that serve as either promises to pay or as orders to pay. For example cheques, bank drafts, credit cards, promissory notes, bills of exchange and bank notes.

Measures that should be taken to reduce inflation

Measures that should be taken to reduce inflation in my country:

- Direct taxes should be increased. Direct taxes can be increased to reduce disposable incomes of people. This can reduce aggregate demand for goods and services and inflation can be reduced or checked.

- Government expenditure on provision of non-essential goods should be reduced. The government can try to reduce her expenditure on non-essential goods. This can assist the government to reduce money supply as well as aggregate demand and this can reduce inflation in Uganda.

- Further liberalisation of the economy can be undertaken. Controls on trade can be relaxed by the government to allow many investors to produce more goods and services. More goods may become available on the market and inflation can be reduced in Uganda.

- Government should control issuance of currency. The government can instruct the central bank to regulate the volume of money in circulation. As a result of this, aggregate demand can be reduced and this may help to keep prices relatively stable.

- Tax incentives should be provided to investors to increase output / investment climate should be improved. Tax holidays and other incentives should be provided to investors so that more goods and services can be produced in Uganda. This can make prices of goods and services stable and inflation can be reduced.

- Infrastructure should be improved. The road network, rail services, and age facilities should be improved to facilitate easy delivery of goods to market places. This can eliminate scarcity of goods in many areas of Uganda. Prices can become stable and inflation may be reduced.

- Modernisation of agriculture should be undertaken to increase supply food items in the country. As food items become more available on the market, prices become stable thereby reducing headline inflation.

- Contractionary / restrictive monetary policy for example sale of government securities should be implemented through the Central Bank. The government can sell treasury bills and bonds to the public. This can help government to reduce money supply which finally reduces aggregate demand and inflation may be reduced

- Further privatisation of state enterprises should be undertaken. Privatization can result into production and supply of more goods and services on the market. This can eliminate scarcity of commodities on the market. Prices can become relatively stable and inflation can be controlled.

- Use of instruments of credit should be encouraged. The use of instruments of credit like cheques, Bills of exchange and promissory notes can reduce the volume of cash transactions. This may reduce paper notes and coins in the hands of the public. Aggregate demand may reduce or fall and this can reduce demand pull inflation.

- Importation of goods from cheaper and friendly countries should be encouraged to reduce imported inflation. The government can identify cheaper sources from which importers may buy goods to be supplied on the Ugandan market and this can help to check imported inflation.

- The political climate / atmosphere should be improved. A stable political climate can encourage and motivate investors to produce more goods and services in Uganda. This can reduce scarcity of commodities and inflation can be controlled since prices become stable.

- Government borrowing from the central bank should be reduced. A reduction in government borrowing from the central bank can reduce the amount of money in circulation. This can reduce the purchasing power of the people and aggregate demand. This may keep prices of goods and services stable and inflation can be reduced.

- Indirect taxes on essential goods should be reduced. This can make such goods to be cheaper on the market and this can reduce inflation in Uganda.

- Exports of some goods should be controlled. This can make goods to be more available on the local market in Uganda and this can reduce inflation.

- Import substitution industries should be established. These industries can produce consumer goods that were formerly imported from other countries. This can help Uganda to avoid importing goods from those countries experiencing inflation and this may eliminate or reduce imported inflation.

Measures that have been taken to reduce inflation

Measures that have been taken to reduce inflation in my country are thus:

- The government has tried to levy high direct taxes on peoples' incomes.
- By increasing direct taxes, people's disposable incomes have been reduced. Aggregate demand has thereby reduced and this has helped to keep the price - stable hence controlling inflation.
- The government has tried to promote modernised agriculture. By modernising agriculture, there has been an increase in production of food items in Uganda. As food items become available on the market, prices become stable thereby reducing headline inflation.
- The government has tried to reduce her expenditure on provision of non¬essential goods and services. Government has tried to implement tight budgetary expenditure controls on non-essential goods. This action has assisted the government to reduce money supply and aggregate demand her checking inflation.
- The government has tried to maintain political stability in most parts of the country. By ensuring political stability, investment in industries, agriculture and other sectors has been promoted or expanded. More goods and services have been produced. This has reduced scarcity of goods thereby controlling inflation in Uganda.
- The government has tried to undertake liberalisation of the economy. Controls on trade have been relaxed by the government. This policy has encouraged investors to produce more goods and services. As more goods and services become available on the market, inflation has been checked.
- The government has tried to undertake the privatisation of state enterprises. Privatisation of public enterprises has resulted into increased volumes of goods and services supplied on the market. This has eliminated scarcity of commodities on the market hence making prices to be relatively stable.
- The government has tried to sale government securities like treasury bills. The government has embarked on the selling of treasury bills and government bonds to the general public. This has helped government to reduce money supply which finally has reduced demand and the prices of goods and services.
- The government has tried to undertake wage freeze and consolidate allowances. This has been done to reduce the purchasing power of those in high income brackets so as to control inflation.
- The government has tried to carry out a currency reform. The central bank on the instructions of the government carried out a currency reform in 1987 which regulated the volume of money in circulation. This involved the issue of a new

currency to replace the old currency. As a result of this aggregate demand was reduced hence the action helped to keep prices relatively stable.

- The government has tried to encourage the use of instruments of credit. The use of instruments of credit like cheques, bills of exchange, and promissory notes has been encouraged by financial institutions to reduce the volume of cash transactions. This has reduced the volume of paper notes and coins in circulation. This has checked aggregate demand and inflation has been reduced.

- The government has tried to encourage increased importation from cheap and friendly sources like China. This policy has helped to avoid buying goods from countries hit by inflation hence has checked imported inflation.

- The government has tried to encourage the development of infrastructure. Improved road network has facilitated the delivery of goods to market places to eliminate scarcity or shortages. This has helped to keep prices stable in the country hence has checked or reduced inflation.

- The government has tried to provide tax incentives to investors. This has been through provision of tax holidays, free land allocation and low interest loans to investors to reduce the cost of production. This has resulted in high production levels and stable prices.

Policy instruments for controlling inflation - a summary

Policy instruments for controlling inflation in my country include:

- High direct taxes. Increasing taxes on incomes reduces the disposable incomes and reduces consumer demand hence controlling inflation.

- Controlled government expenditure. Reduction of government expenditure on provision of non-essential goods and services which reduces the volume of money in circulation hence controlling inflation.

- Frequent selling of securities. The sale of government securities to the members of the public is the most effective tool of reducing the volume of mor\ in circulation in developing economies.

- Currency reforms. Inflation is controlled by withdrawing old currency from circulation and issuing new currency which is more stable so as to restore public confidence in the value of money.

- Liberalisation of the economy. This is done by giving investors the liberty :: trade with a large measure of freedom so as to encourage investment, increase supply of essential goods and meet aggregate demand.

- Privatisation drive. The sale of public enterprises to profit driven private investors leads to increased supply of goods and services and controls demand driven inflation.

- Improved infrastructure. Construction of infrastructure and rehabilitation of existing ones facilitates movement of goods and services thereby overcoming structural rigidities that limit supply and cause structural inflation.

- Controlled issuing of currency. The avoidance of outright printing of un¬backed currency, avoids increasing the volume of money in circulation which would have increase aggregate demand leading to inflation.

Ways in which the tools of monetary policy are applied to control inflation in Uganda

The Central Bank uses the restrictive monetary policies to control the rate of inflation in the country. This may take any of the following:

- Sale of government securities, for example, sale of treasury bills and bonds. As a measure to decrease money supply in circulation, the central bank sells securities to the general public and withdraws money from circulation. This helps to fight inflation.

- Increasing or raising the bank rate. An increase in the charge by the central bank on loans given to commercial banks discourages the commercial banks from borrowing money. The commercial banks therefore, increase the interest rates on the loans given to their customers/ borrowers thereby reducing money supply in circulation. This helps to fight inflation.

- Implementing selective credit control. This involves the central bank giving directives concerning the sector to be given priority when allocating credit / loans. Therefore, commercial banks give loans to some specific sectors of importance /priority and deny other sectors form acquiring loans so as to reduce money supply in circulation. This helps to fight inflation.

- Increasing or raising the variable reserve requirements / increasing cash and liquidity ratio. The central bank increases the variable reserve requirement which reduces the funds available for lending to the public. This ultimately reduces money supply in circulation and this helps to fight inflation.

- Embarking on moral suasion. This involves persuading the commercial banks about the dangers of too much money in circulation. The commercial banks are thus persuaded to restrict lending so as to reduce money supply in circulation. This helps to fight inflation.

- Calling for special deposits / Supplementary reserve requirements. These are deposits the central bank demands from the commercial banks on top of the legal reserve requirement as a short term measure of reducing money supply in circulation. By putting in place a special deposit on top of the legal reserve requirement, the central bank helps to reduce money supply in circulation. This helps to fight inflation.

- Rationing of credit. This is a policy where the central bank fixes a maximum amount of money commercial banks can lend so as to reduce the amount of money in circulation. The central bank therefore, encourages the control of allocation of loans or credit to avoid some sectors from over borrowing money from the commercial banks so as to reduce money supply in circulation. This helps to fight inflation.

- Increasing the margin requirement. This involves increasing the value of the collateral security pledged against the loan advanced by commercial banks. By increasing the margin requirement, people are discouraged from borrowing money from commercial banks so that money supply is limited. This helps to fight inflation.

- Increasing the minimum legal reserve requirements. This involves increasing the minimum amount of money, commercial banks are supposed to keep with the central bank by law. By increasing the legal reserve requirement, the commercial banks are left with limited amount of money to lend out to the general public. This reduces the money supply in circulation and helps to fight inflation.

- Undertaking currency reforms. In times of excess liquidity, the government through the central bank, can organize for a change of currency (replacement of the currency with a new one) so as to increase the value of local currency by having a manageable volume of money in circulation. For example the 1987 currency reform in Uganda was a measure aimed at fighting the triple digit inflation during that period.

Theoretical relationship between unemployment and inflation

- High level of unemployment leads to decrease in output hence aggregate demand exceeding aggregate supply hence inflation.

- In order to control unemployment measures to increase investment are undertaken. The measures lead to increase in money in circulation hence increase in aggregate demand and inflation.

- High levels of inflation prompt producers to lay off workers to cut production costs leading to unemployment.

- High inflationary rates prompts the use of contractionary monetary policies, increased direct taxation and reduced government expenditure which results in reduced aggregate demand, investment and unemployment.

- Both high levels of inflation and unemployment lead to increased crime rates.

- Both high levels of inflation and unemployment lead to reduced government revenue.

- Beth high levels of inflation and unemployment lead to rural-urban migration.
- Both high levels of inflation and unemployment lead to unpopularity of government.

Policies aimed at checking inflation may result into increased unemployment problem because of the following reasons:

- High taxation may reduce demand and therefore investment hence reduced employment creation.
- High bank rates result into reduced borrowing and thus reduced investment. This reduces the employment of factors of production.
- Selling securities by government to the public reduces aggregate demand resulting into reduced investment thus unemployment rate increasing.
- Reduced government expenditure means reduction in the use of factors of production thus rendering these factors idle.
- Selective credit control implies financing a limited range of activities and this may also increase unemployment problem instead of solving it.
- Use of special deposits implies limited loanable funds by the commercial banks and thus reduced investment. This results into low employment creation.
- Setting of maximum price, which discourages production, renders the factors of production idle in the factor market thus, unemployment.
- Commercial policies like setting quotas and regulation of volume of trade may discourage production and the employment of factors of production.
- Privatisation through divesture may result into unemployment in the short run.

Revision questions

Section A

i. Distinguish between deflation and inflation.

ii. Mention two effects of galloping inflation.

iii. Differentiate between creeping inflation and galloping inflation.

iv. State two effects of creeping inflation.

v. Distinguish between structural inflation and demand pull inflation.

vi. Give any two causes of structural inflation in your country.

vii. Differentiate between deflation and reflation.

viii. Mention any two instruments of reflationary policy in an economy.

ix. Differentiate between cost push and structural inflation.

x. State three causes of cost push inflation in your country.

xi. Differentiate between deflation and reflation

xii. State any two instruments of reflationary policy

xiii. Define structural inflation

xiv. Suggest three possible remedies to alleviate structural in an economy

xv. Define the term structural inflation.

xvi. Mention three causes of structural inflation in your country,

xvii. Define the term "cost push inflation"

xviii. Mention any three causes of cost push inflation in your country

xix. Distinguish between 'price-wage inflation' and 'demand-pull inflation'

xx. Suggest two measures that should be taken to fight price-wage inflation in developing countries

xxi. Define the term "cost push inflation"

xxii. Mention any three causes of cost push inflation in your country

xxiii. Distinguish between 'price-wage inflation' and 'demand-pull inflation'

xxiv. Suggest two measures that should be taken to fight price-wage inflation in developing countries.

Section B

1. (a) Examine the causes of inflation in developing countries.
2. (b) Assess the consequences of inflation in your country.

(c) What are the causes of inflation in your country?

3(a) Suggest measures to check inflation in your country.

(b) Why may the government of your country induce inflation?

4(a) Distinguish between imported inflation and structural inflation.

(b) Assess the impact of inflation in your country.

5(a) Distinguish between demand pull inflation and scarcity inflation.

(b) Explain the measures that have been taken for the control of inflation in your country.

6(a) Account for the persistent inflation in your country.

(b) Discuss the measures being taken to solve the inflation problem in your country.

7(a) Distinguish between creeping inflation and hyper inflation,

(b) Explain the instruments used by the central bank to control inflation in an economy.

8(a) Examine the effects of galloping inflation in an economy.

(b) Discuss the measures that have been taken to control inflation in your country.

9(a) What is meant by "demand pull inflation"?

(b) Assess the impact of inflation on the economy of your country

10(a) Assess the effects of inflation in your country

(b) Discuss the measures that have been taken to control inflation in your country

8 (a) What is meant by "demand pull inflation"?

(b)Assess the impact of inflation on the economy of your country

11(a) Assess the effects of inflation in your country.

(b) Discuss the measures that have been taken to control inflation in your country.

12 (a) What are the causes of inflation in your country?

(b) Examine the consequences of the inflation in your country.

13(a) Distinguish between suppressed inflation and hyper inflation.

(b) To what is inflation in your country a result of increased costs of production?

14(a) Account for the persistent inflation in your country.

(b) Discuss the measures being taken to control inflation in your country.

15(a) Why may inflation be undesirable?

(b) Explain the measures that may be taken to control inflation in your country.

16(a) Examine the causes of inflation in your country.

(b)Discuss the policy measures undertaken to control inflation in your country.

17(a) Distinguish between demand-pull inflation and cost-push inflation.

(b) Why does goverment of your country strive to keep a low rate of inflation?

18(a) Distinguish between stagflation and suppressed inflation.

(b) Under what circumstances may inflation be desirable in an economy.

19(a) What are the objectives of monetary policy in your country?

(b) Explain the factors that limit the effectiveness of monetary policy in your country.

TOPIC 9: ECONOMIC DEVELOPMENT PLANNING

Meaning

Economic development planning is a deliberate effort of influencing a s principle economic variables such as incomes, consumption, savings investment to achieve specific objectives of national development within a specific time.

OR

It is a deliberate government effort to formulate decisions on how productive resources shall be allocated among different uses in order to attain targeted economic objective over a given period of time.

OR

It is a deliberate, conscious and attempt (effort) by the state to formulate decisions on how the factors of production shall be allocated among different uses or industries, thereby determining how much of total goods and services shall be produced during the coming period.

OR

It is the deliberate act by government to influence, direct and control economic variables / activities so as to achieve objectives of development.

Economic plan a written document containing government political decisions on how the resources shall be allocated among different uses in order to attain a targeted rate of economic growth. Thus an economic plan is a set of quantitative economic targets to be achieved in i stated time period combined with strategies or measures or policies designed to main the set objectives in the given time period.

Development plan is the documentation by a government planning agency he recurrent national economic conditions, public expenditures, likely development in the private sector, a macro-economic projections of the economy ,and review of government policies.

Macro planning or direct planning -a type of planning in which the central authority has a direct control over resource and management of implementation of projects in the plan as is always the case with socialist countries.

OR planning by a central authority that covers all the sectors of the economy.

A **macro plan** is one which covers the entire (whole) economy or all sectors of the economy.

Comprehensive planning that covers all the sectors of the economy.

OR

An economic planning that sets a target to cover all major sectors of the national economy.

Reasons for comprehensive planning in my country include;

- To ensure proper utilisation of resources.
- To correct deficiencies in the price mechanism.
- To identify areas suitable for public and private in vestmentfs)
- To distribute income equitably.
- For resource mobilisation.
- To determine / influence economic growth rate.
- To solve unemployment problems.
- To attain and maintain price stability / to control inflation.

- To correct BOP problems/ improve BOP position.
- To solicit for foreign aid.
- To encourage public participation in the development process,
- To relate present activities to future trends.

Indicative planning is where government **identifies appropriate invest areas** and **provides incentives** and **required information** to **individual economic** units to **achieve pre -determinedforecast and targets.**

Or

Is a process where the government draws plan targets and pro\. conductive political , social and monetary policies to guide the individuals in the private sector but it does not directly participate in implementation ,for example in capitalist society.

Or

Planning by the central authority by which the private sector is through conducive economic policies without direct government participation in production.

Perspective planning refers to **long term**planning covering a period of **ten years**

A deliberate effort of influencing a nation's principle economic variables such incomes, consumption, saving and investment to achieve specific objectives of national development over a long period of time.

The factors limiting perspective planning in my country;

- Limited information or data
- Natural hazards
- Limited skilled labour / poor planning machinery / weak administrative and technical staff
- Limited government commitment / lack of political will.
- Difficulty in identifying viable projects.
- Limited financial resources
- Corruption (on the paid of planners) dependence on external resources n are uncertain, tied and inadequate.
- Non responsive private sector
- Political instability

- Price instability / high level of inflation
- Over ambitious planning
- Political interferences
- Conservatism / lack of will by the people

Planned economy -an economic system in which the key economic functions what , how and form to produce are principally in satisfaction of merit wants not profit maximisation.

Unplanned economy (laissez faire economy) is an economic system in which resources are mainly owned by private individuals and resource allocation is by market forces of demand and supply.

Decentralised planning at a regional or sectoral level for example district and county. These plans are incorporated into the central government plan.

Centralised planning refers to planning by a central authority and encompasses (includes) all sectors of the economy (see also planned economy)

Project planning refers to planning of projects. Or it refers to project by project planning.

Micro planning refers to planning for a specific sectors or section or region of the economy such as district agriculture or industry.

A **micro plan** is one which covers part or a section or sector of the economy.

Sectoral planning refers to planning for a specific sector of the economy such as agriculture industry ,tourism and forestry.

Ambitions plans refer to plans which require more resources for their implementation than the available resource can allow.

The contents or components of a plan

The following are what makes up a plan;

- A situation analysis which gives a detailed statistical economic and social standing of the economy or sector on which to base the plan.
- The objectives and targets to be achieved within a stated period of time.
- The available resources in the economy on which to base the plan. A realistic and viable plan should be based on the existing resources.
- The source of funds needed to implement the plan. This could be form internal or external sources or both.
- The coverage of the plan that is whether it is covering a particular project or

sector or the entire economy.

- The duration of the plan implementation. It should be indicated whether the plan is short term, medium or long term.
- The policy or plan strategy to be employed in plan implementation. These are a set of economic measures and administrative controls to be employed in order to achieve the set plan objectives.
- The planning machinery to be employed in the plan process should be outlined. This may include a planning committee or the ministry of planning which undertake the planning process.

The rationale (or need or reasons) for economic development planning in developing countries

- Scarcity of resources thus need for proper utilisation. Resources such as capital , skilled labour and land are scarce relative to the demand for their. Planning is necessary in order to put the resources to the best possible so as to optimize their utilisation.
- To correct deficiencies (defects) in the price mechanism especially in responding to circumstances requiring rapid structural changes. Pr :: mechanism does not adequately provide for social and economic over heads requiring huge capital investment provision for emergencies such as wars and natural disasters under which victims have no purchasing power and harmonious development of all sectors of the economy .Al these require proper planning that cannot be undertaken by individuals firms hence need for centralised planning.
- To identify areas suitable for public and private investments. Economic development planning enables government to identify sectors which are highly profitable and attractive to private investors and areas that are unprofitable but essential for a country's development such as provision infrastructure and merit goods hence such as areas are identified as suitable for public investment.
- To distribute income equitably / to reduce income inequalities. Under the price system wealth and incomes are distributed in favour of sectors that produce the most demanded for goods for goods thus income inequality between individuals, sectors and regions. Through planning income inequality reduced by measures such as progressive taxation and subsidisation of the poor, induced simultaneous investment in all the sectors of the economy provision of affordable capital for investment to the poor etc.
- For resource mobilisation. Planning enables the government mobilise resources through sources of public revenue such as taxation borrowing, licensing, fines and fees .These financial resources enable government to meet her recurrent and development expenditure needs.

- To determine the rate of economic growth. Planning enables government to set growth target and carry out measures to achieve targeted rates of economic growth for example provision of attractive tax incent so as to stimulate investment. Increased investment leads to increased output hence economic growth.

- To solve unemployment problem. Developing countries experience widespread unemployment and under employment. Capital being scarce and labour being abundant ,the problem of providing gainful employment opportunities to an ever increasing labourforce is a difficult one. Through planning, private investment can be induced and public investment undertaker to create employment for the masses. Manpower planning policies are also under taken to match labour supply with labour demand and limit unemployment problems caused by disproportionate supply of labour to certain occupations.

- To attain and maintain price stability or to control inflation. Planning is done to attain stability through measures such as reducing government planned expenditure and increasing direct taxation to reduce aggregate demand. Measures to stimulate production, increase aggregate supply and contain inflationary pressure. During a deflation government reduces taxes to increase disposable income and undertakes expansionary monetary policy to increase aggregate demand and stimulate economic activities.

- To solicit for foreign aid. Economic development planning enables government to show potential donors short falls between expected revenue as well as how aid is to be utilized when acquired .This is done to convince donors to part with funds to be used in the implementation of projects in the economy.

- To encourage public participation in the development process. Planning makes it possible for members of the public to be involved in the process of development of the national economy by showing them their role in plan formulation and plan implementation. Planning also enables the government to solicit political support by showing the masses government programmes aimed at improving citizens welfare as well as government successes in managing the economy. Planning can therefore, be used as an instrument for appealing to the electorate to maintain the existing regime in power.

- To reduce external dependence. Planning enables the country to reduce dependence on external resources by raising revenue locally to avoid borrowing from abroad , training labour locally to reduce dependence on imported labour, import substitution industrialization to reduce dependence on imports and diversification of the economy to reduce sectoral dependence.

- For harmonious and consistent use of resources. Planning leads to harmonious use of resources by avoiding duplication of projects that have similar objectives. It also ensures consistency in the use of available resources by ensuring that planned targets are in line with the available resources.

- To relate present activities to future trends /targets. Planning makes sequencing of projects possible. Through proper planning projects that produce outputs to be used as inputs by other projects are implemented first. For example, an industrial based long term plan requires setting up projects in the long run to produce raw materials for industries yet to be established. This way, present activities are linked with future activities.

Problems encountered in the formulation of development plans

- Limited data or information. Statistical data that are available are inaccurate and in some cases lacking due to poor record keeping. Availability of information is also limited due to reluctance by people to give information of their bio-data, income, and employment for purpose of privacy. Statisticians have difficulty gathering accurate information and data for plan formulation leading to either under gathering or inaccurate estimation of resources necessary for successful planning.

- Limited control of natural phenomena leading to uncertainties especially in the agriculture sector. Due to unpredictability and limited control of natural factors, it is difficult to formulate realistic plans for the agriculture sector. It is for example difficult to predict severe droughts or floods in future so that plans can be made to reduce their effects on production and other economic activities. Limited control of natural fact also makes it difficult to estimate accurately output of planned projects.

- Limited skilled labour. Proper formulation of plans requires nig skilled and experienced statisticians who are in short supply in develop -countries due to poor training and insufficient motivation of labour. T results in poor plan formulation due to the inability of statisticians to identify correctly projects to undertake, timing of the projects as well as project costs.

- Limited government commitment. Politicians lack commitment to the drawing of plans due to uncertainty of tenure in power, love for the informal patronage and lack of concern for practical solutions. They therefore, do not commit sufficient resources necessary for formulation of plans.

- Difficulty in identifying viable/ worthwhile projects. It is difficult to identify viable projects due to business uncertainties in developing countries Market conditions are ever changing. Changes in market conditions make projects that are viable today not viable tomorrow. Consequently, medium term and long term development projects are difficult to formulate.

- Limited financial resources. Government has insufficient financial resources to be used for data and information gathering, hire and retention of skilled statisticians and purchasing of facilities necessary for plan formulation.

- External influence. Donors make plan formulation difficult dictating conditionalities that recipient countries must meet, before funds for plan formulation can be released. They also dictate the projects and sectors to be planned for even if the projects are not centra1 the country's development. This causes disagreements between donors and local planners over plan priorities hence delaying the process of plan formulation.

- Corruption on the part of plan formulators. Officials charged with p.ir formulation misuse (misappropriate) funds meant for the activity. This leaves insufficient funds for data gathering, purchase of facilities and hire of statisticians. Consequently, either poor quality plans are drawn or no plan is formulated at all.

A summary of problems encountered by my country during plan formulation include the following:

- Poor infrastructure.
- Limited skilled manpower to design or make appropriate plans.
- Weak planning machinery
- Limited public support or will
- Inadequate statistical data
- Limited capital or funds needed for the planning process
- High level of corruption
- Political instability
- Interference of foreign agencies.

Measures being taken to improve economic development planning in developing countries

- Improving accountability through fighting corruption.
- Improving political climate.
- Training more planners.
- Improving data collection.
- Attaining price stability.
- Encouraging modernization of agriculture so as to reduce dependence on nature.
- Improving infrastructure.

- Avoiding over ambitious plans.
- Raising sufficient funds both locally and abroad through taxation and borrowing.
- Involving the masses in planning process.

NB:explanations to be given; relate a solution to a problem limiting planning.

Factors that influence / affect / determine the effectiveness (implementation) of economic development planning in developing countries

These are the factors that determine the success or failure of a plan in a developing economy. They include:

i. Availability of data / information. Planning is successful where it is based on reliable statistics because sound targets are set but the absence of reliable statistics on the economy makes plan formulation difficult and faulty because of the inability to set sound targets and objectives.

ii. The political atmosphere / climate. A good political atmosphere ensures a successful planning process because there are no interruptions in the implementation of the plan but poor political atmosphere tends to disrupt the planning process by making it difficult to rally the support of the masses to play their role in planning.

iii. Availability of funds from within and abroad. The planning process is more successful where funds are more readily available to be used for gathering data and hiring and retention of skilled labour needed for plan implementation but where funds are not readily available to finance the gathering of data and hiring of skilled labour, then process of plan implementation

iv. Availability of trained manpower to administer the plan (labour skills). Planning is more effective where there is availability of trained manpower to use in the planning process for identification of viable projects and the necessary project resources but when there is limited supply of skilled labour to identify viable projects then the planning process is ineffective.

v. Political will and support of the masses (people) / the level of government commitment / the level of conservatism. The planning process is more successful where the masses and politicians are in support of the plan because they easily rally behind the government to ensure its success but where there is no political will or support of the masses, the plan fails.

vi. Availability and effectiveness of the planning machinery / the efficiency of the implementation machinery. A competent planning institution ensures success of the planning process due to its efficient operations but poor planning machinery leads to failure of the planning process due to inefficiency.

vii. The degree of external interference into the planning process. Planning usually fails where there is increased external interference through donor funding but where there is no external interference, the planning process is successful.

viii. The rate of inflation / the price level. Economic stability ensures success of the planning process because of the stability in the costs of resources needed in plan implementation but high levels of inflation make the amount budgeted for planning inadequate thereby delaying the process of planning.

ix. The level of population growth rate. A stable low population growth rate avails more resources for the planning process but a high population growth rate increases the pressure on the existing resources which negatively impacts on the planning process.

x. The degree of corruption. A high level of corruption by planning officials leaves insufficient resources for planning thus making the process ineffective bin a high degree of accountability ensures success of planning because then limited misuse of funds or resources meant for planning.

xi. The level of infrastructural development. Well-developed infrastructure facilities enables the movement of project resources which makes plan implementation effective but poorly developed infrastructure delays the commencement of projects as it becomes difficult to move project resources hence causing failure of some plans.

xii. The level of dependence on nature / the conduciveness of natural factors. Conducive natural factors like good climate make it easy to realize the plan objectives especially in the agriculture sector but the occurrence of natural hazards like drought or floods disrupts the process of plan implementation and makes it difficult to have realistic plans for the agricultural sector.

xiii. The ambition of planning relative to the means or the degree of ambitiousness of planning. Some plans require more resources than those that can be sourced both locally and abroad hence failure of planning but plans that require minimal resources that can be sourced both locally and abroad become easier to implement hence success of the process of planning.

xiv. The degree of political interference. At times politicians stop the implementation of ongoing projects in order to divert resources to other projects or to areas that suit their private and political interests leading :: failure of the planning process but when politicians support the implementation of ongoing projects by ensuring proper use of resources in various projects or their areas, the process of planning is a success. .

xv. The degree of responsiveness of the private sector. Plans are made by the central authority for all sectors of the economy. Some of the plans are indicative. Government provides inducements such as tax incentives to the firms to invest in given industries or sectors. Since private sector firms are not under direct control of government yet are mainly profit driven, they sometimes do not respond to government inducements to invest in certain sectors, for example, in agriculture, hence failure of planning but when private sector firms respond positively to government inducements by investing in a number of sectors in the economy, the process of planning a success.

Challenges to or failure of planning in developing countries

- High levels of inflation. High level of inflation makes the amount budgeted for planning inadequate due to continuous increase in the general price level. Costs of resources at the time of plan implementation is much higher than at the time of plan formulation This necessitates a review of plan costs as well as sourcing for more funds for plan implementation hence delaying planning.

- Political instability. Unfavourable political atmosphere leads to destruction of productive infrastructures hence halting or hindering planning or productive activities. It also leads to diversion of resources meant for planning to pacification purposes. It makes it difficult to rally the support of the population to play their role in planning as it creates unfavourable attitude in citizens towards government. Lastly, it creates an atmosphere of fear of loss of lives and properties by project officials who keep away from insecure areas where plans are to be implemented.

- Over-ambitious planning. Some plans require more resources than those that can be sourced both locally and abroad hence failure of planning.

- Interference by politicians. At times politicians stop the implementation of ongoing projects in order to divert resources to other projects or to areas that suit their private and political interests.

- Poorly developed infrastructures. The movement of project resources for example heavy machinery and labour is hindered by poorly developed infrastructures. Commencement of project implementation is at times delayed till the infrastructures are put in place. Infrastructure development as a pre-requisite for project implementation increases project costs beyond what was originally planned for.

- Non responsive private sector. Plans are made by the central authority for all sectors of the economy. Some of the plans are indicative i.e. Government indicates to firms in the private sector potentials for investments. Government provides inducements such as tax incentive to the firms to invest in given industries or sectors. Since private sector firms are not under direct control of government yet are mainly profit driven, they sometimes do not respond to government inducements to invest in certain sectors, for example, in agriculture.

- Corruption by planning officials. Corrupt planning officials fraudulently divert resources meant for projects to personal uses. This leaves insufficient resources for planning, for example for gathering data , purchase of facilities, hiring of labour etc. This results in either poorly implemented projects or non-implementation of projects.

- Limited financial resources. Government has insufficient financial resources to be used for data and information gathering , hire and retention of skilled labour and purchase of facilities required for plan implementation.

- Limited data or information. Statistical data that are available are or even lacking due to poor record keeping and lack of will by the population to give information on their bio data , income , expenditure and employment for purposes of privacy. Limited accurate data leads to over-estimation or under¬ estimation of necessary resources for successful planning. It also leads to unrealistic planning targets and objectives being set.

- Lack of control over natural phenomena leading to uncertainties especially in the agriculture sector Due to unpredictability and limited control of natural factors, it is difficult to formulate realistic plans for the agriculture sector. It is for example difficult to minimise the effects of droughts and floods on production due to dependence on nature. Severe natural hazards can wipe out output from agriculture leading to failure of most or all planting activities especially in agriculture sectors.

- Limited skilled labour. There is limited supply of skilled labour to identify viable projects to be undertaken estimate project costs , set realistic project objective as well as carry out various technical activities in projects for example, operate machines.

- Limited government commitment. Politicians lack commitment to planning due to uncertainty of tenure for political patronage and pursuit of populism. Many plans are not implemented because politicians are reluctant to sanction the release of resources meant for implementation when they feel there is no political capital to be harvested from the under taking.

- Difficulty in identifying viable projects. It is difficult to identify viable projects due to business uncertainties and economic volatility in the market. Market conditions are ever changing. Changes in market conditions make projects that are viable today not viable tomorrow. For example, a fall in price and demand of an agricultural product such as vanilla made a vanilla project that was viable in 2001 not viable in subsequent years.

- Dependence on foreign aid which is inadequate, uncertain, inconsistent and tied. Donors provide funds which are not sufficient for purchase of resources for project implementation. Conditionalities that the recipient country must meet are also set before aid is given. This leads to botfc uncertainty as well as delay in planning. At times aid is also tied to projects that are not central to the country's development leading f disagreements between donors and recipients over plan priorities hence delaying the planning process.

Pre-requisites for successful planning

The formulation and implementation of plans requires the following;

- Planning commission. There should be a well organised commission which is sub divided into departments and headed by experts such 25 economists statisticians and engineers dealing with various aspects of the economy .

- Skilled labour. It requires highly skilled labour; who are experts in various fields to gather data, analyse, formulate and implement plans.

- A pool of statistical data. There must exist accurate statistical data obtained through survey of existing resources in the country together win their deficiencies .Data on the available resources both human and non-human, is essential for fixing priorities and targets in planning. This necessitates the setting up of a statistical bureau for collecting statistics data and information for planning.

- Availability of resources, especially funds, for planning. There should sufficient resources both financial and non-financial for planning. The plan should also lay down such policies and instruments for mobilising resources which fulfill the financial outlay of the plan without inflationary and balance of payments pressures. It should also encourage corporate and household savings of the private sector.

- Specification of objectives. A plan should show clear and achievable objectives such as to raise economic growth rate to 10% per annum to reduce unemployment to 1% of labourforce and to create a pool of highly skilled labour of a minimum of 40% of the workforce. The goal should be achievable ,mutually compatible and flexible in keeping with the requirements of the economy.

- Setting targets and priorities. Targets may be specified in quantitative terms such as millions of ores and billions of dollars of national output in a given period of time. Projects that require to be executed first should be given priority while the less important ones are given less priority.

- Balancing in the plan. A plan should ensure proper balance in the economy to avoid shortages or surpluses in output as the planning progresses. There should be balance between savings and investments , between training and manpower requirements, between demand for imports and the available foreign exchange, between exports and local demand for consumer goods.

- Incorruptible and efficient administration. For a plan to be successful .there is need for a incorruptible staff to undertake proper feasibilities studies first before project implementation without such a staff it better for economics of developing countries to be leisure price than pretend to plan.

- Complementary policies. The state should lay down complementary policies such as development of sound infrastructure , provision of specialised training facilities improving legal frame work, of or economic activity, especially laws relating to land tenure ,copy and patent rights, corporations and commercial transactions ,creation of larger and better markets ,assisting investors both foreign and local and promotion of increase in savings both private and public.
- An education and sound moral base. Planning is successful where the education and moral standards of the masses is high without creating honest and morally upright people in the country successful planning is not possible.
- Public cooperation. For planning to be successful, it must win the support of the masses. It should not only be above party policies but also win the support of all political parties and other pressure groups or players. Without popular support of the masses, no plan can be successful.
- Economy of administration. Every effort should be made to effect economies of administration, particularly in the expansion of ministries and state departments The citizens must be made to feel that every contribution they make to public revenue through taxation is not wasted on a large redundant planning staff.

Planning process (stages in economic development planning)

This refers to a situation where the government sets various plan objectives, formulates the plans and organizes the implementation of the project design to achieve the set objectives.

- A planning process involves the following:
- Plan formulation. This largely involves setting objectives and targets for development and identifying plan strategies to employ so as to achieve these objectives.
- Adoption of the plan. This is the act of accepting and owning the plan by the government, usually through parliament with or without amendments. It the becomes a statutory obligation of government and the general public to ensure implementation.
- Plan implementation or execution. This is the process where the measures or policies laid down in the plan are being carried out so as to realize the objectives.
- Plan monitoring, evaluation and revision. Monitoring refers to the supervision of

the plan process to ensure that the process is going on well whereas plan evaluation is the assessment of the success or failure of the planning process and it also involves plan revision in case of failure of the initial plan.

The qualities or principles of planning

The following are the principles of a good development plan:

- Comprehensive. It should cover all sectors and all region of the economy. It should be comprehensive so as to develop all sectors of the economy at the same time, create linkages between all the sectors and avoid imbalance regional development.
- Feasibility. A plan should be achievable within the available economic means and the set time period. Targets that are measured should be set indicating when and how the plan is to be achieved. Targets should be expressed in measurable terms such as miles of roads to be constructed ,saving and investments rates expressed as percentage of GDP to be achieved or economic growth rate per period of time. The targets should not be too ambitious to ensure success of planning.
- Optimality. A plan should aim at utilising the available resource Social relevance. It should be socially relevant by addressing the macro economic and social problems of the country such as unemployment most efficiently so as to produce maximum possible output with minimum wastage. This necessitates carrying out research to identify the potentials of the economy and its weaknesses so that most of the available resources are allocated sectors where the potential is great.
- Proportionality. Resources should be allocated proportionately to sectors or projects according to their significance to the economy or contribution to GDP. Significance of projects depends on national objectives and priorities. Resources allocation for development must be done according to the relative importance of each sector or project to the national economy ,for example sectors that contribute most to GDP may receive more resources than those that contribute little.
- Compatibility. The plan objectives should not conflict with the objectives to the already existing projects or government ideology or and socio-cultural mores of the people in the country. Compatibility of a plan is essential for its acceptance by politicians and people of the country.
- Social relevance. It should be socially relevant by addressing the macro economic and social problems of the country such as unemployment, price instability, poverty and stopping crime. This ensures not only plan acceptability but popular participation of citizens in plan implementation.

- Acceptability. A plan should be acceptable to the masses to ensure their participation in plan implementation. It should be acceptable to politicians to ensure allocation of resources to the plan as well as to avoid interference in planning. It should also be internationally acceptable so as to induce donors to fund it.

- Sequence. It should enable the establishment of projects in a timely manner in order to create linkages between projects, sectors and the economy as a whole. Projects whose output is to be used as inputs by other firms should be established first, for example, construction of transport and communication network should precede the opening up of mines; projects aimed at producing raw materials must precede processing and manufacturing ones; and so on. Thus short term plans should lead to medium term plans and medium term plans should bear relationship with long term plans.

- Continuity. The life of a project should transcend time. It should not be suddenly ended because the authorities of the day cannot identify with it despite its social and economic relevance. Government should not abandon a good plan and start a new one even if the project was conceived by people who are no longer in power.

Characteristics or features or qualities of a good economic development plan

- Should be comprehensive. A good economic development plan should cover all sectors and all region of the economy.

- Should be consistent. A good economic development plan should be consistent with the financial and manpower resources available.

- Should be sequenced. A good economic development plan should enable the establishment of projects in a timely manner in order to create linkages between projects, sectors and the economy as a whole.

- Should be economically feasible. A good economic development plan should be achievable within the available economic means and the set time period.

- Should be compatible. The objectives of a good economic development plan should not conflict with the objectives to the already existing projects or government ideology or and socio-cultural mores of the people in the country.

- Should have an element of proportionality in the allocation of resources. A good economic development plan should ensure that resources are allocated proportionately to sectors or projects according to their significance to the economy

- Should have an element of continuity. A good economic development plan should not be suddenly ended because the authorities of the day cannot identify with it despite its social and economic relevance.

- Should have an element of optimality in the use of resources. A good economic development plan should aim at utilising the available resource most efficiently so as to produce maximum possible output with minimum wastage.

- Should be politically acceptable. A good economic development plan should be acceptable to the masses to ensure their participation in plan implementation.

- Should be socially relevant. A good economic development plan should be socially relevant by addressing the macro economic and social problems of the country such as unemployment, price instability, poverty and stopping crime.

- Should be internationally relevant. A good economic development plan should take into consideration international forces like credit crunch, economic recession etc. that are likely to affect its effective implementation.

Centralised and decentralised planning centralised planning

Centralised planning is planning by a central authority for the whole country. Under centralised planning, the planning process in a country is under a cental planning authority. This planning in a country is under a central planning authority. This planning authority fixes objectives, target and priorities for every sector of the economy. It takes all investment decisions in accordance with the target and priorities for every sector of the economy.

Rationale for centralised planning

- To minimise wastes of scarce resources. Centralised planning avoids resource wastes through duplication of projects which is a problem of regional planning.

- To ensure coordination in sectoral development. Centralised planning encourages creation of line creation of linkages between sectors so that the developing of one sectors is related to the development of other sectors.

- To achieve balanced regional development. Human and non –humanresources are unevenly distributed in an economy. Centralised planning make it possible to allocate the resources to all regions for purpose of reducing imbalance in regional development.

- To promote sequencing of projects. Through centralised planning it is possible to establish projects in timely and orderly manner.

- To ensure consistency of plans. Centralised planning ensures that planned objectives and planned targets for all projects are not in conflict with broad national economic objectives This is possible because central planners are conscious of not only the broad national objectives but also of the national natural resources potential.

- To eliminate divergence between private benefits and social costs-Through centralised planning divergence between private benefits and social costs such as environmental degradation pollution and exhaustion of non-renewable resources are avoided through regulated exploitation of resources for example through licensing.
- To encourage regional specialisation. Through centralised planning each region undertakes activities that it can do best instead of implementing more or less the same projects that leads not only to duplication of projects but also to inefficiency in production.

Merits of centralised planning

- Promotes fair income distribution.
- Promotes balanced regional development.
- Exploitation of consumer due to ignorance is avoided
- Reduces private gain and social costs.
- Eliminates private monopoly.
- Leads to provision of mass employment.
- Fast adjustments in times of emergencies such as during wars or when natural disasters strike.
- Economic instabilities, for example inflation are easy to control.

Demerits of centralised planning

- Distorts the working of the price mechanism
- Kills individual / private initiatives.
- Promotes political dictatorship.
- Limits consumer sovereignty.
- Corruption becomes rampant.
- Leads to wastage of resources for example production of commodities not so much wanted by consumers.
- It encourages bureaucracy and red tape causing delays.
- Misallocation of resources due to distortion of the operation of the price mechanism / Promotes inefficiency in production

- Low quality output due to lack of competition.
- Low quantity output hence low economic growth rate. Quantity of goods produced are low due to inefficiency which demoralises state bureaucrats whose objectives of production is not profit and wage driven but maintenance of employment opportunities.
- High administration costs / It is costly in terms of formulation, implementation etc.

Decentralised planning

Decentralised planning is one in which economic decision making and the implementation of plans is in line with set targets undertaken by the local government.

Or is planning at a regional or district level. Under it, a plan is formulated by the central planning authority in consultation with the different administrative units of the country. The central plan incorporates plans under the central schemes and plans for the regions or districts under the decentralization set up. The state plans incorporate district and village level plans. Similarly plans for different industries are formulated in consultation with representatives of industries

Rationale for decentralised planning

Reasons for decentralised planning in the developing countries include the following;

- To promote use of local resources
- To ensure balanced regional development
- To attain efficiency in resource use
- To ensure that each area takes full advantages of its priorities/interests
- To reduce rural-urban migrations
- To reduce the chain of bureaucracy/red tape
- To ensure equity/fairness in income distribution
- To promote a sense of belonging and commitment/to encourage public participation
- To ensure fair distribution of employment opportunities
- To promote division of labour between the local government and the central government

Advantages / benefits of decentralised planning in the developing countries

- It favours local interest. Since planning is done at the grass roots the local people plan according to local priorities .This is preferable to centralized planning in which the central authority dictates to the local people who they should do even if what is adjudged best is the local people .

- It encourages utilisation of local natural resources. Decentralized planning encourages increased utilisation of locally available natural resources since viable projects that can be sustained by use of available local resources are easily identifiable.

- Provision of employment to the local people. Decentralized planning leads to increased employment opportunities for the locals through increased project to utilise local resources as well as placements in positions in the local government administration.

- Encourages local participation in the development of the region. The local people participate more fully in regional development that are acceptable to them since they contribute to the formulation of plan objectives . The are also the main if not the only beneficiaries of the plan.

- Avoids bureaucracy of centralised planning. Under decentralised planning . planning secessions such as project identification, project costing and implementation are done with minimal delay because there is no need to consult with several departments, ministries and regions unlike national planning which is bureaucratic due to need for multi-lateral consultations and approvals required before implementation.

- It ensures division of labour between the centre and the local authorities Decentralised planning enables the central authorities to train labour for supervision and coordination of projects in regions while each region develops labour which specialized in the execution of projects aimed at utilization of resources that each region is endowed with.

- Ensures efficient tax collection. Taxes are more efficiently collected because of better identification of tax bases ,proper determination of taxable capacity ,and more efficient tax administration in order to raise sufficient revenue to meet local needs.

- Enables each region to look for resources to cater for its interests due to limited finds at the centre. This reduces straining of the limited resources at the centre caused by dependence on the centre by regions for resource5 for project planning.

- Promotes balanced development within the regions. Decentralized planning enables each region to promote projects which are necessary for thedevelopment of all areas within the region unlike decentralized planning which although promotes balance in regional development Jeaves several pockets imbalance in development within the regions

In summary the advantages include:

- Promotes use of local resources.
- Ensures balanced regional development.
- Efficiency in resource use is attained.
- Ensures that each area takes full advantages of its priorities/interests.
- Reduces rural urban migrations.
- Reduces the chain of bureaucracy/red tape.
- Ensures equity/fairness in income distribution.
- Promotes a sense of belonging and commitment/to encourage public participation.
- Ensures fair distribution of employment opportunities.
- Promotes division of labour between the local government and the central government.

Demerits of decentralised planning

- Duplication of projects hence resource wastes. Resource wastage is common as each district carries out its own planning.
- Leads to inconsistency of plans since each district or region focuses on different needs.
- Price instability due to dependence on market mechanism for resource allocation.
- Undermines nation integration or lacks effective national cohesion hence promotes national disintegration. National unit} is not promoted as each region / district plans as an independent body.
- Leads to plan incompatibility.
- Strains the limited resources hence it is expensive.
- Undermines proportionality in planning.
- Promotes inequality in regional development. This is because regions with more resources develop faster than those lacking viable resources.
- Promotes incomes inequality. This is mainly due to differences in resource

endowments that imply different levels of development.

- Encourages corruption at the regional or district level due to limited accountability.

Sectoral, partial and comprehensive planning

Sectoral planning is planning for a specific sector of the economy, for example, agriculture or industry or region.

NB: A Sectoral plan is one that covers a particular sector of the economy.

Advantages of sectoral planning

- It leads to efficient utilization of limited resources
- It pulls up lagging sectors or sub sections.
- Creates sectoral linkages i.e. encourages the development of linkages between the different sectors.
- Each sector is given due attention.
- Allows plans to be detailed and not brief.

Disadvantages of sectoral planning

- Results in lagging of some sectors.
- Uneven development of regions is encouraged.
- Does not promote sectoral inter- dependence.
- Misuse of resources is encouraged due to poor or wrong identification priorities.

Partial planning refers to planning that covers only part or a few sectors of economy.

NB: Partial plan is one that covers part or a section or a few sectors of the economy.

Effects of a partial plan

Negative effects

- Encourages sectoral and regional imbalances.
- Worsens income inequalities.
- Leads to underutilisation of resources.

- Reduces linkages between sectors hence discourages complementarity in economy.
- Encourages economic dependence.

Positive effects

- Less costly and thereby reducing government expenditure.
- Minimises overproduction and wastage of resources.

Comprehensive planning is one that sets a target to cover all or most the major sectors of the national economy. Or is where planning covers all sectors of the economy.

NB: Comprehensive plan is one that covers all the sectors of the economy.

Reasons for comprehensive planning

- To promote balance in regional development.
- To promote equity in income distribution.
- To create sectoral linkages.
- To create employment opportunities.
- To increase output hence economic growth.
- To reduce dependence on imports.
- To promote infrastructural development.
- To control inflation.
- To correct balance of payment problems.
- To widen consumer choices due to production of a variety of goods.

Merits of comprehensive planning

- Leads to balance in regional development.
- Encourages better use of the available resources leading to increased output hence economic growth.
- Increases government revenue due to the widened tax base.
- Priorities are identified and correctly emphasised.
- Promotes fairer income distribution.

- Creates inter-sectoral linkages.
- Creates more employment opportunities.
- Leads to reduced dependence on imported goods and resources in the long run.
- Promotes infrastructural development.
- Controls inflation or contributes to maintenance of price stability.

Demerits to comprehensive planning

- Over taxation of the citizens.
- Over production and hence wastage.
- Inefficiency in resource allocation and straining of the existing limited resources in order to develop the whole economy .
- Lagging behind of some sectors due to planning for major sectors only.
- It is expensive or costly to formulate and implement hence increased government expenditure (debt burden).
- Encourages overexploitation of the available resources.

Limitations to comprehensive planning in developing countries

- Inadequate funds to implement the development of all sectors.
- Inadequate skilled manpower needed to do comprehensive planning.
- Inadequate information for all sectors of the economy on which to base comprehensive planning.
- Political instability.
- Over-ambitious plans.
- Corruption by plan officials.
- Limited information about the different sectors.
- Interference by politicians.

Short term or Operative or Annual plans

An annual plan is one whose set objectives are to be achieved within a period of one year.

The short term plan operationalises the medium term and long term plans.

Medium term plans

A medium term plan is one that covers a period between three to ten years, acting as a link between the short term and long term plans.

Perspective plans

Perspective plan is a long term plan which cover periods of over (above) ten years ,say 15 or 20 or 25years.

Advantages of Perspective plans

- Gives direction to short term or annual plans in a sequential manner.
- Enables balanced growth of the economy.
- Helps to avoid sectoral imbalances.
- Enables planners to set priorities for the economy.

Disadvantages of perspective planning

- It is rigid ,it cannot easily be changed even when errors are seen doe to unforeseen changes occurring abruptly between plan period ,It s therefore not feasible administratively
- Its downward revision demoralises the public psychologically. It ~& downward revision causes confusion, cynicism and defeatism in business, the administration and the public as it makes the future appear more uncertani than it actually maybe.

Democratic planning -a planning system in which the masses are involv in planning process.

Totalitarian planning; in authoritarian planning, the planning authority is the supreme body. It decides targets, schemes, allocation, methods and procedure of implementation of the plan. There is absolutely no opposition to the plan, people have to accept and rigidly implement the plan. Economic and political powers are polarized and social life is regimented .There is thus no democratic freedom in authoritarian planning because it is extremely rigid.

Directive planning is one where the central planning authority plans, directs and orders the implementation of the plan in line with pre-determined targets and economic policies.

Demerits of directive planning

- It is expensive i.e. requires a lot of capital.

- It involves bureaucracy or red tape.
- It does not provide incentives for the private sector.
- Denies people the freedom of choosing economic activities.
- Mistakes made between the planning processes may be difficult to solve.

Indicative planning is one where government identifies appropriate investment areas and provides incentives and required information to individual economic units to achieve pre-determined targets or objectives.

Or Planning where government identifies priority areas and provides incentives and conducive atmosphere to the private sector but without directing their decisions.

Manpower planning is the long term projection of manpower supply and manpower demand so as to strike a balance between future supply and demand for labour so as to achieve the objectives of development.

Problems faced manpower in Uganda

- High level of unemployment and underemployment.
- Discrimination in the labour market.
- Limited supply of skilled labour.
- Increased use of child labour.
- Misuse or misplacement of labour.
- High cost of training labour.
- Low / poor remuneration.
- High rates of brain drain.
- Negative attitude towards work.
- Poor working conditions.
- Poor health of many workers.
- Unbalanced supply of skilled labour in different fields.

Role of planning in uganda

Positive role of planning include;

(Benefits of carrying out economic development planning)

- Ensures proper resource allocation. Resources such as capital, skilled labour and land are scarce relative to the demand for them. Planning enables us to put such resources to the best possible use so as to optimise their utilisation.

- Ensures equitable redistribution of income. Through planning, income inequality is reduced by measures such as progressive taxation and subsidisation of the poor, induced simultaneous investment in all the sectors of the economy , provision of affordable capital for investment to the poor etc.

- Reduces the unemployment problems. Through planning, private investment can be induced and public investment undertaken to create employment for the masses. Manpower planning policies are also under taken to match labour supply with labour demand and limit unemployment problems caused by disproportionate supply of labour to certain occupations.

- Ensures stability in prices. Planning helps to attain stability through measures such as reducing government planning expenditure and increasing direct taxation to reduce aggregate demand measures to stimulate production ,increase aggregate supply and contain inflationary pressure. During a deflation government taxes to increase disposable income and undertakes expansionary monetary policy to increase aggregate demand and stimulate economic activities.

- Corrects deficiencies of the price mechanism, mostly during situations of rapid structural changes. Price mechanism does not adequately provide for social and economic over heads requiring huge capital investment, provision for emergencies such as wars and natural disasters under which victims have no purchasing power; and, harmonious development of all sectors of the economy. Therefore, centralised planning enables the correction of such defects of the price mechanism.

- Ensures faster economic growth, planning enables government to set growth target and carry out measures to achieve targeted rates of economic growth for example provision of attractive tax incentives so as to stimulate investment. Increased investment leads to increased output hence economic growth.

- Ensures self-sufficiency and therefore reduces economic dependence. Planning enables the country to reduce dependence on external resources by raising revenue locally to avoid borrowing from abroad, training labour locally to reduce dependence on imported labour, import substitution industrialisation to reduce dependence on imports and diversification of the economy to reduce sectoral dependence.

- Promotes resource mobilisation. Planning enables the government mobilise resources through sources of public revenue such as taxati borrowing, licensing, fines and fees .These financial resources enables government to meet her recurrent and development expenditure needs.

- Encourages public participation in the development of the economy. Planning makes it possible for members of the public to be involved in process of development of the national economy by showing them role in plan formulation and plan implementation.

- Ensures / harmonises consistent use of resources. Planning leads harmonious use of resources by avoiding duplication of projects that similar objectives. It also ensures consistency in the use of avail resources by ensuring that planned targets are in line with the avail resources.

- Means of attracting foreign aid or resources. Economic development planning enables government to show potential donors short falls between expected revenue as well as how aid is to be utilised when acquired. This is d. to convince donors to part with funds to be used in the implementation projects in the economy.

- Helps in identifying areas suitable for public and private investments. Economic development planning enables government to identify sectors which are highly profitable and attractive to private investors and areas that are unprofitable but essential for a country's development such as provision of infrastructure and merit goods hence such as areas are identified as suitable for public investment.

- Relates present to future trends and targets thus consistency in growth and development. Through proper planning projects that produce outputs to be used as inputs by other projects are implemented first. For example an industrial based long term plan requires setting up projects in the long run to produce raw materials for industries yet to be established . This way. present activities are linked with future activities.

Negative role of planning include:

(Costs of carrying out economic development planning / demerits of a centrally planned economy)

- Distorts the working of the price mechanism. This is due to government interference in distributing resources and running economic activities.

- Kills individual / private initiatives. Private individuals are discouraged from working hard due to the lack of profit motive in the economy.

- Promotes political dictatorship. The government usually has maximum control in all activities and this limits the freedom enjoyed by the citizens.

- Limits consumer sovereignty. This is because consumers do not have the freedom to buy goods they desire and prices are fixed by government.

- Corruption becomes rampant. This is because people use different ways to access means of production and commodities.

- Leads to poor quality products because of lack of competition in the economy.
- Promotes inefficiency in production. This is due to the various mistakes made in the economy by the central planning authority.
- Leads to wastage of resources, for example, production of commodities not much wanted by consumers.
- It is costly in terms of formulation and implementation. The government spends a lot of funds in ensuring the allocation of resources to different sectors and regions which is costly and requires borrowing.
- It encourages bureaucracy and red tape causing delays in decision making.

REVISION QUESTIONS

(1) Distinguish between Macro-plan and Micro-plan

(2) State any two factors that limit effective implementation of economic development plans in your country

(3) Define the term "comprehensive planning"

(4) Mention any three merits of comprehensive planning in an economy

- Why should countries carry out economic development planning?
- Explain the merits of decentralised planning in an economy.
- Differentiate between comprehensive and perspective planning.
- Discuss the merits associated with economic development planning in your country
- Why do developing countries carry out developing planning?
- What problems are faced in plan implementation and formulation in developing countries?
- Differentiate between "decentralised economic planning" and "centralised economic planning in your country
- What are the necessary conditions for the successful formulation of development plans in the developing countries?
- Why do countries undertake development planning?
- What problems limit the success of development planning in developing countries?
- Differentiate between "decentralised economic planning" and "centralised

economic planning in your country

- What are the necessary conditions for the successful formulation of development plans in the developing countries?
- Explain the characteristics of a good economic development planning.
- What are the characteristics of a good national economic development plan?
- Explain the limitations to the implementation of national economic development plans in your country.
- Explain the need for economic development planning in your country.
- Examine the factors that influence economic development planning in your country.
- Explain the factors that have affected Economic development planning in your country.
- Explain the advantages of Economic development planning in your country
- Explain the effects of economic development planning in your country.
- Examine the merits and demerits of economic development planning.
- What are the stages involved in a planning process?
- Explain the limitations to plan formulation in your country.
- What is meant by economic development planning?

TOPIC 10: INTERNATIONAL TRADE

International trade is the trade between two or more countries. It involves the physical transfer of goods and services from one country to another .A purchase of goods from another country is called an import and sale of goods to another country is called export.

Trade between two countries is called bi-lateral trade. It occurs when the objective of the two trading partners is to try to balance trade with one another. This could be brought about by a trade agreement between two countries.

Trade between one nation and many others is called multi-lateral trade. It implies freedom of a nation to trade with whichever country it pleases.

Reasons for carrying out international trade

It is necessary for countries to carry out international trade for the following reasons:

- Differences in natural resource endowment. No country in the whole world has enough resources to meet its demand. Due to differences in natural resources, countries produce certain goods and not others hence there is need for exchange.
- Variations in human resource development. There is need to engage in international trade to enable transfer of highly skilled labour from especially the developed countries to the poor countries which have a skilled manpower gap.
- Different levels of capital accumulation. Countries have different levels of capital accumulation hence foreign trade is necessary to enable the transfer of capital from one country to another. This is to enable the filling of the saving-investment gap in the capital deficient developing countries.
- Inadequate output of given goods/ services. There is need to engage in foreign trade to get goods or services a country cannot produce given the limited resource endowments.
- Surplus output in various goods / services. Countries engage in foreign trade to sell off surplus output which would have got spoilt since it cannot be absorbed by the domestic market.
- Comparative advantage. Countries specialize in the production of goods for which they have the greatest comparative cost advantage or least comparative cost disadvantage as compared to other countries hence the need for exchange to acquire what a country cannot produce.
- Need to acquire foreign exchange to finance development needs. There is need to engage in international trade to acquire the foreign exchange form exports that enables government to meet the recurrent and development expenditure needs.

- Variations in tastes and the need to have variety of goods. Countries engage in foreign trade so as to avail to consumers a greater variety of goods to meet the varying tastes of citizens.
- Need to strengthen political ties. There is need to create friendly relations by engaging in international trade. This leads to increased volume of trade which further leads to stimulation of production to increase supply.
- Climatic and geographical differences. Differences in various climatic zones dictate different items to be produced. There is thus need for exchange to get the goods they cannot produce.

The role of international trade in development positive role / advantages of international trade

- It enables a country to get what it cannot produce. Countries differ in natural resource endowment enabling them to produce certain goods and not others. For example a country like Uganda is deficient in capital but endowed with land and labour while a country like Japan is endowed with capital but deficient in labour and land. This enables Japan to produce cheaply manufactured goods such as locomotives while Uganda specialises in the production of primary products. Trade therefore, enables Uganda to acquire manufactured goods thus improving the welfare of her citizens.
- A greater variety of goods is made available to consumers. Citizens of Uganda, for example, are able to choose between substitute goods from USA, Germany, Egypt and China which widens consumers' choices.
- Leads to efficiency of domestic firms due competition with foreign firms. In the absence of international trade, domestic producers would becor -monopolies and charge high (exorbitant) prices. Competition also forces local producers to improve the quality of their products in order to compete with foreign producers for both the domestic and foreign market.
- A country is enabled to sell off surplus output which would have got spoilt. Most countries of the developing world consume less than twenty per cent of what they produce .Foreign trade enables the developing countries to dispose off (about 80%) surplus production that cannot be absorbed by the domestic market.
- Enables a country to alleviate the effects of natural catastrophes. In the event of natural calamities such as floods, droughts etc., supplies and aid can be obtained from countries not experiencing similar problems. This is not possible when an economy is an autarky.
- Enables countries to specialise in the production of goods for which they have the greatest comparative cost advantage or least comparative cost

disadvantage as compared to other countries. Specialisation, among other advantages, leads to increased volume of production at lower average costs.

- Leads to international friendship and peace. Due to a country's trade dependence on another, friendly relations increase leading to increased volume of trade between countries. Increased volume of trade leads to stimulation of further production to increase supply. International trade also enhances international peace as countries fear to go to war with one another because wars disrupt among other things output and supply of goods.

- Leads to technological transfer. Trade promotes transfer of technology from one country to another mainly by multi-national corporations (MNCs) hence filling the technological gap in developing countries.

- Encourages transfer of highly skilled labour from especially developed to poor countries through foreign aid and international exchange programmes. This enables the poor countries to fill the skilled manpower gap-

- Leads to the filling of the savings - investment gap. Trade enables firms from especially developed countries to establish branches in other countries. This involves transfer of capital from one country to another hence filling the savings - investment gap in the capital deficient developing countries.

- Promotes utilisation of idle resources. Resources previously lying idle due to limited domestic market for what they help to produce are brought to use .This is because international trade creates demand for goods whose production potential exists in other countries and the resources are put to use to produce the goods.

- Leads to economies of large scale production. Economies of large scale production are possible because of increased demand for goods in the international market .This results in increased production at low cost per unit of output thus availing consumer goods at relatively lower prices.

- Increased revenue for government due to increased tax base.Imports and exports are taxed to raise revenue that enables government to meet recurrent and development expenditure needs, for example, infrastructural development.

- Increased economic growth rate. Creation of demand abroad by international trade, stimulates investment to increase output to meet market demand .Trade also promotes the transfer of more efficient producer resources like capital, labour, technology and enterprise which leads to increased output hence economic growth.

Negative role (or demerits) of international trade

The following are the demerits of international trade.

- Fluctuations in revenue due to too much specialisation. Too much specialisation by depending on exports of few commodities whose supply and demand are price inelastic and prices are externally determined leads to price fluctuations hence loss of revenue during the frequent down swing in the prices. This impacts on the economy negatively as it makes planning difficult, discourages investment and encourages speculation in production.

- Leads to natural resources exhaustion. International trade leads to exhaustion of non-renewable natural resources, for example, minerals, due to their over exploitation.

- Home industries are out competed by foreign ones. Home industries a out competed by foreign industries that produce similar goods. This leads to decline in the home industries and creation of unemployment.

- Leads to negative demonstration effects. International trade leads to transfer of negative foreign ways of life on nationals of a country. Such effects are mainly cultural and attitudinal including consumption habits, modes of dressing approaches to education, leisure and recreation.

- Results into importation of demerit goods. It leads to importation of dangerous goods such as drugs, pornographic materials ,spirits and tobacco which are harmful to the health of citizens of a country.

- Exploitation of poor countries by rich countries through unequal exchange. The rate at which raw materials such as minerals and agro products are exchanged for manufactured goods keep on deteriorating in the world market largely due to determination of prices of exports externally ,import substitution policies in the export markets and protectionist policies in the export markets hence poor countries gain from international trade has been continuously declining.

- Leads to trade dependence. Foreign trade leads to dependence on imports which is dangerous during war times because supply of essential and strategic goods can be cut off.

- Leads to imported inflation. This arises from continuous importation of consumer and capital goods from countries experiencing inflation leading to a continuous rise in the general price level in the importing countries.

Limitations to international trade

- Transport difficulties and high transport costs due to poorly developed infrastructure and long distance between countries. This results into high prices of final products and reduced profits for traders.

- Differences in currencies. International trade is carried out in hard currencies.

Importers have to convert the local currencies into currencies acceptable to foreign suppliers. This often is time wasting and increases the cost of trade because those who change currencies make profits by manipulating the market rates of the currencies.

- Differences in weights and measures. Weights and measures differ from country to country. This poses a difficulty of converting the measurements and weights from one unit to another, for example pound to kilogram.

- Differences in languages. There is no single international language but several international languages used in trade. An importer/ trader must therefore use the national language of the country with which he/she trades. This may require employment of language specialists such as translators that add on to costs of trade.

- Differences in cultures and customs. Cultures and customs differ from one country to another due to differences in national histories, religion, race and other demographic characteristics. An international trader must know the cultural tolerances of other countries if he or she is not to break the laws and go against the culture of the people with whom he trades.

- Differences in the political ideologies of countries. Countries subscribe to different ideologies. The two common ideologies are capitalism and socialism. This limits international trade because the countries belonging to each of the ideologies are always mutually suspicious of each other and do not allow free flow of goods amongst them for political reasons.

- Imposition of tariff and non-tariff barriers to trade. Many countries impose tariff and non-tariff barriers to trade such as quotas, total ban, licenses and tariffs in order to achieve desired and national objectives such as to protect home industries, protect the health of citizens and to correct balance of payments problem. This hinders the free flow of goods from one country to another.

- Long procedures involved in trade. Many procedures such as making inquiries, placing orders, getting national approval to import, acquiring of hard currencies to acquire imports, among others. All these delay international trade.

- Political instabilities and wars in some parts of the world. Political instability and wars make acquiring imports supply and exporting to such countries hazardous. Political instabilities increase the risk of trade due to risk of losing goods in transit from the importing and exporting country and loss of lives caught in the crossfire. This too impedes international trade.

The basis of international trade

The theory of comparative cost advantage

The theory of international trade also known as the theory of comparative costs, was put forward by David Ricardo and modified by later economists. The principle of comparative advantage is based on differences in production costs of similar commodities in different countries. Production costs differ in different countries because of geographical division of labour and specialization in production. Due to differences in climate, natural resources, geographical situation and efficiency of labour, a country can produce one commodity at a lower cost than another. In this way each country specialises in the production of that commodity in which its comparative cost of production is least.

Therefore, when a country enters into trade with some other country, it will export those commodities in which its comparative production costs are high. This is the basis of international trade. More specifically law states that countries will benefit more from international trade b\ specialising in the production of that commodity in which they have the greatest relative advantages or the least relative disadvantages compared to another country.

A country has comparative advantage over another if in producing a commodity it can do soi at a relatively lower opportunity cost in terms of foregone alternative commodities that could be produced. Therefore, a country should specialise in the production of a commodity in which has least opportunity cost in comparison with another country.

Simply put, comparative advantage exists when given two countries and two commodities with a given amount of resources, one country can produce one of the commodities more cheaply but the other country can produce the second commodity more cheaply.

Absolute cost advantage is where given two countries and two commodities, one country can produce both commodities more cheaply than the other, therefore, if country A can produce more of B. the country A is said to have an absolute cost advantage over country B in the production of the commodity.

Determination of comparative cost advantage

Country	**Resources**	**Commodities**	
		Cars	Wine
X	100 men	800	1200
Y	100 men	200	600

Country X has absolute advantage in the production of both commodities.

Calculate the opportunity cost of production each commodity in each country.

Opportunity cost of producing each commodity in each country

Opportunity cost = alternative foregone / actual output produced Country x

Opportunity cost of country X in producing a car

800 cars = 1200 barrels of wine

800/800 cars =1200/ 800 barrels of wine

1 car =1.5 barrels of wine

Opportunity cost of country X in producing wine

1200 barrels of wine = 800 cars

1200/1200 barrels of wine = 800/1200 cars

1 barrel of wine = 0.667 cars

Country Y

Opportunity cost of country Y in producing a car cars

200 cars = 600 barrels of wine

200 /200 cars = 600/200 barrels of wine

1 car = 3 barrels of wine

Opportunity cost of country Yin producing wine

600 barrels of wine =200cars

600/600 barrels of wine=200/600 cars

1 barrel of wine =0.33 cars.

A country should specialise in the production of a commodity in which they have the least opportunity cost.

The above information can be tabulated as follows to determine the commodity in nch each country should specialise:

I	Cars	Wine.
Country X	1.5	0.67
Country Y	3	0.33

Exercise

Study the table below showing output levels of two countries in two commodities given the same units of labour.

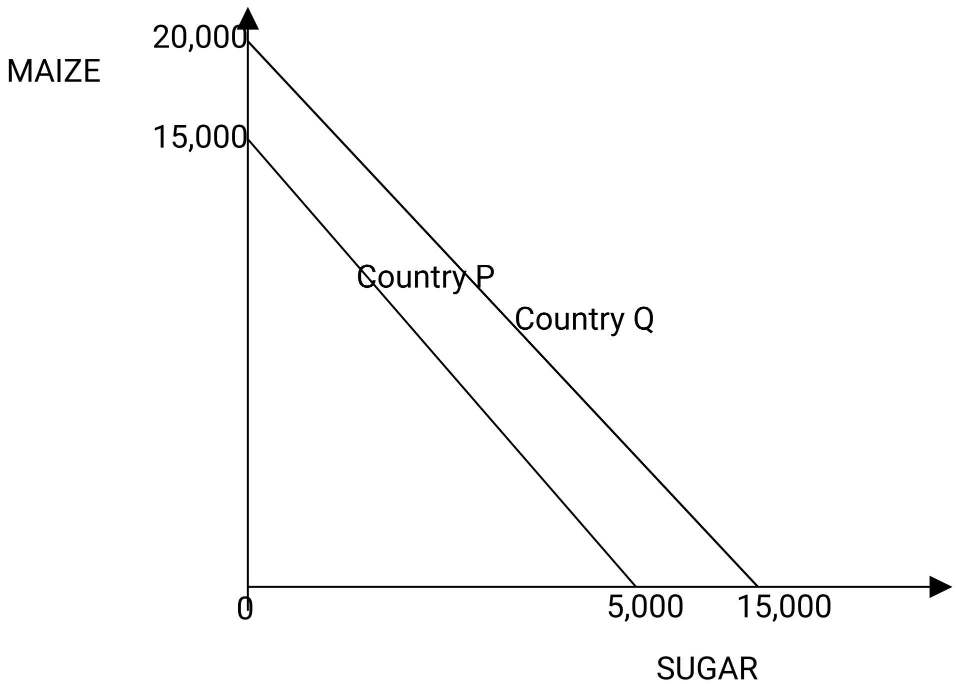
Country	Commodities	
	Generators	Coffee
X	400	600
Y	100	300

(i) State the country with absolute advantage in the production of both commodities.

(ii) Calculate the opportunity cost of producing each commodity in each country.

(iii) In which commodity should each country specialize?

Study the figure below showing the production possibility Frontiers for countries P and Q:



(i) What principle of cost is illustrated by the two frontiers?

(ii) Which country has absolute advantage in the production of both commodities?

(iii) Calculate the opportunity cost of producing each commodity in each country.

ASSUMPTIONS OF THE THEORY

The Ricardian theory of comparative costs is based on the following assumptions:

- There are only two countries A and B.
- The countries produce the same two commodities X and Y
- There are similar tastes in both countries.
- Countries use the same currency.
- Labour is the only factor of production.
- The supply of labour is constant.
- All units of labour are homogeneous.
- Prices of the two commodities are determined by labour costs, that is, the number of labour units employed to produce each product.
- Commodities are produced under the laws of c constant costs and constant returns.
- Technological knowledge is constant.
- Trade between the two countries takes place on the basis of barter.

- Factors of production are perfectly mobile within each country, but perfectly immobile internationally.
- There is free trade between the two countries, there being no trade barrier or trade restrictions in the movement of commodities
- No transport costs are involved in carrying out trade between two countries.
- All factors of production are fully employed in both countries
- The international market is perfect so that the exchange ratio for the two commodities is the same.

Relevancy or applicability of comparative advantage theory to developing countries

To a smaller extent the comparative cost theory is applicable to developing countries:

- There exists barter trade. In some developing countries, barter trade arrangements exist where goods are exchanged for goods or services, making the theory relevant.
- Developing countries tend to use labour intensive techniques. There is use of labour intensive techniques of production in many developing countries since labour is abundant and the theory assumes that labour is the only factor of production.
- Developing countries like Uganda often specialise in agricultural production or production of primary products where they have a lowest opportunity cost / greatest comparative advantage.
- Developing countries often import manufactured goods where they have a lesser comparative advantage.
- Mobility of factors of production exists. There is some degree of mobility of factors of production within the developing countries, for example capital and labour.
- At times free trade takes place. There are some cases of free trade among developing countries especially under regional economic integration like East African Community (EAC) and COMES A.

However, to a greater extent the comparative advantage theory is inapplicable in developing countries: (LIMITATIONS OF THE THEORY)

- Simplicity in considering only two countries. International trade involves exchange among many countries.
- False assumption of two commodities because there are many commodities dealt in international trade.
- It ignores transport costs in determining comparative advantages in trade. This is unrealistic because transport costs play an important n determining the pattern of world trade. High transport costs may nullify the comparative advantages and the gain from international trade.
- The assumption of similar tastes is unrealistic because tastes differ with different income brackets in the same country. Moreover, they also change, the growth of the economy and with the development of its trade relation w other

countries

- The assumption that labour is used in the same proportion for the production of all commodities is unrealistic. Labour is used in varying proportions in the production of commodities. For instance, less labour is used per unit of capital in the production of steel than in the production of textiles. Moreover, some possibilities of substitution of labour for capital always exist in production.
- The assumption of constant costs is unrealistic because in reality there is decreasing costs and rising costs as well. If large scale production increases costs then comparative advantage will be reduced, and in some cases it may even disappear. On the other hand, if increased output results in reduced costs, then comparative advantage will be increased.
- Its assumption of perfect factor mobility at home and immobility internationally is unrealistic. Factors of production even within one country do not move freely from one industry to another or from one region to another. The greater the degree of specialisation in an industry, the less is the factor mobility from one industry to another. Thus factor mobility influences costs and hence the pattern of international trade. It is also wrong to assume factor immobility internationally because resources are ever shifting from one country to another for example through foreign aid and private foreign investment.
- It assumes full employment in an economy. This is unrealistic because some forms of unemployment exist in all economies.
- The doctrine assumes perfect and free world trade yet in reality world trade is not free .Every country applies restrictions on the free movement of goods to and from other countries. Thus tariffs and other methods of trade restrictions affect world trade.
- It ignores the desires by countries to be sell-sufficient. A country with a comparative disadvantage in the production of a commodity may not wish to import the commodity cheaply from another country due to strategic, military or development considerations. Thus often self-interest stands in the way of the theory of comparative costs.
- It ignores the effect of technological development in increasing supply. Technological innovations help in increasing supply of goods both at home and abroad. World trade has gained a lot from innovations, research and technological development. Technological change leads to changes in costs of production and in the comparative costs.
- The theory takes into consideration only labour costs and neglects non labour costs involved in production of commodities. This is unrealistic because other factor costs also go into the final cost involved in the production of a commodity. In reality therefore, it is money costs not labour costs that are the basis of national and international transactions. It further assumes that labour is homogeneous. This too is unrealistic because labour is heterogeneous - of different kinds and grades.

- The theory assumes that resources are static in supply (that is, the supply of labour is unchanged). In reality factors of production change over time, for example, change in climate, natural resources base , change in population size and structure and labour skills etc., all have effect on production .

- The theory emphasises barter trade. This is static because modern international trade is conducted on the basis of money exchange in, that is, in hard currencies.

To what extent is the comparative advantage theory applicable to developing countries?

Merits of comparative advantage

- Benefits of specialisation. When countries specialise in the production of goods which they can produce best, they enjoy benefits of specialisation such as increased skills of labour improved quality and quantity of output and reduced average costs of production.
- Expansion of market. Specialisation in the production of one commodity widens markets for products as all countries provide markets for commodities which they do not produce.
- Economic growth due to increased output. Due to concentration of resources in the production of what the country can produce best, output increases leading growth of the economy.
- Increased utilisation of resources. Resources required for the production of a good in which the country is specialised in are highly utilised due to efficiency in production as well as increased demand.
- Favourable terms of trade. Terms of trade are more favourable under comparative cost due to exchange of goods through barter system of trade.
- Avoids duplication of resources. Resources and product duplication is avoided due to production of only one commodity. Thus duplication that leads to wastage of resources is avoided.
- Greater employment creation. Employment opportunities are created for many people due to mass production of the only commodity.
- Greater political cooperation and international peace. Comparative advantage encourages greater cooperation between countries because of the heavy dependence of a country on others for the supply of what it does not produce. In the absence of cooperation supplies can be cut leading to socio- economic hardships experienced by all countries. Specialisation therefore, leads to greater political cooperation and international peace as no country is self-reliant.

Reasons for protectionism

- To protect infant industries. Protectionism aims at protection of infant industries from foreign competition. Infant industries need time to organise factors of production and establishment of the most efficient techniques of production and lower production costs. During such a time they need protection from goods produced by low cost firms outside the economy.
- To encourage production of goods of strategic importance incase supply is cut off. A country should adopt the policy of protecting its industries from a stand point of national defense. If a country is dependent on other countries for its basic

requirements of agricultural and industrial products it is harmful for her national interest in times of war. Therefore, a country should be self-sufficient as far as possible even if it involves making economic loss in the production of certain commodities which are essential for national defence in particular.

- To improve terms of trade. The imposition of a tariff on imports improves the rate at which the country's exports are exchanged for imports.
- To maintain domestic employment. The imposition of tariffs reduces imports and encourages employment directly in import competing industries. This in turn generates employment in other industries dependent upon this import competing industry and may spread to import substituting industry.
- To correct temporary unfavourable balance of payments position.
- Imposition of restrictions on imports both tariff and non-tariff barriers reduces quantities of goods imported into a country ,reduces expenditure abroad and corrects balance of payments disequilibrium in the short run.
- To retaliate against protectionist measures imposed by another country. Tariffs and other protectionist measures are also taken to retaliate against protectionist measures taken by one country against another. The measure is therefore aimed at blocking goods from the protecting country from entering another country previously not sheltered from imports. For example if country A slaps trade restrictions on country B making it difficult for B to export to her ,country B may retaliate by imposing similar restrictions on goods from country A
- To prevent dumping. Protectionism is an anti-dumping device. Dumping means the selling of a product in a foreign market at a lower price than in the home market. Dumping aims at flooding a foreign market with low priced commodities. As a result, theimport competing firms are ruined .To protect such firms, a tariff is imposed, this raises the prices of the product in the importing country and removes the threat of dumping.
- To discourage consumption of harmful or demerit products. Protection through bans and heavy import tariffs reduces consumption of demerit goods. Banning prevents the availability of the banned goods legally in the importing country. Tariffs make demerit products unaffordable there by discouraging their consumption.
- To strengthen regional cooperation. Tariffs are imposed on goods from non-member states while barriers on goods produced by member states are removed in order to promote trade and other benefit of cooperation in the region.
- To guard against imported inflation. Protectionism in form of licensing used to discourage importation from countries experiencing inflation by giving import licenses only for importation from sources not experiencing inflation.
- For purposes of self -sufficiency. Protection is done in order to attain self-sufficiency in agriculture and industry. Imports are discouraged for example through protective tariffs, to enable local production of goods previously imported. The attainment of self-sufficiency is aimed at reducing dependence on foreign imports.
- To achieve political objectives. Protectionism inform of trade sanctions -imposed on

countries in order to force them meet specific political objectives such as observance of human rights of its people .The economic sanctions are meant to cause economic hardship on the country against: which they are imposed till it complies with the political demand.

- To encourage use of local resources. Imposition of tariffs on imported inputs causes domestic producers to put local resources to use hence avoiding waste. Protection of domestic firms through both tariffs ar.:. subsidies enables them not to be out competed by imports .These loc; firms increase use of local resources since raw materials used as inputs by the firms are locally extracted.
- To increase output hence economic growth. Protection of local:'-from foreign competition encourages the firms to increase production -domestic demand. This leads to growth of the economy.
- To raise revenue for government. Protectionism through tariffs on imports and import license enables government to raise revenue for recurrent and development expenditure needs. In many developing countries taxes on imports contribute more than 30 per cent of total government revenue.

Conditions under which protectionism may be adopted in Uganda

- When it protects infant domestic industries from foreign competition.
- When it discourages dumping with its associated problems.
- When it improves / corrects the Balance of Payment (BOP) deficit.
- Where it is a source of government revenue through taxation, for example, import duties.
- When it creates employment opportunities at home.
- In case it reduces external economic dependence / promotes self-reliance.
- When it encourages the use of local resources.
- If it prevents importation of undesirable / harmful goods.
- In case it can check on imported inflation.
- Where it improves on the terms of trade (TOT).
- Where it reduces / controls political dominance.

Methods of protectionism

The following are the tools of protectionism that economies use;

- Tariffs, especially import duties. Tariffs as protective devices are taxes imposed on imports to make them more expensive than locally produced goods by the domestic industries.
- Quota. Quotas are quantity (physical) controls imposed on imports .The maximum quantity of particular goods to be imported into a country is fixed. The government authority that issues import licenses would not issue them in excess of the predetermined quota thus controlling the importation of the commodity into the country.
- Subsidisation of domestic industries. Domestic industries are subsidised by government donating to them either inputs or funds in order to lower their

production costs, this makes their products more competitive than imports.

- Total ban or embargo. Total ban is the complete restriction or stoppage of the importation of particular goods into a country in order to protect the health of its citizens. Embargo or sanction is the policy of making it illegal to import to and or export to a given country in order to achieve specified political objectives , for example , force the country against whom the embargo is imposed to respect human rights of her people .
- Administrative controls. This involves carrying out physical checks and applying tight bureaucratic procedures to guard against foreign competition. Trade can be restricted by giving contracts to local contractors only.
- Licencing. Trade can be controlled through use of licenses; the licenses give permission to only a limited number of firms to trade in a restricted product.
- Quality control. Imports are restricted by setting minimum quality requirements that imports must meet in order for them to be allowed into a country. Usually a national bureau of standards is empowered to ensure that only quality goods are imported to discourage importation of poor quality products.
- Exchange (rate) control. Trade is restricted by the central authority reducing the foreign exchange allocated towards the importation of non-essential goods and services.
- Depreciation in the value of the local currency. The value of the local currency relative to other currencies can be allowed to depreciate, so that exports become cheaper and imports more expensive. Consequently earnings from exports increase while expenditure on imports reduces thus improving the balance of payments position.
- Devaluation. The value of the local currency relative to other currencies is legally/deliberately/ officially lowered so as to make exports cheap and imports dearer.

Implications of protectionism

Protectionism has both positive and negative implications .The positive implications of protectionism are the following.

- Increased employment opportunities due to growth of local industries. Imposition of restrictions on imports encourages investments to produce goods in the domestic market .This leads to creation of new employment opportunities in the new investments. Domestic firms, sheltered from cheaper imports, remain in production hence maintaining the existing employment opportunities.
- Promotes growth and survival of infant industries due to reduced competition with foreign industries. Protectionism in form of import duties makes imports relatively more expensive than locally produced goods. Thus, making domestic firms more competitive than foreign firms in the domestic market. The domestic firms are therefore, not only able to survive but also given time to find efficient factor combination so as to produce goods at the lowest possible price and become

competitive with foreign firms without the need for further protection.

- Discourages consumption of demerits goods thus protecting the citizens from imported undesirable goods. Imposition of heavy tariffs on demerit imports such as wine and cigarettes increases their prices and discourages their consumption thus maintaining a healthy population in the country. Total ban imposed on imports makes the dangerous products not available for use legally in the country.
- Reduces dependence on other economies due to reduced reliance on foreign resources. Protectionism in the form of tariffs, quotas and administrative control reduces the volume of imports and foreign expenditure thereby improving the balance of payments position.
- Improves terms of trade by reducing importation of highly priced goods. Tariffs improve terms of trade when demand for imports is price elastic thereby forcing the foreign producers to meet some of the burden of taxation inform of increased cost of production and reduced profits. This improves the rate at which exports exchange for imports.
- Promotion of strategic industries. Protectionism through tariffs, total ban and import quota enables strategic industries, fhose that are essential for a nation's survival especially during external wars, to grow. Through protectionism a country is able to develop her strategic industries especially the arms and food supply industries so that she does not suffer during war.
- Discourages dumping of poor quality or duplicate goods. By imposing heavy tariffs on dumped goods which are sold at relatively cheaper prices in the foreign market than in the domestic market. This makes the products more expensive than local ones thereby protecting the domestic economy from dumping.
- Protects the economy against imported inflation due to reduced importation of goods from countries suffering from inflation. Licenses and foreign exchange control can be used to allow importation of goods from countries not experiencing inflation and discourage importation from inflation prone countries. The central authority does not allocate foreign exchange nor give import licenses for importation from inflation prone sources.
- Source of government revenue through increased import duty. Tariffs imposed on the imports and licenses given to traders to permit them import goods are sources of revenue to government to be used for recurrent and capital expenditures.
- Improves Balance of Payments position. This is due to reduced volume of imported goods.
- Reduces on political dominance because it reduces foreign decision making. There is a reduction in reliance on foreign influence as the local domestic industries are developed.
- Encourages utilisation of local natural resources due to local industrial development. The local industries that are protected by the trade barriers make use of the available inputs in their production process.
- Leads to economic growth or GDP due to increased local production. There is increased output of goods from the protected domestic industries which increases

the rate of economic growth.

Negative implications of protectionism

- Production of poor quality goods by inefficient local firms. Due to absence of competition protected local firms do not improve the techniques of production and other inputs thus production of low quality output. Citizens are thus subjected to consumption of poor quality local products since they cannot easily access imports.
- High prices of goods in the domestic market. Protectionism leads to increased price of imports when increased costs due to tariffs are transferred to consumers in form of increased prices. Local producers also charge high prices for their products because they are high cost firms with guaranteed market.
- Rise of monopoly producers. Local firms become sheltered monopolies since tariff and non-tariff barriers protect them against competition by efficient firms abroad. They become local monopolies because protection enables them to become the only suppliers to the local market.
- Infant industries fail to grow. Due to absence of competition, infant industries tend to remain infant forever due to absence of incentive to attain efficiency in production. Instead of making effort to become efficient, they lobby government for continued protection from foreign producers thereby becoming infant forever.
- Limited variety of goods in the domestic market. Protectionism in form of banning limits the availability of varieties of goods in the domestic market thereby limiting consumer's choices. Heavy import duties also limit consumer choices as they are limited to the consumption of the relatively lowly priced domestic goods.
- Retaliation from trading partners. Imposition of restrictive barriers on imports causes countries on whose products the barriers have been imposed to retaliate by imposing restrictions on goods from the importing country hence limited gains from trade.
- Loss of revenue from import duties (in case of quantity restrictions). When bans and quotas are imposed on imports; government loses tax revenue that would have been got from taxing the banned and quantity restricted products.
- Increased government expenditure on subsidisation and enforcement of policy. Protection of infant industries from foreign competition requires government subsidisation to reduce production costs. Government for example is involved in establishing and running inspection points to ensure policy compliance. Encourages trade malpractices. Protectionism encourages trade malpractices such as smuggling of banned substances and highly taxed products in order to evade tax payments.
- Discourages private investment. Private investment is discouraged due to bureaucratic delays involved in acquisition of license, foreign exchange and import permits. The bureaucratic delays may cause inefficiency in production. For example when importation of intermediate products is delayed, thus acting as a disincentive to investment.
- Reduces volume and pace to free trade hence lowering the welfare of consumers. Trade restrictions, for example, import quotas reduce quantities of goods available

to consumers, trade turnover (sales) and consumer access to the goods.

Free trade

Free trade refers to trade in which goods and services can be imported and exported without any barriers (such as tariffs, quotas, bans, administrative control and exchange control).

Or It is the absence of any form of government interference with the flow of international trade.

Or it is a trade policy without any tariffs, quantitative restrictions and other devices obstructing the movement of goods between countries.

The case for free trade

- Facilitates transfer of capital from one country to another ,usually developed to developing economies .The transfer of modern technology enables the technology importing economy to improve her local technology ,increase quality and quantity of output among other advantages.
- Widens market. Free trade widens markets for goods and services both in the domestic market and abroad. Wider market enables countries to dispose off surplus output that would have got spoilt due to limited consumption in the domestic market.
- Firms enjoy economies of scale. Increased market size enables firms to increase their scale of production leading to falling average cost of production or economies of scale.
- Encourages specialisation. Free trade encourages countries to specialize in the production of goods in which they have comparative cost advantages .This enables countries to enjoy the benefits of specialization such as efficiency in production increased quantity and quality of output and so on.
- Improves international cooperation. Nations cooperate with one another in order to sustain benefits of international trade leading to stability. Nations therefore, fear to go to war with one another for fear of disrupting international peace and stability that would disrupt gains from international trade.
- Efficiency in the allocation of factors of production. Under free trade, factors of production are allowed to where they can be most efficiency utilised in the production of the most profitable goods since the price mechanism holds way.
- Prevents the rise of local monopolies. Free trade prevents the emergence of sheltered monopolies at home since there are no restrictions on imports. Since domestic producers compete with foreign ones the disadvantages of monopoly

firms such as charging of high prices poor quality products is avoided.

- Increases the level of employment. It encourages firms to increase production in order to meet foreign demand for goods. Firms thus, employ more factor inputs in order to meet the external demand for goods.

- Increases economic growth rate. Firms produce more goods in order to meet external demand. Output also increases due to increased labour skills technological transfer, increased resources utilization and improved entrepreneur ship.

The case against free trade

- Local industries are outcompeted. Free trade results in stiff competition which pushes inefficient local firms out of the industry.

- Results into increased external economic dependence. Free trade encourages an economy to highly depend on foreign supplies for survival.

- Imported inflation may result. Free trade exposes an economy to inflationary pressures due to importation of goods from countries affected by inflation.

- Loss of tax revenue from imports. The government loses the tax revenue that would have been imposed on imports.

- Worsens Balance of Payments (B.O.P.) problems.

- Low level of exploitation of local resources. Free trade results in factors of production like capital and land not being adequately utilised.

- Importation of undesirable products with adverse effect on nationals. Free trade exposes the local population to harmful products imported into I country which endangers the lives of the nationals.

- May lead to unemployment due to outcompeting of local firms. Stiff competition which is created in the economy pushes the inefficient local out of production thereby leading to loss of jobs.

- May worsen the country's political and economic dominance.

Trade liberalization in developing countries

Meaning of trade liberalization:

It is the removal of unnecessary controls on trade thereby giving people the liberty to trade without undue government controls like total ban, quota syst tariffs and administrative controls to increase value, volume and benefits of trade.

Or Is the removal of unnecessary restrictions to trade by relaxing the use of instruments such as quota, total ban, tariffs and administrative controls in order to give people opportunity for increased participation in trade.

Or It is the removal of unnecessary controls on trade thereby giving people the liberty to carry out economic activities with reduced or minimal government interference, for example, by relaxing quotas, tariffs, total ban and administrative control so as to increase the value, volume and benefits of trade.

It is one of the conditions under the Structural Adjustment Programmes (SAPs) given to developing countries by the World Bank and IMF to embark on economic reforms in order to attain higher levels of economic growth and development.

Ways of liberalising trade

- Reduction of tariffs. Removal or abolition of quotas.
- Removal of unnecessary subsidies to domestic firms.
- Privatisation of state owned firms.
- Removal of price controls.
- Removal of foreign exchange controls (floating the exchange rate)
- Reduced administrative control for example removal of bureaucracy making it easy to acquire a license.

In Uganda, trade liberalisation is manifested in the following:

- Liberalisation of coffee export.
- Liberalisation of the foreign exchange markets.
- Liberalisation of the telecommunications sector.
- Liberalisation of university education/ tertian education.

Trade liberalisation is an engine for increasing the role of the private sector in the economy as well as attaining economic transformation.

Effects / impact of trade liberalisation on the economies of developing countries positive effects/impact:

- Results into increased employment opportunities. It opens up trade activities to private investors. As more economic activities are undertaken by private investors, this leads to creation of more jobs to the people. For example by liberalising coffee exports more jobs are created in the coffee exporting firms.
- There is increased level of output hence higher economic growth rates. Since investors are free to participate in economic activities there is greater output of

goods and services in an economy. With increased production of goods and services developing countries enjoy higher economic growth rates. This finally leads to high national income figures.

- Encourages / promotes resource utilisation. Trade liberalisation in economic sectors like industry, agriculture, service sector etc. promotes the tapping of resources that would have remained idle. This has a benefit of reducing excess capacity in the economy.

- Tends to control structural inflation. Trade liberalization usually attracts more investors who increase output of goods and services. As output of goods and services increases, prices are pushed down wards. This helps to control inflation which arises out of supply rigidities in an economy.

- Quality of goods and services is improved. It gives rise to stiff competition among producers which forces firms to be more efficient in order to remain in business. This competition also compels firms to improve the quality of goods produced and services rendered to the public. As quality of commodities is improved so is the standard of living of the people.

- There is increased tax revenue due to a widened tax base. Since many economic activities are set up as a result of trade liberalisation, the country's tax base is widened. The government is now able to levy taxes on the various activities; hence more tax revenue is collected by government. This revenue is used to finance government expenditure.

- Encourages inventions and innovations. Due to existence of a liberalised and competitive trade environment, business entrepreneurs always strive to introduce new ways of production and also improve on existing technology. Entrepreneurs develop cost -saving techniques of production.

- Improves the balance of payment position where exports are being encouraged. By liberalising the trade export sector, more export promotion industries are set up. The volume of exports is expanded leading to increased export revenue in developing countries. In the long run, the balance of payment position is improved.

- A variety of goods and services are produced. When trade is liberalised entrepreneurs produce a wide range of commodities. The consumers are exposed to a variety of consumer goods and services. Consumers' choice is widened hence higher standard of living for the people.

- Reduces income and wealth inequalities among people in various regions. Investors are likely to be spread in many parts of the country to set up income generating projects like horticulture, dairy farming and other agro- based activities. Such investment projects assist in reducing regional imbalance with in the country.

- Upholds consumer sovereignty. When trade is liberalised, production is guided by consumers' desires and what they demand. Therefore, consumers' demand determines the type of commodities to be produced. Production activities are aimed at maximizing consumer's welfare. This makes the consumers to be at the fore-front of production decisions of investors.

- Encourages foreign investment / resource inflows. Many foreign investors are encouraged to come and invest in the country due to the existence of liberalised trade environment (economy). As a result, the level of investment in an economy increases.

Negative effects / impact of trade liberalisation

- It makes an economy to be exposed to economic instabilities like imported inflation, Balance of payment problems, foreign exchange rate instabilities/fluctuations etc. Such economic instabilities are not good for the economy because they tend to discourage investment.

- Inefficient firms are out-competed by the stronger firms. Stiff competition which is created in the economy pushes the inefficient firms out of the industry thereby leading to unemployment (loss of jobs). Other factors of production like capital and land that would have been put to use become idle.

- There is a danger of resource misallocation. This arises because most of the economic activities are undertaken by the private sector. Therefore resources may not be adequately utilised, while others are over exploited by the private investors (irrational use of resources)

- There is duplication of resources which may result into wastage. Many producers undertake persuasive advertisement and in most cases, they are competing with in a very narrow market which causes wastage of resources.

- There is likely to be consumer exploitation due to ignorance of the consumers in the economy. Thus, the producers take advantage of consumer ignorance to charge high prices for usually poor quality goods and services.

- Trade liberalisation encourages capital out flows / profit repatriation by foreign - owned firms. As a result of liberalisation, many foreign investors are attracted to the country. They make profits out of their investments which are repatriated to their mother countries. This reduces investment multiplier effects hence slowing down the development process in the host country.

- It exposes the population to harmful products. This arises where trade liberalisation is not accompanied by strict laws to enforce quality standards of goods and services. Harmful products can be sold to the public hence endangering people's lives.(for example selling of expired and adulterated products to consumers)

- Generates income inequalities. The rich and prosperous people continue to dominate business activities in a liberalised economy. They make higher economic gains at the expense of the poor who are unable to save and invest. This worsens income inequality in an economy .(especially where government does not come out to fight this inequality)

- Gives rise to monopoly powers. In a liberalised economy, strong business firms usually out- compete the small and inefficient firms. The stronger firms which remain in the industry attain monopoly power which is associated with evils like overcharging, production of low quality goods, limited variety of commodities

STUDY QNS.

la). Distinguish between Privatisation and Trade liberalisation.

b) Examine the implications of trade liberalisation in an economy.

2a) What is meant by the term Multinational corporations?

b) Assess the impact of Multi - national corporations in your country.

Some key concepts

Infant industry

An infant industry is a firm in the industrial sector that has just started operating and therefore has limited market, low output level and incurs high average costs. It is protected through banning substitutes, import quotas, quality control, imposition of high import duties on substitutes, giving tax incentives or concessions for the infant industries, administrative controls or licensing and depreciation of local currency.

Commercial policy

Commercial policy refers to government policy aimed at influencing and directing the volume ,value and level of trade in an economy .

Instruments of commercial policy in Uganda.

- Liberalisation of the economy
- Licensing
- Indirect taxation /tariff
- Subsidies
- Quotas
- Embargoes / total ban /sanctions
- Administrative control /bureau of standards.

OBJECTIVES OF COMMERCIAL POLICY

- To protect domestic industries / to promote growth of the industrial sector.
- To improve balance of payments position.
- To improve terms of trade
- To attract foreign investment
- To increase the level of employment
- To attain and maintain price stability
- To reduce dependence on other countries.
- To increase economic growth rate.
- To discourage demerit consumption
- To promote economic integration
- To increase the rate of utilization of natural resources.
- To increase the level of savings
- To promote growth of strategic industries.

Advantages of commercial policy

- Protects domestic industries / to promote growth of the industrial sector.
- Improves balance of payments position.
- Improves terms of trade
- Attracts foreign investment
- Increases the level of employment
- Ensures attainment of price stability
- Reduces dependence on other countries.
- Increases economic growth rate.
- Discourages demerit consumption
- Promotes economic integration
- Increases the rate of utilisation of natural resources.

- Increases the level of savings
- Promotes growth of strategic industries.

Vent for surplus theory of international trade

Vent for surplus theory asserts that world trade enables countries to utilise formerly under utilised resources (land and labour) to produce output for export resulting into an out ward shift in the production possibility frontier.

Beggar -my neighbor policy

Beggar-my neighbor policy refers to a policy by which government extendsto each other similar concessions or restrictions in trade.

OrRetaliation by a country to protectionist policies of a trading partner.

Dumping is the selling of a product in a foreign market at a lower price than in the home market.

Dumping aims at flooding a foreign market with low priced commodities. As a result, the import competing firms are ruined .The dumping firms the raise up prices after becoming monopolies in the foreign market .To protect domestic firms against dumping ,heavy tariffs are imposed on the dumped goods .This raises the price of the product in the importing market and removes the threat of dumping .

The objectives of dumping

- To earn foreign exchange
- To dispose off surplus output
- To out compete local production (till the foreign producer becomes a monopolist.)

Effects of dumping to the exporting economy

- Producers acquire new markets for their products.
- Increase of revenue of the firms practicing dumping
- Provision of revenue to the government of the exporting economy
- Foreign exchange earnings by the dumping economy
- Maintaining of employment opportunities in the country practicing dumping
- Increased output hence economic growth
- Increased utilisation of resources in the exporting economy

- The exporting firm is able to cover some or all the variable costs of production and remain in production .

Effects of dumping to the importing market

- Local firms are out competed by cheap imports.
- Consumers' real income increases.
- Controls inflation in the importing economy
- Revenue is raised through duties imposed on imports.
- Improves relations between the exporting and importing country
- Unemployment due to the outcompeting of domestic producers
- Local producers are forced to be efficient in order to compete with foreign producers and remain in production.

Control of dumping

Dumping can be controlled through the use of import duties ,bans ,quotas and licensing.

Smuggling

Smuggling is the movement of goods across national borders without appropriate customs procedures .

Or it is the illegal movement of goods across national borders.

Effects of smuggling

- Government is deprived of revenue through customs duties
- Out competing of local firms by the smuggled goods
- Inability to control importation of harmful or banned substances.
- Failure to limit exportation of essential goods.
- Inability to achieve given political objectives due to failure at enforcing trade sanctions or total ban.

Discussion

“Developing countries should encourage protectionism rather than free trade if they are to maximise gains of international trade”. Discuss P220/2-2003

A candidate that agrees with the statement should bring out the arguments for protectionism and against free trade . Arguments for protectionism

- Protection infant industries from foreign competition
- Discouraging dumping
- Improves balance of payments (BOP) position
- Reduces external economic dependence / promotes self sufficiency
- Source of government revenue.
- Creates employment opportunities
- Prevents importation of undesirable goods.
- Checks imported inflation .
- Encourages use of local resources
- Improves the countries terms of trade
- Used as a tool of retaliate /reduces foreign dominance.

Demerits of free trade

- Local industries are out competed.
- Results into increased external economic dependence.
- Imported inflation may result.
- Loss of tax revenue from imports.
- Worsens B.O.P. problems.
- Low level of exploitation of local resources.
- Importation of undesirable products with adverse effect on nationals.
- May lead to unemployment due to our competing of local firms.
- May worsen the country's political and economic dominance.

The candidate should however balance his or her argument by proposing that free trade is not entirely bad nor protectionism entirely good by giving merits of free trade and demerits of protectionism.

Merits of free trade

- Improvement in quality of goods
- Low prices of goods

- Mobilisation of /inflow of foreign resources
- Widens market
- Wide variety of goods are produced
- Widens tax base
- Creation of more employment
- Increased foreign exchange earning
- Encourages specialization and its advantages
- Increased efficiency of local firms due to competition
- Promotes international cooperation
- Discourages monopoly tendencies in the economy
- Encourages faster growth of infant industries.
- Discourages trade malpractices
- Reduces government expenditures on protectionism.

Demerits of protectionism

- Subjects nationals to poor quality goods
- Subjects national to highly priced goods
- It frustrates in flow of foreign resources.
- Reduced market
- Protectionism limit variety of goods
- Results into reduced government revenue e.g. banning and quota
- Leads to low employment creation
- Limits foreign exchange earnings
- Discourages specialisation and its advantages
- Encourages in efficiency in the protected firms.
- Encourages retaliation hence reduced gains from trade.
- Encourages trade malpractices

- It is an expensive exercise since it calls for subsidisation
- Protected firms hold government at ransom to continue reaping high profits.

Terms of trade

Terms of trade (TOT) is the relation or comparison between the average price (price index) of a country's exports and the average price (price index) of her imports in a given period of time.

It is measured as a ratio of the price index of exports to the price index of imports of a country in a given time period.

For example if a country's export price is 90 while its import price is 110, then the

Country's terms of trade during that period is **90/110=0.818** (or less than one) or **90/110*100=81.8%(**or less than 100%) implying that the terms of trade are not favourable.

Terms of trade is also the rate at which a country’s exports are exchanged for imports. If in the following year, the terms of trade increased to 120, then it is said to have improved and the terms of trade are said to be deteriorating or poor if the index falls. An improvement in a country's terms of trade is good for that country in the sense that it has to pay less for the products it imports hence the import purchasing power of a unit of her exports is high or increasing i.e. it has to give up fewer exports for the imports it requires.

Terms of trade are expressed in the following ways:

Barter terms of trade or commodity terms of trade

Barter terms of trade is the ratio of the price index of exports to the price index of imports. Or

The relationship between the price index of exports and the price index of imports. Or

The rate at which a country's exports are exchanged for imports. It is calculated as;

$$\text{Barter terms of trade} = \frac{\text{Price index of exports (Px)}}{\text{Price index of imports (Pm)}}$$

Or

$$\text{Barter terms of trade} = \frac{\text{Price index of exports (Px)} \times 100}{\text{Price index of imports (Pm)}}$$

Thus net barter terms of trade is the ratio (expressed as a percentage) of relative export and import prices when volume is held constant. The net barter terms of trade index is calculated as the ratio of the relative change in the price of the export goods and services basket to that of the corresponding import basket of goods and services.

Thus, the terms of trade of a country when export price indices and import price indices are provided can be calculated as below;

Year	1990	1991	1992	1993
Exports	50	50	60	70
Imports	50	40	30	20

Calculate the terms of trade for the period 1990-1993

Factors that influence the trend of the barter terms of trade in a market economy

- The quality of exports.
- The quality of imports.
- The price elasticity of demand for exports.
- The prices of exports relative to the prices of imports.
- The exchange rate.
- The substitutability of exports with synthetic products.
- The number of producers of exports / the supply of exports.
- The availability of raw material saving techniques of production.
- The people that / who determine the prices.
- The income elasticity of demand for exports.

Income terms of trade

Income terms of trade is the measure of the import purchasing power of a country's exports.

Or The ratio of the value of exports to the price index of imports.

Given the table below;

Year	Export price index	Import price index	Quantity of exports
2000	100	100	120
2001	142	110	125
2002	120	115	200
2003	128	136	250
2004	154	173	

Calculate income terms of trade from 2001 – 2004

Causes of poor or deteriorating terms of trade for developing countries

- Falling prices of exports. Developing countries export primary products that fetch low prices on the world market yet they import manufactured goods at high prices hence poor terms of trade.

- Importation of expensive manufactured capital and consumer goods.Developing countries import expensive manufactured goods while exporting mainly low quality products that are lowly priced hence poor terms of trade.

- Increasing competition / substitution of exports with synthetics produced by the developed countries. Developed countries substitute natural products such as rubber, cotton, wool, silk, camphor, pyrethrum, sisal etc. with commodities that are artificially produced such as nylon and plastics but which are cheaper and serve the same purpose. This results in declining demand and falling prices of natural products hence deteriorating terms of trade since prices of imports are high or even rising.

- Exportation of semi-processed agricultural and other (mineral) products.Developing countries export semi-processed agricultural and other natural products with low value added hence lowly priced while importing expensive manufactured products.

- Market flooding or oversupplying of raw agricultural products resulting in a fall in export prices. Many developing countries produce the same primary products. This results in market flooding by the raw materials. Due to continuous over supply relative to the fixed demand for the products, prices of the products are low or even fall due to the need by the suppliers to dispose of the products. This leads to unfavourable terms of trade because of low or falling prices of exports while prices of imports are high.

- Protectionist policies of developed countries. Developed countries restrict entry of products from developing countries into their markets through measures such as tariffs, quotas and quality control. Since only a small fraction of the products from the developing countries can be sold in the export markets, prices fall (because of competition by the producers to out-sell each other) yet imports are highly priced.

- Weak bargaining power of developing countries in the world market.Developing countries have weak bargaining position in the world market therefore; prices of exports are determined by buyers who set low prices for exports of developing countries while selling dearly to the developing economies.

- Invention of raw material saving techniques of production. Due to scientific advancements in the developed economies, raw material saving techniques of production which use less and less raw material inputs have been developed. This has resulted in reduced demand for raw material inputs used in production of final products because supply of raw materials is high and inelastic. Terms of trade is unfavourable because export prices are low than the prices of imports.

- Low income elasticity of demand for exports. Exports are income inelastic in demand because even if incomes of consumers in the export markets increased, quantity demanded does not change. Increased supply of exports results in a fall in their prices due to the desire by producers to dispose off their products at even low prices. This leads to poor terms of trade due to exportation at low prices while importing at high prices.

- Low quality exports. Exports from developing countries are of low quality compared to imports from the industrialised economies. Consequently, the lowquality products command low prices as compared to the high quality imports which command higher prices.

- Exportation of raw materials. Some of the exports from developing countries are raw materials with no value added therefore sold at low prices yet imports are expensive manufactured consumer and intermediate products.

Effects of poor or deteriorating terms of trade for ldcs

Negative effects

- Leads to shortage of foreign exchange due to low foreign exchange earnings from exports.

- Reduces the volume of investment in the country.

- Leads to low production hence low volume of exports.

- Leads to inflation due to highly priced imports.

- Causes unemployment in export related sectors.

- Leads to low foreign exchange earnings (declining inflow of foreign exchange).

- Reduces the level of investment in the export sector.

- Makes the government unpopular due to reduced income from exports.
- Causes currency depreciation (declining value of the local currency relative to other currencies).
- Worsens the balance of payments and balance of trade position due to reduced exports and increased imports.
- Decline in economic growth rate.
- Declining incomes of export producers.
- Planning difficulty due to declining and unpredictable export earnings.
- Declining government revenue from taxation of exports.
- Under utilisation of resources due to exit of firms or disinvestment.

Positive effects

- Promotes regional co-operation.
- Encourages import substitution.
- Promotes processing of exports to add value / Promotes manufacturing of exports.
- Promotes diversification of exports.

Effects of favourable terms of trade

- Leads to decline in demand for locally produced goods.
- Leads to high export prices.
- Leads to a favourable balance of payments position.
- May lead to a fall in local production causing reduced employment opportunities.
- Reduces demand for highly priced exports.
- Increased importation of cheaper commodities due to fall in import prices.

POLICY MEASURES TO IMPROVE TERMS OF TRADE OF DEVELOPING COUNTRIES

The following are ways that the government should/ can/may employ to improve the terms of trade in my country:

- Undertake import substitution. The government should promote the setting up of industries to produce formerly imported goods. This should reduce dependence on highly priced imported goods as the local industries provide cheap substitutes.

- Process products for exports. The government should encourage the setting up of processing industries to add value to the primary products before exportation. This will result in relatively high prices for the goods.

- Improve quality of the exports. This can be done through encouraging agricultural modernisation so that exports of primary products fetch high prices.

- Strengthen regional cooperation or diversification of export markets. The government should promote or join regional groupings like East African Community, COMES A etc so as to widen the market for primary products. This can enable the developing countries to benefit more from international trade.

- Encourage importation from cheaper sources. This can be done by looking for countries willing to supply imports at relatively cheaper prices to avoid dependence on expensive consumer, capital and manufactured goods.

- Diversify exports. This can be done by encouraging the local people to increase on the range of products for export especially the non-traditional products so as to reduce the effects of falling export prices.

- Negotiate for the removal of trade barriers in export markets. There should be negotiation for the removal of barriers to trade in the developed countries. This can be through asking for relaxation on tariff laws, quotas and quality restrictions imposed on exports from developing countries so as to enable us benefit more from world trade.

- Strengthen or join commodity agreements (international commodity agreements). The government should actively participate in the signing of trade agreements between buyers and producers of primary products to ensure that high prices are paid.

BALANCE OF TRADE

This is the difference between the value of the country's visible exports and the value of the country's visible imports for a given period of time.

Or

Is the difference between the monetary values of visible exports and visible imports of a country during a given period of time.

Or

Is the difference between the value of goods and services exported and imported in a given period of time.

Visible trade items are exportable goods and importable goods

Factors that influence the balance of trade of a country

- Cost of production in the exporting country against the cost of production in the importing country.
- Cost and availability of raw materials, intermediate inputs and other inputs.
- Exchange rate movements in favour or against the country's currency.
- Bi-lateral and multi-lateral taxes and restrictions levied on the country.
- Non-tariff trade barriers for example environmental standards that may be levied on the country's exports.
- Availability of adequate foreign exchange used to pay for imports.
- Prices of goods manufactured at home.

Causes of unfavourable balance of trade in developing economies

- Exportation of primary products.
- Low quality of the products exported.
- Lowly priced exports.
- Excessive importation of expensive manufactured products.
- Low volume of exports.
- Inelastic income elasticity of demand for exports.
- Determination of prices of exports by developed countries.

Review question

Why may an improvement in terms of trade not lead to improvement in balance of trade?

Balance of payments

Definition: Balance of payments is the difference between receipts from both visible and invisible exports and payments for both visible and invisible imports of a country, including capital inflows and outflows during a given period.

Or

Balance of payments is a summary record of all the financial transactions of a country with the rest of the world on visible and invisible trade as well as net capital transfers during a given period.

Or

It is the relationship between earnings from abroad and payments abroad on both visible and invisible trade and net capital transfers during a given time.

N.B. When receipts are more than expenditures abroad, the balance of payments is favourable. The balance of payments position is unfavourable when expenditure abroad exceeds receipts. When expenditure on imports is equal to earnings from exports, the balance of payments position is in a state of equilibrium.

The Balance of Payments account

The balance of payments account is a summary of transactions between a country and the rest of the world.

Composition of the Balance of payments account

A: Current account. A current account consists of all transactions relating to trade in goods and services. It indicates the market value of a country's visible exports and imports during the year.

B: Capital account. A capital account consists of a country's transactions in financial assets in the form of short term and long term lending and borrowing and private direct foreign investment.

It is the portion of the balance of payments account that shows the volume of private foreign investment and public grants and loans that flow into and out of the country during a given time.

C: Cash account. A cash account shows transactions in a country's net official reserve assets.

It is the balancing portion of a country's balance of payments account that shows how cash balances (foreign reserves) and short term financial claims have changed in response to changes in the current and capital account.

D: Errors and omissions account. Errors and omissions account is a balancing item so that total credits and debits of the three accounts must equal in accordance with the principles of double entry book keeping so that the Balance of payments of a country always balances in the accounting sense.

Illustration of the balance of payments accounts

	Debits (Payments for imports) US$ millions	**Credits (Receipts) US$ millions**	**Net balance US$ millions**

A. Current account commodity exports (visible Services Exports invisible)	50 08	60 05	+10 -03
Balance on current account			+07
B. Capital account Private direct foreign investment Private loans and portfolio investments Government and multilateral flows Loans Grants Amortisation/ debt payments	09 06 12 10	08 02 04 06 02	-1 -4 -08 +06 +02 -10
Balance on capital account			-15
C. Cash account/official settlement account Cash reserves		03	+03
Balance			
D. Errors and omissions account balancing item (deficits)			
Total	95	95	

Significance / importance of balance of payment accounts in an economy

The balance of payments account of a country is useful in the following ways/aspects:

- It shows the volume of the country's outflows and inflows.
- It shows the country's indebtedness to other countries i.e. it shows the country's degree of external dependence.
- It is a good indicator of relative importance of certain sectors in an economy. For example the balance of payments on the current account shows international

trade transactions which are basically imports and exports (the foreign trade sector)

- It is a basis on which economic planning is done i.e. it provides data needed for economic planning. For example it helps an economy to decide whether to pursue import substitution or export promotion industrial development strategies.
- It is used to study the causes of balance of payment deficits or surpluses and also used to design measures to overcome the disequilibrium.
- It is necessary as the donors require it to provide aid. For example the International Monetary Fund (IMF) provides aid in form of foreign exchange to correct B.O.P. problems of its member states.

Causes of Balance of Payments disequilibrium in Uganda/ Account for the unfavourable balance of payments in Uganda

N.B: When explaining the causes of B.O.P, the major focus is on low earnings from exports as opposed to high expenditure on imports. At the same time, we also consider low volumes of exports as opposed to high volumes of imports.

The explanation of points for unfavourable Balance of Payments is different from that of Poor terms of trade. For poor terms of trade, we focus on only prices i.e. low export prices as opposed to high (rising) import prices. This is an important aspect which must be seriously noted. Please refer to your lesson notes on Terms of trade.

Dominance of exports by primary products with low value added. Uganda exports semi-processed goods like coffee and tea which have low value added to them before they are exported. This makes Uganda to earn less from the export of primary products than what is spent outside to buy imports hence Balance of payments disequilibrium / problems.

Low volume of exports. The volume of Uganda's exports is lower than the volume of her imports. There is more expenditure abroad to buy the imports than the earnings from exports sold abroad hence causing unfavourable Balance of payments position.

The high marginal propensity to import / Importation of high volumes of manufactured and consumer goods. Uganda continuously buys large volumes of consumer and capital goods from other countries. This leads to high expenditure abroad compared to the low receipts from abroad. This causes Balance of payments deficit in Uganda.

Protectionist and discriminatory policies of developed countries. The developed countries tend to protect their economies against goods from developing countries like Uganda. This reduces the volume of goods sold abroad by Uganda. This causes low earnings from abroad yet the country's foreign expenditure is high. This brings about balance of payments disequilibrium in Uganda.

Limited markets for Uganda's exports because the markets are flooded by products

from other primary producers. Uganda and other developing countries sell similar products to the same external markets. This causes excess supply of goods to those markets. There is a reduction in export prices. Foreign exchange earnings from Uganda's exports become low leading to unfavorable Balance of payments position.

High / Heavy expenditure on imports of military equipment or hardware due to political instability. This increases foreign exchange expenditure in order to buy military equipment from abroad yet the country's earnings from abroad are low. This leads to Balance of Payments disequilibrium.

Excessive expenditure by Uganda's government on bureaucrats, foreign travels of government officials, running of foreign diplomatic missions and contributions to the running of international organisations. This greatly increases the country's expenditure abroad yet earnings or receipts from abroad are low thereby causing unfavourable Balance of Payments position in Uganda. **High rate of profits and wage repatriation**. A lot is paid abroad through repatriation of profits by foreign investors and wages by foreign expatriates yet earnings from abroad from the exportation of goods , labour and capital is low hence balance of payments deficit in Uganda.

High levels of debt servicing. A lot of foreign exchange is used for debt servicing and repayment of principle on debts some of which were used for deadweight purposes yet earnings from abroad for example from exportation of capital, goods and services are low hence external expenditure exceeding earnings from abroad.

Trade restrictions in export markets. Protectionism in the export markets in form of tariffs, quotas and quality control limit the volume of goods that could have been exported hence less earnings from exports yet the volume of and therefore, expenditure on imports is high hence balance of payments problems.

Developed countries dictate prices of products from Uganda or weak bargaining power of Uganda in foreign markets. The major buyers fix low prices for Uganda's exports. This causes low earnings from exports (from abroad) yet there is high expenditure abroad. This causes Balance of Payments disequilibrium.

Limited variety of exports. There is a narrow range of export products from Uganda. Exports are mainly agricultural products, few industrial goods and limited services (invisible exports). This causes low earnings from abroad leading to Balance of payments deficit in Uganda.

Importation of expensive manufactured goods and fuel. Uganda spends heavily to buy manufactured goods like tractors, industrial machines, computers, motor vehicles, telecommunication facilities etc. However, the country earns less foreign exchange from her exports due to exportation of low volume of low quality and lowly priced products. This causes Balance of Payments disequilibrium or deficit in Uganda.

Effects of Balance of Payments deficits in developing countries

Negative effects

- Reduction in level of savings and investment.
- Causes unemployment/ limited employment opportunities.
- Leads to foreign exchange shortages.
- Leads to disinvestment.
- Leads to low standards of living.
- Leads to high taxation levels.
- Leads to increase in government expenditure.
- Leads to low levels of importation / reduces volume of imports.
- Leads to high capital outflows / depletion of foreign reserves due to running down of the reserves to finance imports.
- Makes government planning difficult.
- Retards economic growth due to low prices and low demand for exports.
- Leads to increased foreign dependence.
- Leads to inflationary problems due to shortage of essential goods.
- Encourages currency depreciation due to a reduction in the supply of foreig* exchange.
- Reduces the volume of imports.
- Promotes protectionism and its negative consequences for example retalhrMi
- Led to devaluation.

Positive effects

- Promotes import substitution industrialisation.
- Promotes regional cooperation.
- Encourages diversification of exports.
- Promotes development of local skills to reduce dependence on imported labour/ expatriates.
- Stimulates efforts to increase volume of exports.

- Strengthening of commodity agreements.
- Results in restructuring of foreign missions and reduction in foreign travels by government officials.

Measures that should be taken to solve Balance of Payments problem in Uganda

Export promotion strategy should be undertaken to increase the volume and quality of exports. This can increase Uganda's earnings from exports and improve the balance of payments position.

Trade restrictions should be put in place to discourage imports. Restrictions like heavy tariffs, import quotas; administrative controls should be used in order to reduce volume of imports. This can help Uganda to check the Balance of payments deficit.

Further liberalisation of the economy can be undertaken to increase output for both domestic and foreign markets. A liberalized export sector can result into increased export earnings hence checking the Balance of payments deficit.

The Government of Uganda should create peaceful, political atmosphere to limit military expenditure. This can help to cut down on the massive spending by government to buy military weapons thereby improving Balance of payments position

The export sector should be diversified by having a variety of goods and services for export. Uganda can stop relying on a few exports and concentrate on exporting many products in order to diversify her earnings. This can improve on her Balance of Payments position.

Import substitution industries may be encouraged. This can increase domestic production in order to minimize or reduce expenditure on imports since those goods which were formerly imported can be locally produced in Uganda.

Strengthen commodity agreements to which Uganda is a signatory or member. This can assist Uganda to have a better and stronger bargaining position so that more revenue can be earned from her exports.

Export markets should be diversified, through formation of regional trading blocs and consolidating existing ones like COMESA. These markets can expand the volume of exports from Uganda hence enabling the country to increase her earnings.

Appealing for debt relief. Uganda can lobby for debt re-scheduling, debt relief, debt conversion etc. This can help Uganda to control or reduce the expenditure abroad related to servicing the external debt.

A conducive investment climate should be consolidated in Uganda. This can take the form of investment incentives such as tax holidays. Investors canbe attracted to produce more high quality goods for the export markets. This can increase export earnings in Uganda.

Uganda can encourage depreciation of her currency to encourage exports and discourage imports. Currency depreciation makes exports cheaper and this can increase the volume of exports and foreign earnings. At the same time, it can increase expenditure on imports since imports become more expensive. Traders are discouraged to import. The volume of imports reduces. This can lead to improved Balance of Payments position.

The government of Uganda should cut down expenditure on foreign missions and diplomatic travels of government officials (i.e. restructuring of foreign missions and reduction of foreign travels). This can be attained by reducing the number of officials attached to foreign embassies and sending fewer officials for foreign travels. This can reduce government's expenditure abroad and the Balance of Payments position can be improved.

Barter trade can be encouraged in some situations. This can help to cut down on the high expenditure incurred to buy imports since goods are being exchanged for goods without any monetary payment. This can improve the Balance of payments position in Uganda. For example, Uganda can get fuel from oil producing countries in exchange for commodities like coffee, beans or maize.

Man power training (development) should be undertaken in Uganda. This can reduce the government expenditure on paying salaries and allowances to expatriates working in the country. Foreign exchange is saved and this can improve the Balance of payments position.

REVIEW QUESTIONS:

1 a) Account for the existence of balance of payments disequilibrium in your country.

b) Suggest measures that should be taken to solve the balance of payments problem in your country, (i.e. Use a suggestive tense by employing words: should / may / can)

N.B: Be keen on the tense if the question is calling for measures that are being taken to check the balance of payments deficit.

2. a) Distinguish between Balance of trade and Balance of Payments
b) Explain the effects of unfavourable balance of payments in an economy.

3. a) Explain the objectives of improving the Balance of payments position in economy.

b) Distinguish between the following as used in Economics:

i. Commercial policy and Fiscal policy

ii. Currency devaluation and currency depreciation

iii. Currency appreciation and Exchange rate

iv. Currency revaluation and currency under- valuation

v. Protectionism and Free trade

vi. Dumping and Import Quota.

Regional economic cooperation

Regional economic cooperation refers to the coming together of two or more countries in a given region for the sake of mutual (economic) benefit of all members states.

Regional economic cooperation is also at times referred to as economic integration which means the merging to various degrees the economies and economic policies of two or more countries in a given region for the mutual benefit of all members countries

Regional trading bloc, an economic condition among countries within a geographic region, usually characterized by liberalised internal trade and uniform restriction on external trade, designed to promote regional economic integration and growth.

Conditions necessary for success of economic integration

The following conditions may favour economic integration among countries:

Similar socio-cultural factors. This enables easy exchange of ideas especially with the use of a common language resulting in greater volumes of trade.

Similar economic policies for the member countries. This is to enable successful implementation of the economic decisions of the regional government which are supreme to those of its constituent states.

Implementation of protocols by the member countries. This is to ensure that agreements and time lines agreed upon by the regional government are respected by the member states.

Countries should be in the same region or share common borders. This minimises transport costs and helps when undertaking construction of joint infrastructures like roads, railways and harbours linking member countries.

The countries or intending members must be at relatively the same level of development. This ensures equitable distribution of costs and benefits.

Intending countries should be of approximately the same population size or market size. This is important in sharing costs of infrastructural development and creation of a wider market in the region.

Intending member countries should have similar political and economic ideology. This enables harmonisation of political and economic ideas.

The countries should be ready to maintain good political ties or relations among themselves. There should be peace in all member countries, harmony and cordial relationship among leaders of member countries.

Member countries should have well developed infrastructure. This enables easy transport of goods and better communication among member countries.

Comparative advantage in production must differ among the countries. This enables specialisation in different products to take place (production of different commodities).

Political will or support in the countries. This enables the intending member countries to solve common problems in the region and collectively implement agreed economic and political decisions.

Fair / equal sharing of benefits. This is aimed at ensuring equal access to markets for products of intending member countries and avoiding polarisation of trade where one country is more industrialised / developed than the others.

Existence of political stability in the member countries. This would ensure smooth flow of trade and exchange between the intending member countries.

Stages of regional economic cooperation (integration)

The degree of economic integration can be categorized into six stages:

- Preferential trade area.
- Free trade area.
- Customs union.
- Common market.
- Economic union.
- Complete economic integration.

These stages differ in the degree of unification of economic policies, with the highest one being the complete economic integration of the states, which would most likely involve political integration as well.

The process of regional economic cooperation goes through the following

Preferential Trade Area. This is a form of regional cooperation where countries reduce tariffs among themselves for selected goods only while maintaining tariffs on non-selected goods from member states.

Free trade Area. This is a form of regional cooperation where by the existing internal trade barriers are eliminated among member states but each member state imposes different external tariffs.

Customs Union. This is a form of regional cooperation where by the existing internal trade barriers are eliminated among member states. Member states agree to impose a common external tariff (on all non-member states).is a form of economic integration in which member countries have free trade amo`ng themselves and common external barriers or tariffs,

Common Market is a form of regional cooperation whereby the existing internal trade ~ers are eliminated among member states, there is a common external ' (on all non-member states) and free mobility of factors of production

ng member states.

a form of economic integration in which member states have free trade among selves, common external trade barriers and free mobility of factors of uction among themselves, nomic union

's is a form of regional cooperation in which there is free movement of goods ad services among member states (absence of internal tariffs), common iternal tariffs and other barriers , free mobility of factors of production among members states ,common social services (research , transport and communications), common monetary policies, use of a single currency (or monetary standard), common fiscal policies, harmonious economic policies ,simi\ar political system, and existence of a supra national organisation (such as regional council) to eliminate policy differences .nong members states.

It is the full integration of two economies into a single economic entity. Full or Complete integration

This is the highest and last level of integration .At this level ,member states surrender all national sovereignty on economic social, finance and political spheres to the regional supra-national body. Total economic integration is followed by political integration

The supra-national authority is equipped with extra political and military power over the land on behalf of the member states in accordance with the objectives and wishes of member states. This stage embraces the features of the above stages.

Reasons for promoting regional economic cooperation

Trade creation effects. Through regional integration, there is trade shifting from a high cost area to a low cost area following its formation than before its formation.

- To promote specialisation. Through regional integration, specialisation is promoted as production is based on the principle of comparative cost advantage. Therefore, each country produces mainly what it can produce best .Cooperation thus leads to gains of specialisation such as greater efficiency in production, greater output and lower costs of production.
- To stimulate industrial development. Through regional integration industrial

growth is stimulated due to existence of larger markets. In order to meet demand of a large market , industries increase their scale of production and grow large.

- To avoid duplication of resources. Through regional integration, resource duplication is avoided due to specialisation in production. Therefore, resources are not wasted by each member country attempting to achieve self-sufficiency in the production of all goods.

- To carry out joint research and information gathering at low average costs. Through regional integration, member nations pool resources in order to carry out joint research which is very expensive for a member nation to carry out individually .The ratio of total cost of research to the member states is lower than when the research is done individually by each state.

- To attract foreign resources. Through regional integration, the existence of large market following the formation of the regional cooperation attracts foreign investors ,who come to take advantage of the large markets to invest in the region .Consequently ,more foreign capital is invested in the region than the total capital invested in the individual member states as whole before the cooperation.

- To increase resources utilisation hence avoiding wastage. Through regional integration, resources that were formerly idle are put to use due increased output in order to meet the increased market demand by the widened market. Idle resources especially capital and labour are also put to use due to free mobility of goods and factors among member states.

- To increase output hence economic growth. Through regional integration, due to increased resource utilisation, firms also increase production in order to meet the increased market. Furthermore, firms both foreign and local join production to gain from the large market and this leads to economic growth.

- To encourage use of one currency hence facilitation of trade. Through regional integration, trade is facilitated by use of one currency thus saving time that would have been wasted in inter-currency convertibility before a trader can purchase goods from another member state. Loss by traders due to cost of converting one currency to another is also avoided by use of a single currency.

- To improve the bargaining ability of the region in the international fora. Through regional integration, countries in the region provide positions in the international fora as one entity. When voting for a position to be adopted in the international fora, they also act and vote as one bloc. This therefore increases the bargaining position of the region in the international fora than the individual governments.

- To create political cooperation and understanding among member states. Through regional integration, member countries cooperate to solve common problems in the region. In the event of one country being invaded by a non-member state or facing a problem of internal armed insurgency ,military assistance can be obtained from the other members of the regional cooperation.

- To ensure variety of goods are produced hence widening consumer choices. Through regional integration, goods from all member countries are available to consumers hence widening their choices since they have more goods to choose from than before the formation of the regional cooperation.

- To create more employment opportunities. More employment opportunities are created due to free factor mobility, specialisation, growth the industrial sector and increased investments in the region.

- To increase production of quality output due to competition. Through mal integration, there is intense competition among firms that produce similar products but sell in the regional market, quality of output is increased by firms in order to increase market share for their products at expense of rival firms.

- To enjoy economies of scale by firms. Due to widened market through ration, firms increase their scale of output .Increased scale of output by firms lead to falling average cost of productions consumers are thus availed goods at relatively low price due to economics of scale.

- To increase provision of infrastructures at relatively low average cost to each member country. Through integration, resources are pooled to provide infrastructures such as roads ,railways ,ports and harbours and airports which : times are too expensive for one country to provide alone.

Merits of regional cooperation

Trade creation effects. Regional cooperation leads to trade shifting from : high cost area to a low cost area following its formation than before its formation.

Promotes specialisation and its benefits. It promotes specialisation as production is based on the principle of comparative cost advantage. Therefore, each country produces mainly what it can produce best. Cooperation thus leads to gains of specialization such as greater efficiency in production, greater output and lower costs of production.

Stimulates industrial development. Industrial growth is stimulated due to existence of larger markets, in order to meet demand of a large market ; industries increase their scale of production and growth large.

Avoids duplication of resources. Resources duplication is avoided due to specialisation in production ,therefore resources are not wasted by each member country attempting to achieve self-sufficiency in the production of all goods.

Leads to low average cost of joint research and information gathering. Member nations pool resources in order to carry out joint research which is very expensive for a member nation to carry out individually .The ratio of total cost of research to the member states is lower than when the research is done individually by each state.

Attracts foreign resources. The existence of large market following the formation of the regional cooperation attracts foreign investors ,who come to take advantage of the large markets to invest in the region. Consequently, more foreign capital is invested in the region than the total capital invested in the individual member states as whole before the cooperation.

Leads to increased resources utilisation hence avoiding wastage. Resources that were formerly idle are put to use due increased output in order to meet the increased market demand by the widened market. Idleresources especially capital and labour are also put to use due to free mobility of goods and factors among member states.

Leads to increased output hence economic growth. Due to increased resources utilisation firms also increase production in order to meet the increased market. Furthermore, firms both foreign and local, join production to gain from the large market and this lead s to economic growth.

Leads to use of one currency hence facilitation of trade. Trade is facilitate d by use of one currency thus saving time that would have been wasted in inter-currency convertibility before a trader can purchase goods from another member state. Loss by traders due to cost of converting one currency to another is also avoided by use of a single currency.

Improves the bargaining ability of the region in the international fora. Countries in the region provide position in the international fora as one entity ,when rooting for a position for a position to be adopted in the international for a than the individual governments.

Strengthens political cooperation and understanding among memberstates. Member countries cooperate to solve common problems in the region. In the event of one country being invaded by a non-member state ef¬facing a problem of internal armed insurgency ,military assistance can be obtained from the other members of the regional cooperation. Countries may also cooperate to solve problems caused by natural factors such as famine, earthquakes and floods by mobilising resources to provide emergency relief.

Varieties of goods are produced Goods from all member countries available to consumers hence widening consumer choice since they have more goods to choose from than before the formation of the regional cooperation

Creating of more employment opportunities. More employment opportunities are created due to free factor mobility (for example unemployed labour from one country where there are no jobs to another country where jobs exist), specialisation, growth of the industrial sector and increased investments in the region.

Leads to creation of a wider market. The integration of countries result into a widened market for goods and services from the member states ther. avoiding wastage.

Production of quality output due to competition. There is intense competition among firms that produce similar products but sell in the regional market. Quality of output is increased by firms in order to inaeaac market share for their products at the expense of rival firms.

Economies of scale are enjoyed by firms. Due to a widened market, fans increase their scale of output .Increased scale of output by firms leads! falling average cost of productions consumers are thus availed goods at relatively low price due to economies of scale.

Increased provision of infrastructures at relatively low average each member country. Resources are pooled to provide infrastructures as roads ,railways ,ports and harbours and airports which at times are : expensive for one country to provide alone.

Demerits of regional cooperation

Loss of tax revenue. There is free mobility of goods and services among member states in a regional cooperation .Governments therefore, lose tax revenue from customs duties previously imposed on imports from non-member stales before the formation of regional cooperation.

Unequal distribution of benefits due to goods moving mainly in one direction only. Benefit of cooperation may be unequally distributed due to one or a few member states being more industrialised than others such that other member states provide markets for products of the more developed states while exporting to the dominant member country very little in return. This results in one member country benefiting than others.

Trade diversion effect. Regional cooperation leads to trade shifting from a low cost non-member state to a high cost member state when economic integration takes place .Tariff are imposed on imports from non-member states to protect the domestic industries. Consumers are therefore, forced to consume highly priced goods within the region as a result of regional cooperation.

Surpluses may result due to production of similar goods. Member states may have comparative advantages in the production of the same commodities hence fail to specialise in production. This leads to production of similar goods in all the member states for the same regional market resulting in surplus production of goods that cannot be absorbed by the regional market.

Buying of poor quality goods from members states. Regional cooperation leads to imposition of heavy protection tariffs on import from non-member states and free mobility of goods produced within the region. This makes imports much more expensive than the poor quality local products thus forcing consumers to buy the cheap inferior locally produced goods.

Sacrifice of national interest since member countries have to act in the interest of all. The national interests such as attainment of self-sufficiency in all areas of production, development of strategic industries, and foregoing production of some goods in which a nation has absolute advantages over other countries have to be sacrificed so as to ensure continued cooperation of the member states in the region.

Distribution of industries may be done at the cost of economies of scale but for purposes of distribution of projects and benefits. One country may be having greater advantages in the production of majority of the commodities but for purposes of cooperation, industries are distributed (located) even in the high cost states leading to production of highly priced products produced by small but high cost firms.

Loss of political sovereignty. There is loss of political sovereignty due surrender of national autonomy to the regional supra -national organisation. The laws, political and economic decisions of the regional government are supreme to that of its constituent states ,for example, a ruling or decision of the regional court or government must be respected by the member states.

Unequal development due to unequal distribution of industries. Industries may be concentrate in one or few member states due to their having relatively greater comparative advantages of production than the other member states, for example, Kenya being more industrialised than Uganda, Rwanda, Burundi and Tanzania). This results in unequal development of states in the region.

High costs of running the regional government. Member states have to meet the costs of running regional organisation member states make have to meet the cost of running the regional organization. Member states make heavy periodic financial contributions lo the regional body. This may necessitate taxing citizens more heavily than before in order to raise sufficient revenue for both national use and for regional administration.

N.B. Trade creation effect, following the formation of economic integration, trade shifts from a high cost trading partner to a lower cost member state.

Or A situation in the theory of customs union that occurs when , following the formation of a customs union, there is shift in the geographic location of production from a high cost trading partner to a lower lost member state.

Or A situation in the theory of customs union that occurs when following the formation of a customs union ,there is shift in the geographic location of production from higher cost to lower states.

Effects of trade creation are

- Promotes specialisation and its advantages.

- Leads to a widened market for goods.
- Leads to low prices paid by consumers in member states.
- Leads to increased resource utilisation in the member states.
- Encourages the growth of infant industries within the region.
- Saves on excessive outflow of foreign exchange to non-member countries.
- Leads to limited variety of goods and services to the consumers.

Trade diversion effect means that following the formation of economic integration ,trade shifts from a lower cost non-member state to a higher cost member state.

Effects of trade diversion are

- Encourages growth of infant industries in member states.
- Employment creation in the infant industries.
- Regional self-reliance is encouraged.
- Loss of revenue from customs (import and export taxes).
- Declining consumer welfare due to reduced purchasing power (leads to low consumption level).
- Leads to limited variety of goods.
- Leads to high prices for goods and services.
- Discourages unity among member states.
- Leads to low quality of goods due to limited competition.
- Leads to smuggling of cheap commodities from non-member states.

Factors that influence / determine /affect / the strength of economic integration in developing countries

The will to sacrifice national interest. Limited will to sacrifice the national interest due to the desire to maintain national sovereignty and inability to understand the benefits of integration by the masses and politicians limits the effectiveness of economic integration but the existence of the will to sacrifice the national interest and ability to understand the benefits of integration by the masses and politicians ensures the effectiveness and success of economic integration.

The availability of a common currency. Absence of a common currency makes it difficult to carry out trade smoothly which limits the effectiveness of economic integration but use of a common currency makes it easy to carry out trade smoothly which promotes the effectiveness and success of economic integration.

The level of specialisation in trade. Same opportunity cost in all countries /absence of specialisation in production results into surpluses hence wastage as member states produce almost similar goods which limits the effectiveness of economic integration but increased specialisation in different products taking place (production of different commodities) allows countries to exchange surplus output which results into success of economic integration.

The will to sacrifice tax revenue from customs. Desire to tax goods of member states to raise revenue due to the fear of loss of tax revenue which occurs as a result of promoting free trade among the member states limits the effectiveness of economic integration but willingness to lose tax revenue which occurs as a result of promoting free trade among the member states enables the success of economic integration.

The level of development of infrastructures. Poorly developed infrastructure hinders effective transfer of goods across borders and increases the cost of doing business in the region which limits the effectiveness of economic integration but well developed infrastructure enables effective transfer of goods across borders and reduces the cost of doing business in the region which ensures the effectiveness and success of economic integration.

The level of coordination of the industrialisation programmes. Poor coordination of the industrialisation programs results in polarisation of trade with industries concentrating in one country instead of equal distribution of industries basing on sharing of benefits principle which limits the effectiveness of economic integration but effective coordination of the industrialisation programs results in smooth trade with industries equally distributed which promotes the effectiveness and success of economic integration.

The availability of a mechanism for equitable sharing of the gains of cooperation. Unequal gains from cooperation due to absence of a mechanism to facilitate equitable sharing of the gains of cooperation limits the effectiveness of economic integration but equal gains from cooperation due to presence of a mechanism to facilitate equitable sharing of the gains of cooperation enables the effectiveness of economic integration.

The level of political differences. Differences among political leaders creates a lot of tension and animosity making it difficult to co-operate economically and thus limits the effectiveness of economic integration but existence of political will or support in the intending member countries enables the intending member countries to solve common problems in the region and collectively implement agreed economic and political decisions hence success of economic integration.

The level of knowledge by the people of benefits of cooperation. Ignorance of people of the benefits of cooperation since many of the citizens of countries tending to integrate are not aware of the potential benefits of regional integration limits the effectiveness of economic integration but extensive awareness about the benefits of cooperation among many of the citizens of countries tending to integrate promotes success of regional integration.

The availability of ideological differences. Ideological differences make it difficult to have common political and economic ideas hence slowing down the process of integration which limits the effectiveness of economic integration but when intending member countries have similar political and economic ideology, it enables harmonisation of political and economic ideas hence success of economic integration.

The degree of inequality in the development member states. Unequal development of the member states results into unfair gains during exchange will trade moving in one direction and this limits the effectiveness of economic integration yet when the countries or intending members are at relatively the same level of development, it ensures equitable distribution of costs and benefits hence success of economic integration.

The availability of shared boundaries. Absence of shared boundaries since there is limited geographical proximity among many developing countries, making exchange difficult and this limits the effectiveness of economic integration yet countries that are in the same region or share common borders, it minimises transport costs and helps when undertaking construction of joint infrastructures like roads, railways and harbours linking member countries hence success of economic integration.

The degree of differences in historical background. The differences in cultural aspects like languages and religion make it difficult to carry out exchange, for example, language problems may necessitate an interpreter of trade documents making exchange expensive and this limits the effectiveness of economic integration yet similarity of socio-cultural factors enables easy exchange of ideas especially with the use of a common language resulting in greater volumes of trade hence success of economic integration.

Factors that limit effective economic intergration in developing countries

The following factors have undermined the advancement of regional economic integration in developing countries:

Limited will to sacrifice the national interest. This is due to the desire to maintain national sovereignty and inability to understand the benefits of integration by the masses and politicians.

Absence of a common currency. The differences in currencies make it difficult to carry out trade smoothly. Same opportunity cost in all countries /absence of specialisation in production. This results into surpluses hence wastage as member states produce almost similar goods.

Desire to tax goods of member states to raise revenue. This is due to the fear of loss of tax revenue which occurs as a result of promoting free trade among the member states.

Poorly developed infrastructure. This hinders effective transfer of goods across borders and increases the cost of doing business in the region.

Poor coordination of the industrialisation programs. This results in polarization of trade with industries concentrating in one country instead of equal distribution of industries basing on sharing of benefits principle.

Unequal gains from cooperation due to absence of a mechanism to facilitate equitable sharing of the gains of cooperation.

Desire for self-sufficiency. Some member states cherish economic independence instead of integration thus causing failure of such regional blocs Absence of strong regional authority to enforce compliance of member states.

Differences among political leaders. This creates a lot of tension and animosity making it difficult to co-operate economically.

Ignorance of people of the benefits of cooperation. Many of the citizens of countries tending to integrate are not aware of the potential benefits of regional integration.

Ideological differences. This makes it difficult to have common political and economic ideas hence slowing down the process of integration.

Unequal development of the member states. This results into unfair gains during exchange with trade moving in one direction.

Absence of shared boundaries. There is limited geographical proximity among many developing countries, making exchange difficult.

Cultural differences (absence of shared language or language differences).The differences in cultural aspects like languages and religion make it difficult to carry out exchange, for example, language problems may necessitate an interpreter of trade documents making exchange expensive.

Differences in historical background.

Desire to avoid trade diversion effect.

Causes of the collapse of the east african community in 1977

- The desire for self sufficiency
- Trade diversion effect
- Duplication of industries revenue
- Lack of will to sacrifice customs duties.
- Ignorance on the part of the people of the benefit of cooperation.

Foreign exchange

Foreign exchange are claims on a country by another country held in the

form of currency of that country. (Todaro)

Or

Are currencies of other countries that a given country keeps. Or

Are foreign currencies and claims to them in such forms as bank deposits, cheques and promissory notes payable in hard currency . (Lipsey)

Foreign reserves the total value of all gold, foreign currencies and special drawing rights held by a country as both reserves and a fund from which international payments can be made. Or

The total value, usually expressed in dollars of gold, dollars and special drawing rights (SDRs) held by a country as both a reserve and a fund from which international payments can be made. (Todaro)

Uses or importance of foreign reserves

- Used for covering trade deficits.
- Used for closing balance of payments deficit.
- An indicator of performance of an economy in international trade.
- Provides reserves for future payments, for example, meeting debt obligations.
- Determine the value of domestic currency.

How foreign reserves are acquired

- From a balance of payments surplus or increased exportation.

- Capital inflow especially from foreign investors.
- Bon-owing externally from the World Bank and IMF.
- Remittances of nationals working and living abroad.
- Disinvestment, that is, the sale of government assets abroad.

Foreign exchange market, the market where foreign exchange is traded at a price that is expressed by the exchange rate. (Lipsey)

Or

The market where foreign currencies are traded at a price that is expressed by the exchange rate.

Net foreign exchange earnings is the sum total of all foreign currency receipts less expenditure a given fiscal year (Todaro) Foreign exchange earnings -refers to a country's income from other countries (mainly through exportation)

Foreign exchange control refers to the regulation of all receipts and payments in foreign currencies by the central bank.

Exchange rate control refers to the government policy of regulating the rate at which the local currency exchanges for other currencies.

Or Is the state regulation of the rate at which the local currency can exchange for foreign currencies.

Features of foreign exchange control

The exchange control system has the following features.

- Complete government control over the foreign exchange market.
- All foreign currencies are required to be surrendered to the central bank.
- The central bank sanctions and allocates all foreign payments in respect of different currencies.
- The central bank fixes the official exchange rate.
- There is regulation of currency to be supplied to importers.
- Exporters are required to surrender foreign currencies to the central bank.
- Only specified banks and licensed dealers can deal in foreign exchange.
- The central bank acts as a discriminating monopolist by charging low rates of exchange for the purchase of essential and high rates for purchase of luxury imports.

Objectives of exchange control

The following are the objectives of foreign exchange control.

- To improve balance of payments position. Imports are limited by limiting the allocation of foreign currencies for importation. Thus with limited imports and limited outflow of foreign exchange ,the balance of payments position improves.
- To raise revenue for government. Exchange control is used as a means to traders foreign currencies at rates higher than the rate it buys from them.
- To retaliate against another country. Exchange rate control gives monopoly power to a country over the currencies it holds ,it can retaliate against devaluation measures by a trading partner by lowering the value of her currency in terms of other currencies by a bigger margin.
- To reduce or discourage consumption of harmful products. Exports of non - essential goods ,luxuries and harmful products are controlled by allocation of less foreign exchange for exchange for the exportation of essentials only so as to conserve the use of foreign exchange.
- To protect domestic industries. Exchange control is used as means of protecting domestic industries against competition by foreign producers by allocating the foreign exchange for the importation of goods not locally produced only.
- To create employment. Exchange control can be used for employment creation by allocating scarce foreign exchange for the importation of intermediate products for further production so as to maintain current employment level as well as create new jobs.
- To control imported inflation. Currency regulation is under taken in order to allocate limited foreign exchange for countries not experiencing inflation ,limited foreign exchange is also used for importation of essential goods to supplement domestic supply.
- To improve terms of trade. Exchange control is used to improve terms of trade by restricting the volume of foreign exchange available for importation of high priced goods.
- To promote strategic industries. Foreign exchange can be used for the establishment of strategic industries which are vital for a nation's survival.
- To discourage speculation in foreign exchange market by stabilising exchange rates. Control of exchange rates maintains the rate at which the local currency exchanges for other currencies over a (long) period of time. This discourages speculation because the exchange rate does not change. Fluctuating exchange rates harm commerce and industry thereby creating uncertainty and speculation

in commerce and production.

- To increase the level of investments by preventing capital flight. When exchange rate is controlled ,gold and capital funds cannot be exported without the permission of the exchange authority. The exchange authority may ban or give foreign exchange in limited quantities to export capital for specific purposes. Flight of foreign capital is averted and is instead used for investment at home.
- To pull an economy out of a depression. Through currency under valuation ,the currency authority can fix the value at which the local currency exchanges for foreign currencies at a lower stimulate exports and reduce import and to raise the general price level in the economy.
- To repay foreign debts through currency overvaluation. This is done by fixing the value at which the local currency exchanges for foreign currencies at a higher value than that allowed by the market forces of demand and supply .The currency is overvalued in order to import more goods at a low cost ,import capital equipment and raw materials cheaply and Co accumulate reserves to repay a /arge foreign cfe6t.
- To encourage long term planning.
- To minimise capital outflows.
- To stabilise incomes of exporters

A SUMMARY

Reasons for exchange control include:

- To control imported inflation
- To attain a favourable balance of payments position by restricting outflow of foreign exchange (forex).
- To prevent dumping by restricting foreign cheap products.
- To encourage development of infant industries by restricting forex to import foreign goods that would outcompete local goods.
- To increase employment opportunities by encouraging the growth of local industriesthat would increase employment opportunities.
- To attain favourable terms of trade by restricting forex for purchase of highly priced foreign goods as compared to exports with low prices.
- For strategic reasons for example agriculture. It is not wise to over depend on foreign food supplies lest these be threatened in times of political instability or war.

- To avoid importing harmful goods by restricting forex to import harmful goods that would lead to deterioration of health of the population hence declining growth rates.
- To attain self-sufficiency / to reduce dependence by allowing countries to build independent, integrated and self-sustaining national economies.

Factors that determine the demand and supply of foreign currency in my country include:

- Price of imports.
- Volume of imports.
- Price of exports.
- Volume of exports.
- Debt servicing requirements.
- Government's external obligations.
- Corporate expatriation needs.
- Central bank intervention.
- Government's external borrowing for consumption.
- Need to accumulate reserves.
- Level of capital inflow.
- Level of inflow of grants or donations.

Factors which determine the exchange rate in a money market

The factors that influence the strength of a currency relative to other currencies include;

- The volume of domestic output; the higher the domestic output the stronger the currency.
- Rate of domestic money supply; the higher the rate of domestic money supply, the weaker the currency.
- Volume of exports; the higher the volume of exports, the stronger the currency.
- The volume of imports; an increase in the volume of imports weakens the domestic currency value.
- The level of foreign exchange reserves; an increase in the ratio of foreign exchange reserves to the domestic money supply, makes the domestic currency

stronger.

- The rate of inflation in other countries.
- The political climate in the country; political stability increases investment thus making the local currency stronger.
- The government policy on exchange rate such as pegged or fixed exchange rate.

Foreign exchange rate determination

Foreign exchange rate can be determined through the following ways:

- Foreign exchange control
- Market forces of demand and supply

Devaluation

Devaluation is the legal or official reduction in the value of the local currency in relation to currencies for example if the shilling exchanges with the dollar at a rate of 2000 shillings to US$ 1 and the shilling is devalued by 20% ,the new exchange rate would be : Old exchange rate + rate of devaluation of old exchange rate 2000+ (20% x 2000) =2400 shillings to the US dollar.

Objectives of devaluation

- To increase the volume of exports. Devaluation aims at making exports relatively cheaper than before thereby making them more attractive and increases their demand abroad.
- To increase foreign exchange earnings by making exports cheaper and more attractive to foreign buyers.
- To reduce importation by making imports expensive / dear.
- To correct balance of payments by increasing foreign exchange earnings and reducing the volume of imports.
- To increase foreign capital inflow. Devaluation is aimed at increasing capital inflow by increasing capital flow by increasing market for domestic forms foreign investors are thus attractive thus attracted to invest in the country.
- Alternatively, devaluation also makes factors of production which are locally available to be cheaper than in other countries ,this too induces foreign investment .
- To increase economic growth rate by stimulating increased use of domestic

inputs due to increase demand for exports.

Conditions necessary for the success of devaluation

The policy of devaluation may become successful under the conditions when the:

Demand for imports is price elastic. Devaluation can only succeed to solve the balance of payments problems when imports are price elastic in demand such that when their prices increase due to currency devaluation, the demand for imports reduces.

Demand for exports is price elastic. Devaluing of a currency can only succeed when the exports are price elastic in demand such that a decrease in the price due to devaluation, leads to increase in their demand.

Supply for exports is price elastic. Devaluation can only succeed when the exports are price elastic in supply such that an increase in demand for exports as a result of exports becoming cheaper, is accompanied by increased supply.

Supply for imports is price elastic. Devaluation makes imports dear and reduces their demand. Therefore, devaluation can be successful when the foreign suppliers are not willing to supply at the lower prices.

There is no competitive devaluation. Devaluation can succeed when other countries do not carry out retaliation measures or impose trade barriers on goods of the devaluing economy. This enables a country to increase her export earnings.

There is no inflation in the devaluing country. Devaluation can succeed when there is no hyper inflation in an economy thereby making the products affordable in the foreign markets.

Devaluation is not followed /accompanied by an expansionary monetary policy.

There is no smuggling of goods across borders of a country.

Circumstances when the policy of devaluation may become successful:

- When the demand for imports is price elastic
- When the demand for exports is price elastic
- When the supply for exports is price elastic
- When the supply for imports is price elastic
- When there is no competitive devaluation
- When there is no inflation in the devaluing country
- When devaluation is not followed /accompanied by an expansionary monetary

policy.

- When there is no smuggling of goods across borders of a country.
- When a country devaluing is not a price taker but a price maker.

Effects of devaluation

Reduces the volume of imports when a currency is devalued, imports become more expensive than before making them less affordable. This discourages importation.

Increases foreign exchange earnings .by encouraging demands for exports devaluation leads to increased foreign exchange earnings.

Increases foreign capital inflow. Devaluation attracts foreign capital investments by creating demand for locally produced goods. Foreign capital is also attracted by the decrease in the relative values of local resources labour and raw material inputs.

Leads to improvement of the balance of payments position by reducing importation and expenditure abroad while increasing exportation and foreign earnings from abroad.

Leads to economic growth. It stimulates output due to increased demand for exports.

Leads to inflation. Devaluation is inflationary when reduction in exchange rate of the local currency leads to overall increase in the general price level. This occurs especially when an economy is import dependent therefore devaluing the currency increases the cost of importation and the prices of goods in the economy. Trade unions and suppliers of raw materials inputs may also demand for increased pay thereby increasing production costs hence cost push inflation.

Leads to retaliation. Devaluation induces other countries to retaliate by devaluing their currencies as well or by imposing tariffs on products from the devaluing economy in order to protect their domestic industries. This reduces the benefits of devaluation in the devaluing economy

Failure of devaluation to solve balance of payments problems.

The following are causes of failure of devaluation to solve balance of payments in developing countries:

The demand for exports is price inelastic. Exports from developing countries being price inelastic in demand, even when their prices decrease due to devaluing of a currency their demand does not increase. Quantity of exports demanded remains more or less the same. Devaluation therefore, does not lead to increase in exportation and increased foreign exchange earnings. Therefore, the balance of payments position does not improve.

The demand for imports is inelastic. Devaluation fails to solve the balance of payments problems because imports are price inelastic in demand such that even when their prices increase due to devaluing of a currency there not increase demand remains more or less the same. This leads to failure in the objective of discouraging imports and reducing expenditure abroad to improve the balance of payments position.

The supply of exports is price inelastic. Exports being price inelastic in supply ,due to dependence on nature in production and long gestation period, an increase in the demand for exports as a result of the exports becoming cheaper is not accompanied by increased supply. Thus devaluing a currency does not lead to increased earnings from exports and the balance of payments position is not improved.

The supply of imports is price inelastic. Devaluation is meant to make imports dear and reduce their demand. However, foreign suppliers are willing to maintain supply at even lower prices but make less profit. Without a reduction in the supply of imports expenditure abroad remains more or less unchanged and balance of payments position does not improve.

The devaluing country may be experiencing inflation. When the economy is experiencing inflation, devaluation is accompanied by rising costs of production as prices of raw material inputs and wages increase due to union pressure. Costs of production and prices of products increase making the products unaffordable in the foreign market.

Retaliation by trading partners. When other countries retaliate by devaluing their currencies as well or by imposing trade barriers on the products of the devaluing economy in order to protect their domestic industries and employment Revaluation does not lead to increased earnings from abroad.

Trade restrictions in the importing country. Devaluation does not lead to increased volume of exports due to trade restrictions in form of tariffs, quality control ,import substitution and total ban. Therefore, devaluation does not lead to increased export earnings.

Prices of exports remaining high even after devaluation. If after devaluation the prices of exports remain high compared to products from other countries. Consumers in the export markets will continue to prefer products from the cheaper source to the products of the devaluing country.

People in the devaluing country have high marginal propensity to import. Due to high marginal prosperity to import an increase in earnings from abroad (due to devaluation policy) leads to proportionate increase in demand for imports. Therefore devaluation which makes imports more expensive may not lead to reduced expenditure abroad and the balance of payments problem remains.

Exports in the devaluing country are of poor quality. When the exports are of poor quality, consumers in the export markets continue to demand for the more expensive high quality products from other countries and ignore the cheap low quality products of the devaluing country. In such a circumstance, devaluation does not lead to increased volume of and earnings from exports.

Weak administrative machinery to coordinate and implement the devaluation policy. Developing countries do not have efficient administrative machinery to identify the correct time to carry out the policy ,for example ,sometimes devaluation is carried out when there are no surpluses to be exported.

When there is full employment in the devaluing country. In situations of full employment of national resources, an increase in demand for exports following the devaluation policy cannot be accompanied by increase in supply because the productive capacity of the country cannot increase.

Methods of exchange control

There are two methods of exchange control ,direct and indirect.

Direct methods

Among the direct methods are the following:

Flexible or floating or free exchange rate is that system where the rate at which the local currency exchanges for foreign currencies is determined by market forces of demand and supply. Or

the exchange rate in which the value of the local currency relative to other currencies is determined by the forces of demand and supply(without the intervention of the authority)

Advantages of floating exchange rate

- It encourages investment.
- Leads to generation of adequate foreign exchange through exports ,loans and grants.
- Provides an automatic mechanism for correcting balance of payments position.
- Does not require maintenance of large official reserves.
- A country can pursue an independent internal monetary policy.
- Discourages emergence of illegal or parallel foreign exchange market.

Disadvantages of floating exchange rate

- May lead to imported inflation.
- Encourages speculation in currency.
- Difficult to plan for imports and export sectors.
- Encourages the development of parallel markets for goods for example smuggling.

Managed exchange rate (dirty float or managed float) is one in which the forces of demand and supply are left to determine the exchange rate but within limits set by the monetary authority. Or

One in which the value of a currency is allowed to fluctuate within limits or margins beyond which the monetary authority intervention in the currency market.

Advantages of managed exchange rate

- Controls fluctuations in the value of the currency
- Protects importers and exporters against adverse effects of price fluctuations.
- Ensures that there is favourable exchange rate in the market
- Controls the actions of speculators
- The monetary authority maintains some control over the exchange rate.

Fixed exchange rate refers to one in which the value of the local currency relative to other currencies is fixed or set by the monetary authority.

Pegged exchange rate is one in which the value of a given currency is fixed in relation to a particular foreign currency ,for example exchanging Uganda shillings 1000 for one united states dollars so that the values of other currencies are determined according to the shilling dollar relationship.

Advantages of fixed / pegged exchange rate

- Induces production and promotes economic growth.
- Encourages long term planning or contract trade.
- Stabilises prices in the economy by checking inflationary tendencies.
- Helps to stabilise value of the domestic and foreign currencies.
- Encourages long term capital inflows.
- Discourages or reduces speculation in the foreign exchange market due to limited or restricted depreciation or appreciation of currencies.
- Encourages investment.
- Minimises capital outflows or movement (capital flight).

Demerits of fixed / pegged exchange rates

Requires exchange control administration which is costly to maintain (it is expensive to enforce).

Requires a country to hold large reserves of foreign currency for the policy to succeed.

Some key terms / concepts

Devaluation is the deliberate or official lowering of the rate at which the local currency exchanges for other currencies.

While

Currency under valuation is the fixing of the value of the local currency by the monetary authority below the equilibrium exchange rate.

Effects of currency undervaluation.

- Increases exportation.
- Reduces imports .
- Encourages domestic production.
- Reduces imported inflation.
- Improves BOP position.
- Worsens external debt burden.

Currency over-valuation refers to the fixing of the rate at which the local currency exchanges for other currencies above the equilibrium exchange rate.

Or

The fixing by monetary authority ,of the value of the local currency relatively to other currencies above the equilibrium exchange rate.

Effects of currency over valuation

- Reduces exportation.
- Increases imports.
- Discourage domestic production i due to reduced demand).
- Worsens balance of payment position.
- Reduces the external debt burden.
- Leads to imported inflation.
- Promotes trade malpractices, for example ,black market. •

An overvalued exchange rate refers to an exchange rate which is fixed abo\ the equilibrium exchange rate.

Effects of an overvalued exchange rate

- Increases volume of imports.
- Reduces the volume of exports.
- Discourages foreign capital inflows.
- Discourages domestic production.
- Worsens the country's balance of payments position.
- Reduces the external debt burden.

An undervalued exchange rate refers to an exchange rate which is fixed below the equilibrium exchange rate.

Effects of an undervalued exchange rate

- Reduces imports.
- Increases exportation of goods.
- Improves the BOP position.
- Encourages domestic production.
- Reduces imported inflation.
- Encourages foreign investments / increases foreign capital inflows.
- Worsens the external debt burden.

Currency revaluation is the deliberate government act of raising the value of its currency in terms of other currencies.

Or The legal or official increase of the external value of a currency.

While Currency appreciation refers to the increase in the value of currency relative toother currencies due to the forces of demand and supply in the currency market.

Effects of currency appreciation

- Encourages investment.
- Reduces revenue from import duties.
- Leads to low pay for export producers.
- Exports become less competitive.

- Worsens competition against local producers.
- Worsens balance of payments position.
- Disorganises exporters because they are paid less in local currency.

Currency depreciation refers to the decrease / decline in the value c currency relative toother currencies due to the forces of demand and supply in the currency market.

Causes of currency depreciation

- Narrow exports.
- Heavy debt servicing.
- Increase in fuel prices on the world market.
- Decline in the service sector.
- Increased demand for foreign currencies.
- Deteriorating terms of trade.

Effects of currency depreciation

- Leads to inflation.
- Discourages investment.
- Encourages speculation.
- Leads to loss of confidence in the local currency.
- Worsens the external debt burden.
- Increases foreign capital inflow.
- Leads to unfavourable terms of trade (high prices of imports).
- Increases the volume of exports (reduces the balance of payments problem).
- Exporters gain high local currency revenue.

Dual exchange rate refers to one in which the monetary authority maintains two exchange rates, one for essential and the other non-essential imports or sectors.

Reasons for adopting a dual exchange rate

- To encourage importation of priority goods.
- To discourage importation of luxuries.
- To make foreign exchange available to all categories of importers.
- To encourage development of priority sectors.

Advantages of a dual exchange rate

- Encourages importation of priority goods.
- Discourages importation of luxuries.
- Makes foreign exchange available to all categories of importers.
- Encourages development of priority sectors.

Trade liberalisation refers to the removal of unnecessary restrictions to trade.

Any three ways of liberalising trade in my country include:

- Reduction of tariffs.
- Removal of unnecessary subsidies to domestic firms.
- Privatisation of state owned enterprises.
- Removal of price controls.
- Floating of the exchange rate / Removal of exchange rate restrictions.
- Abolition of quotas.
- Reduced bureaucratic or administrative controls for example easing the process of acquisition of licenses.

Economic liberalisation refers to the removal of unnecessary government controls on productive economic activities.

While

Economic diversification refers to the establishment or development of various sectors and activities in an economy.

Any two objectives of economic liberalisation in my country include:

- To encourage efficiency.
- To control structural inflation.
- To attract foreign investment.

- To improve the country's balance of payments position.
- To encourage production of quality goods and services.
- To increase the country's revenue from taxation.
- To encourage innovations and inventions in the country.

Infant industries are firms in the industrial sector that have just started operating and therefore have limited market, low output levels and thus have high average costs (not enjoying economies of scale).

Ways of protecting infant industries in the country:

- Banning substitutes.
- Import quotas.
- Imposition of high import duties on substitutes.
- Quality controls.
- Giving tax incentives or concessions for infant industries.
- Depreciation of the local currency.
- Administrative controls.

Economic policy is a statement of objectives and methods of achieving these objectives by the government, political party and business community.

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Special Drawing Rights(SDRs) are assets created by the International Monetary Fund (IMF) which give the holder unconditional drawing rights

Or Financial assets created by the IMF to increase the international liquidity of members countries.

While

Foreign reserves refer to the total value of all gold, hard currencies like US dollars and special Drawing Rights held by a country as both reserve and a fund from which international payments can be made.

Structural Adjustment Programmes (SAPs) are economic policies for developing countries that have been promoted by the World Bank and International Fund (IMF)through the provision of loans conditionalonthe adoptionof such policies.

Forms/examples of structural adjustment programmes that have been implemented in developing countries.

- Privatisation/expanding the role of the private sector
- Liberalisation of trade/economy
- Restructuring of the public service/demobilization of workers or soldiers
- Reduction of government expenditure on non-essential services/cost sharing

- Devaluation
- Tightening of monetary and credit policies
- Restructuring of tax administration or system

Revision Questions

Distinguish between currency depreciation and appreciation of currency devaluation

Give two demerits of currency appreciation in your country

Distinguish between comparative advantage and absolute advantage as used in international trade

State any three assumptions underlying the principle of comparative advantage

Define the term 'trade liberalisation'

Mention any three ways of liberalising trade in your country

Explain the benefits of adopting protectionist policies in your country

What are the demerits of protectionist policies in your country?

Why should countries devalue their currencies?

Under what conditions may the policy of devaluation become successful in improving the balance of payment position?

What are the causes of poor balance of payments in your country?

How can the balance of payments position of your country be improved?

Distinguish between "Appreciation of currency" and "Revaluation of currency"

Give any two consequences of the recent appreciation of Uganda's currency

Distinguish between "Appreciation of currency" and "Revaluation of currency"

Give any two consequences of the recent appreciation of Uganda's currency

Distinguish between income terms of trade and barter terms of trade

State any two ways of improving the terms of trade in an economy
Distinguish between balance of payment and balance of trade

State any two effects of balance of payment deficit in your country Distinguish between trade protectionism and trade liberalization Assess the consequences of adopting trade protectionism in your country

Define the term "Balance of trade"

Give any three factors responsible for the unfavourable balance of trade in your country

Differentiate between "Balance of payments" and "Balance of trade"

Account for the persistent deteriorating terms of trade in your country

Differentiate between a "customs union" and a "common market"

"The expanded East African community is beneficial to the economies of all five nations". Discuss

Explain the different forms of economic integration.

Explain the factors that are necessary for the formation / success of regional integration.

Distinguish between Preferential Trade Area (PTA) and Free Trade Area (FTA).

Examine the likely contribution of the East African integration to the member states.

Distinguish between balance of payment surplus and balance of payment deficit. Explain the causes of balance of payment surplus in an economy.

Describe the tools of protectionism.

Explain the barriers to free trade in an economy.

What are the arguments for and against protectionism?

What are the arguments for and against free trade?

Distinguish between tariff and ■on-tariff barriers to trade.

Examine the effects of protectionism in international trade.

To what extent has the liberalisation of trade in your country benefited the economy? What is meant by foreign exchange control?

Explain the merits and demerits of foreign exchange control in an economy. Distinguish between income terms of trade and barter terms of trade. Account for the unfavourable terms of trade in developing countries.

Suggest measures to improve the terms of trade in your country. Distinguish between terms of trade and balance of trade. Study the table below and answer the questions that follow;

YEAR	**2008**	**2009**	**2010**	**2011**
Average price of exports in	150	180	250	280

(in 000's) $				
Average price of imports in (in 000's) $	125	140	280	350
Terms of trade (TOT) index	-	-	-	-

Calculate the terms of trade index for each year and indicate the years where terms of were favourable or unfavourable, improving or deteriorating.
Account for the persistent deteriorating terms of trade against developing countries.
What are the features of an economic union?
Explain the factors that may encourage the formation of an economic union in loping countries.
Account for the balance of payment problems in developing countries.

What measures should be taken to solve the problem of balance of payments in loping countries.

Account for the economic development planning in your country, in the challenges of implementing economic development plans in your country.

Distinguish between customs union and common market.

Discuss the gains of joining an economic integration for your country,

What measures may government take to protect an economy in international trade? the consequences of protectionism in your country, the term international trade, three reasons why it is necessary to carry out international trade, the following: ral trade.

Multi-lateral trade.

Visible trade.

Invisible trade.

State the principle of comparative advantage.

Give three assumptions of the principle of comparative advantage.

Distinguish between tariff and non-tariff barriers to trade.

Mention two examples of non-tariff barriers to trade.

Distinguish between balance of payments and balance of trade.

State two major accounts of the balance of payments record.

Differentiate between currency revaluation and currency appreciation.

Give two demerits of currency appreciation in your country.

Distinguish between a custom union and an economic union.

Mention two necessary conditions for economic integration to succeed.