S5 ECONOMICS CONTINUED… (NATIONAL INCOME)

CAUSES OF INCOME INEQUALITY IN DEVELOPING COUNTRIES:

Differences in the level of education and skills/training: The Highly educated people secure better paying jobs and earn higher incomes because they are expected to be more productive at work than those who are less educated because they are less productive at work

Differences in natural resources endowment/distribution and the level of exploitation. People who live in areas which are well endowed with natural resources and endeavor to exploit them, produce more goods and services which help them to earn more income than those who live in areas which are less endowed with natural resources or where the existing natural resources are not well exploited.

Differences in natural talents and other abilities of people; People with special abilities like artistes, soccer stars etc., which act as sources of income earn more than those who are less talented hence causing income differences.

Differences in family/social background; some people are born in families which are rich and as such inherit a lot of wealth from their relatives therefore, they have a better start than those who inherit nothing hence income inequality.

Differences in the amount of output produced; People who produce more output earn more income than their counter parts that produce less output in case they are paid according to the output produced

Differences in the elasticity of supply of labour; Labourers with inelastic supply earn higher income due to the fact that it is not easy to acquire such labourers yet those with elastic supply earn low income because it is very easy to acquire them when there is need.

Differences in trade unions ability to bargain; Workers who are organised under strong trade unions are able to agitate for better pay and hence earn higher income than their counter parts who have weak trade unions which fail to agitate for better pay for their members.

Differences in employer's ability and willingness to pay; workers whose employees have the financial ability and willingness to pay better wages earn higher incomes than their counterparts whose employers do not have the financial ability to pay better wages hence end up earning low incomes.

Differences in the accessibility to developed infrastructure; People who live in areas with well-developed infrastructure in terms of roads, railways, banks carry out a number of economic activities which help them to earn higher incomes than their counterparts who live in areas with poor infrastructure or less developed infrastructure because these are unable to engage in a number of economic activities hence earning less incomes.

Discrimination in the labour market on the basis of gender, race, age, or religion. Some communities discriminate members from enjoying certain privileges and benefits while others are denied entry into certain occupations all of which cause income differences.

Differences in the nature of occupations and risks involved: People who are employed in more risky jobs such as mining, fishing and forestry earn higher income in order to attract them to take on such jobs than their counterparts who are employed in less risky jobs because they are many ready to take up such jobs.

Differences in the ability of individuals to bargain for incomes. People with high bargaining power earn high income because they are to convince their employers to give them better incomes than those with low bargaining power who fail to convince their employers to give them better incomes.

Differences in the number of hours worked. People who work for long hours earn higher incomes than those who work for a few hours in case of time rate system of wage payment.

Differences in the cost of living: People who work in areas where the cost of living is high e.g. in urban areas tend to earn higher incomes to enable them live a reasonable standard of living than their counterparts who live in rural areas where the cost of living is relatively low e.g. in rural areas earn employees tend to earn less incomes.

Differences in access to credit facilities /contracts. People who have access to credit facilities and able to use up such facilities to start income generating activities, earn higher incomes than their counterparts who do not have easy access to such facilities and therefore earn low incomes.

Differences in the degree of political climate/state of security: People living in areas which are politically stable are able to carry out a number of economic activities which help them to earn higher incomes than those who live in areas which are politically unstable who are unable to effectively engage in economic activities leading to low incomes earned by such people.

Non-matching wage policy by the employers. Employers especially government pays their workers different wages depending on the nature of the assignments/departments where they are deployed. Workers in departments which are favoured by the employers tend to earn more incomes than those deployed in less favoured departments.

Political influence in the allocation of resources in favour of certain regions/sectors. People in those areas favoured in terms of resource allocation in form of infrastructural development, industrial establishment are in position to engage in a number of economic activities which are more paying hence earn higher incomes than those who stay in areas which are not favoured in terms of infrastructural development and other resources who fail to engage in different economic activities and thus leading to low incomes earned by such people.

MEASURES THAT CAN BE TAKEN TO REDUCE INEQUALITY IN UGANDA:

Reform the education system/emphasise practical/vocational education to create job makers other than job seekers. This helps them to start up their income generating activities and earn an income hence reducing the gap between them and those who are highly paid.

Impose progressive taxes: Government taxes the rich more than the poor and use the income to subsidise the commodities used by the poor.

Build/ Improve infrastructure such as roads, railways, power facilities. This enables the poor to engage in economic activities which help the people to improve their earnings since they can easily market their products hence the gap between those who earn those who earn high income and low income is reduced

Modernise agriculture: this involves encouraging people to produce for commercial purposes rather than for subsistence purpose. People increase their output, sell the excess output and improve their earnings.

Provide affordable credit through micro-finance institutions; credit facilities enable individuals to set up self-employment activities which help them to improve their earnings.

Encourage control of population growth; this reduces the dependence burden which helps people to save and be able to invest in projects and improve their earnings.

Undertake decentralisation policy, where local administration units are empowered to solve the problems affecting the people in their localities and therefore enabling them to improve their earnings and thus helping to reduce income inequality.

Ensure political stability so as to encourage people to participate in a number of economic activities and hence improve their earnings.

Government should subsidise the poor e.g. through Universal Primary and Secondary Education to enable the children of the poor people acquire knowledge and skills to be able to get jobs in future and hence improve their earning which helps to reduce the gap between such people and those in the high income bracket.

Reform the land tenure system; this is intended to enable people acquire land easily where they can carry out agriculture and other activities and hence improve their earnings.

Encourage diversification of the economy: this helps to create a number of economic activities from which people acquire employment opportunities and hence improve their earnings.

Encourage liberalisation of the economy. Government should remove restrictions to allow individuals to engage economic activities without any undue government influence hence widening opportunities of measuring employment opportunities and thus enabling people to improve their earnings.

Raise wages of low income groups or relax minimum wage. Government should raise wages and salaries of low income earners so as to protect their interests and break the income gap.

Encourage development of small-scale industries or enterprises. Government should encourage development of small-scale industries through provision of investment incentives to enable firms reduce costs of production and increase earnings of the people.

MERITS/ADVANTAGES OF INCOME INEQUALITIES:

Induces more investment /it encourages investment by the rich. The rich have a high marginal propensity to save and in an economy where they are the majority, there tends to be a high rate of investment.

Cheap labour is readily available; the poor provide cheap labour which results into increased production in the economy.

Promotes labour mobility; income inequality encourages mobility of labour both occupationally and geographical as workers struggle to look better paying jobs. This increases employment opportunities.

It creates harmonious existence between the employees and the employers /Builds good employee employer relationship. This is so because income inequality makes the employees humble so as to retain their jobs and continue earning a living.

It increases the tax base; income inequality broadens the tax base more especially where the rich are the majority. This is possible where progressive tax system is used. Government gets high tax revenue from progressive taxes.

Awakens government to undertake some re-distributive development policies i.e. establishing productive supporting infrastructure in all areas of the country to enable people engage in different economic activities and be able to improve their earnings.

DEMERITS OF INCOME INEQUALITY:

- Increases crime rate in the country e.g. robbery, prostitution, child sacrifice due to poverty.
- Minimises the level of economic welfare among the poor, this is because the poor cannot afford certain commodities.
- It leads to rural-urban migration and its associated evils such as urban unemployment, congestion in town etc.
- It causes brain drain hence the economy loses lots of human capital (skilled labour force) which is needed for her development.

- Accelerates exploitation of the poor by the rich. The poor are exploited by the rich whereby they enjoy services of the poor through taking the advantage of the poor being desperate and in need for basic necessities for survival hence accepting low wages/low pay.
- Leads to creation of social classes in society which kill national unity or cohesion.

- Leads to political tension; the poor can become envious of the rich and use different crude methods of eradicating the rich through killing.
- Gives rise to low tax revenue where the majority of the people are poor.
- Balance of payment problems arise as the rich people have a high marginal propensity to import expensive goods.

THE CONCEPT OF COST OF LIVING AND STANDARD OF LIVING:

COST OF LIVING: This refers to the amount of money required by an individual to sustain the lifestyle he/she is accustomed to.

STANDARD OF LIVING:
Standard of living refers to the socio-economic wellbeing or welfare of an individual/society as represented by the basket of goods and services enjoyed.
OR: it is the measure of the level of human or social and economic wellbeing of an individual/society as represented by the basket of goods and services consumed.

Factors that influence/affect/determine people's standard of living in an economy:
1. **The general price level in the economy**. High prices of goods and services in an economy lead to a fall in standard of living of people because of high cost of living. On the other hand, low prices of goods and services lead to high level of standard of living due to low cost of living.

2. **Nature of income distribution of a country** Fair distribution of income in a country shows that people are able to purchase available goods and services hence high standard of living enjoyed. On the other hand, uneven distribution of income indicates that people are unable to purchase available goods and services thus low standard of living.

3. **Level of income**. For high income groups standard of living is high because the purchasing power is enough to enable them access better needs for themselves. On the other hand, low income earners enjoy low standard of living because their purchasing power is very low to enable them access better needs for themselves.

4. **Level of education and skills/training** People who are educated and learned enjoy high standard of living because they look after themselves well and maintain good hygiene. On the other hand, people with low level of education and training enjoy low standard of living as they cannot plan well for themselves.
5. **Nature of goods produced i.e. capital goods or consumer goods**. Production of more capital goods at the expense of consumer goods leads to low standard of living because they do not improve people's welfare directly. On the other hand, production of more consumer goods leads to high standard of living because they improve consumer's welfare directly.

6. **Quality of social amenities / level of development of infrastructure/Nature of government expenditure.** Provision of better infrastructure by the government in form of better hospitals, electricity, schools etc. improves standard of living as people have access to better social services. On the other hand, areas with poor infrastructure lead to low standard of living.

7. **Political climate**. For those areas which are politically stable standard of living is high as people feel that there is security for life and property. On the other hand, politically unstable areas experience low standard of living due to fear of loss of life and property.

8**. Quality and quantity of goods and services produced**. Existence of a few and low quality goods and services being sold at high prices, leads to low standard of living. On the other hand, presence of large quantity of goods and services and of high quality leads to high level of standard of living.

9. **Level of employment in the country**. High level of employment in a country improves people's standard of living as people le have access to enough incomes to meet their needs. On the other hand, high level of unemployment reduces standard of living as people find it hard to meet even the basics of life.

10. **Degree of political freedom**. People with more freedom and their rights are observed and respected enjoy high standard of living. On the other hand, those people with limited freedom, are highly persecuted hence their standard of living are low.

11. **Level of environmental pollution**. High level of environmental pollution in form of industrial fumes, sewerage blockages makes people susceptible to various diseases which reduce their standard of living. On the other hand, pollution free environment improves standard of living.

12. **Availability of time for leisure**. Adequate time for leisure especially after work enables people to enjoy high standard of living. On the other hand, limited or no time for leisure means that people are over worked and have no time for relaxing hence low standard of living.

13. **The level of taxation in the country**. High level of taxation in the country leads to high general price levels leading to a high cost of living and thus low standard of living, on the other hand low level of taxation leads to low general price levels leading to low cost of living and thus high standard of living.

Relationship between cost of living and standard of living:

When the cost of living is low, the standard of living is high i.e. people tend to incur less expenses on their living thus they can afford to opt for a good welfare and when the cost of living is high, the standard of living is also low i.e. people tend to incur high expenses on their living and can hardly afford to opt for a good welfare.

WELFARE. This is the satisfaction which an individual or the society as a whole derives from wealth. It is a state of the mind which reflects human happiness and satisfaction. Welfare is influenced by the level of education, health condition, leisure, employment and political situation.

Welfare is categorized as economic welfare and non-economic welfare.

- **Economic welfare** is that part of social welfare which can directly or indirectly be measured in monetary terms.
- **Non-economic welfare** is that part of social welfare which cannot be measured in monetary terms i.e. moral welfare

PRICE INDICES

Price index is a measure of the average percentage change in prices from one period (base year) to another year.(current year).

OR: Price index refers to measurement of the relative change in consumer prices over time.

The base year is conventionally given a value of 100 and this is typical of a single period.

Price index is expressed mathematically as below;

$$\text{Price index} = \frac{\text{current year price}}{\text{Base year price}} \times 100$$

OR:

$$\text{Price relative index} = \left[\frac{\text{Current year price} - \text{base year price}}{\text{Base year price}} \times 100\right] + 100$$

When it is compiled, to measure changes in the prices of consumer goods, it is called the consumer price index. And when it is used to measure variation in prices of specific set of consumer goods, which would be bought by household on a regular basis it is called the cost of living index/ retail price index.

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Procedures involved in calculating the cost of living index

1. Selecting a representative basket of goods. Data is collected mainly on consumer goods which are popularly bought and sold. This data is collected by conducting surveys from say branded goods and from local authorities.

2. Choosing a base year i.e. one where prices are relatively stable.

3. Getting prices of goods in the representative basket for both the base year and the current year.

4. Calculating the price relative index by determining the percentage/relative change below or above the base year i.e. price relative index = $\frac{\text{current year price}}{\text{Base year price}} \times 100$

5. Calculating the average price relative/the simple index for the year i.e. average price relative = $\frac{\Sigma\text{Price relative index}}{\text{Number of items}}$

6. Attaching weights to the commodities: these show the relative importance attached to the commodities by the consumers.

7. Calculating the weighted index for each commodity i.e. the value that gives commodities their relative importance for that commodity by using the formula;
Weighted index = price relative index x weight
8. Calculating the average weighted index i.e.
$$\text{Average weighted index} = \frac{\Sigma \text{ weighted index}}{\Sigma \text{Weight}}$$

Example:

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

Commodity	Base year price (2000)	Base year index (2000)	Selected year price (2001)	Weight.
A	200	100	700	5
B	150	100	500	4
C	500	100	1000	3
D	100	100	300	2
E	400	100	1200	1

i) Calculate the simple price index for each commodity in 2001.
ii) Average price relative index for 2001.
iii) The weighted index for each commodity in 2001.
iv) The average weighted index for 2001.

REASONS FOR COMPUTING CONSUMER PRICE INDEX:

- Measuring changes in the value of money/Determining the rate of inflation/deflation. Where the average price relative exceeds the base year index, it implies an increase in the general price level and thus a fall in the value of money. On the other hand where the average price relative is less than the base year index, this implies a decrease in the general price level and thus an increase in the value of money.
- To assist in wage determination. The wage rate and allowances should be adjusted to match with the rate of inflation. In this case the consumer price index used to remove the effect of inflation from the nominal wage.
  i.e. Real wage = Nominal wage/consumer price index X100

- To deflate/ to adjust nominal national income figures to give real national income. The consumer price index helps to convert nominal national income figures to get real national income figure
  i.e. Real national income = Nominal national income/ consumer price indexX100.

- To compare the cost of living of the people in a country over time. In period when a country is experiencing a high cost of living it implies that her people are incurring a high cost of living and therefore low standard of living, yet in a period when the country experiences a low cost of living index, it implies that the people are incurring low cost of living leading better standard of living.
- To compare the cost of living between countries. A country with a high cost of living index implies that her people are incurring a high cost of living and thus low standard of living, yet a country with a low cost of living index implies that her people are incurring low cost of living and thus better standard of living.
- Determining the tax rates/levels. As the cost of living index increases it compels the government to reduce the tax rates in the country so as to reduce the costs of production in order to enable the people afford the goods and services.
- To measure the terms of trade of a country. The price index of exports and that of imports are used to determine the country's terms of trade, i.e. where the price index of imports is greater than the price index of exports, then a country is experiencing unfavourable terms of trade and where the price index of exports is greater than the price index of imports then a country is experiencing a favourable terms of trade.

IMPORTANCES/ USES OF PRICE INDICES:

- They are used in measuring changes in the value of money i.e. whether there was inflation of deflation
- They are used in wage determination
- They used are in determining tax rates
- They help in deflation of nominal national income so as to obtain real national income
- They help in comparing the cost of living of the people in a country over time
- They help in comparing the cost of living between countries
- They are used to measure the terms of trade of a country

PROBLEMS/LIMITATIONS ENCOUNTERED IN THE COMPUTATION OF PRICE INDICES:

Difficulty in selecting a representative basket of goods and services. It is difficult to determine the representative basket of goods and services that caters for all the people in the economy. The commodities are usually sampled so the representative basket of goods does not cover all the goods consumed by all the people.

Difficulty in choosing a suitable base year. It is difficult to choose a reliable base year especially in developing countries which experience persistent inflationary tendencies year after year.

Difficulty in attaching weights to goods and services in the representative basket of goods. This is so because of varying importance attached to the commodities by the people.

Changes in the level of prices overtime/ Price instability. This requires continuous computation of price indices.

Changes in tastes and preferences in a year and overtime. People's tastes and preferences keep changing, this leads to changes in the basket of goods as well as the importance attached to those commodities and this calls for frequent computation of the price indices which is costly.

Limited information/data about households/peoples expenditure. Many people do not keep records of their expenditure and therefore it hard to get the necessary information required to compute the price indices.

Emergence of new goods and exit of old ones./ Problem of appearance and disappearance of products from the market. The new discoveries bring in new commodities on the market hence the basket keeps on changing and thus requiring frequent computation of price indices which is very costly.

Absence of standardised weights and measures i.e. products are sold in tins, heaps, baskets etc. Some people use heaps, baskets, tins yet in other areas there is use of weighing scales i.e. spending patterns vary among societies.

Absence of standard prices due to use of bargaining in price determination. This brings about difficulty in determining prices to attach the commodities in the representative.

Variations in prices in different areas/regions. This brings about a challenge in determining prices to attach to the representative basket of goods.

Limited facilities like computers, vehicles etc that are required in the compilation and processing of the data.

Limited personnel with appropriate skills needed for compiling relevant information, and handle the exercise carefully.