Course Name	: Macro Economics
Course Code	: APBBA 1206
Course level	: level 1
Course credit	: 4 CU
Contact Hours	: 60 Hrs

Course Description
This course deals with international and Economic integrations, the main features of the Country's economy, basic features of international economies as well as understanding the Country's monetary and financial system.

Course Objectives
On completion of this course the student will be able to:

- Identify and describe the main features of the Uganda economy.
- Explain the basic features of International economics
- Demonstrate an understanding of the Uganda monetary and financial system.

Course content

- **Introduction to Macro Economic theory**
  Definition & scope in this context
  Influence of the Uganda Government on the economy
  Fiscal and monetary policy
  Inflation
  Unemployment
  Economic Growth
  National Income Accounting

- **Introduction to International Economics**
  International trade theory
  Exchange rates
  Balance of payments

- **Economic Integration**
  W.T.O
  East, Central and Southern Africa (e.g.COMESA, E.A Co-operation)
  Other Areas (E.U.; NAFTA)
- **Uganda Monetary and Financial System**
  Banking system
  Interest rates
  Capital Market

Mode of delivery Face to face lectures

Assessment
Course Work 40%
Exams 60%

Total Mark 100%

INFLUENCE OF THE GOVERNMENT ON THE ECONOMY

FISCAL AND MONETARY POLICY

PUBLIC FINANCE AND FISCAL POLICY

Anything to do with government earning and government expenditure is known as public finance. Public finance and fiscal policy is a science that deals with government revenue, government expenditure and financial administration and control by the sate. This study includes five divisions.

i. Public revenue: This is a study about the methods for raising public revenue mainly under the principle of taxation.
ii. Public expenditure: This consists of the study about how the government spends money on social facilities e.g. defense, education, health, infrastructure, etc.
iii. Public debt: This deals with the cause and methods of how the government gets loans from the public and how these loans are paid back.
iv. Fiscal policy: This is a study how public finance is used to bring stability and growth in the economy.
v. Finance administration: This includes the preparations and reading of budgets.

PUBLIC EXPENDITURE

Public expenditure means government expenditure for different processes. Usually public expenditure is incurred to provide goods and services for the public. It is divided into recurrent expenditure and development expenditure.

RECURREING EXPENDITURE

This is expenditure for the day to day running of the country. E.g. expenditure on general administration, expenditure by the local government, on defence, education, health, etc. This expenditure is to cater for day-to-day expenses like salaries, allowances and other expenses.

DEVELOPMENT EXPENDITURE

This is the expenditure on long term activities that will result into economic growth and development e.g. expenditure on roads, dams, mining, industrialization, etc Therefore public expenditure = public recurrent expenditure + public development expenditure.

ADVANTAGES OF PUBLIC EXPENDITURE

1. Public expenditure increases production of goods and services. This can be done directly or indirectly. Directly, expenditure is incurred by government on state owned enterprises and on development projects resulting into increased output and hence more goods and services. Indirect expenditure is incurred by government on peace and security which leads to stability which stimulates more investment hence leading to more output.
2. Public expenditure is important for distribution of income. Public expenditure helps to maintain a fair distribution of income. Through public expenditure the government can provide subsides to the poor which can improve on distribution of income.
3. Public expenditure is also used to maintain economic stability by ensuring stability of price and other economic variables e.g. during a deflation period, public expenditure is increased and during inflationary period, public expenditure is reduced thereby ensuring price stability.
4. Through public expenditure the government is able to ensure maximum welfare to its citizens by spending on the provision of social services.
5. Public expenditure can be used to correct balance of payment deficits. This can be done by reducing public expenditure which leads to decrease in aggregate demand for imports thereby improving on the BOP position of the country.
6. Public expenditure can as well be used to establish good understanding with other countries e.g. when the government spends on assistance to other countries.

PUBLIC REVENUE

Public revenue refers to income received by the government from different sources. The government under takes various activities and therefore needs income to finance these activities. The main source of government revenue include the following:-

1. Taxation: This may be in form of direct or indirect taxes. This is the main source of government revenue.
2. Non-tax sources of government revenue. These include:
   (a) Fines and penalties on law breakers
   (b) Fees: These are payments made by individuals to the government for personal services rendered to them by the state e.g. valuing property, education etc.
   (c) Special assessments: These are compulsory contributions levied on special benefits derived from a special improvement on property under taken in public interest e.g. drainage, parking places, etc.
   (d) License dues: This refers to payment to the government to secure permission to carry out any profitable activity e.g. trade.
   (e) Rates: These are payments made on urban private property such as land and houses. These are imposed to get money for providing services like sewerage and other facilities.
   (f) Market dues: these are paid to get a right to sell commodities in the market.
   (g) Profits from government enterprises
   (h) Income from lotteries
   (i) Gifts and grants from within and outside the country.
   (j) Motor vehicle licenses
   (k) Graduated tax: this is collected by local authorities. Revenue from graduated tax is utilized by the local units i.e. Districts, counties, sub-counties, etc.
   (l) Sale of government property.

TAXATION

Taxation is a method used by the government to raise revenue by extracting money from the public. A tax is a non-quid -proquo compulsory payment made to the fiscal authority as a charge for the cost of administering certain services to the public. A tax paying unit can be an individual or body of persons.

ROLE OF TAXATION

There are two major roles

a) Revenue function
b) Social economic function instrument of economic policy. As an instrument of economic policy taxation plays these roles.

1. Raising revenue for both recurrent and development expenditure.
2. Control aggregate demand
   a. During period of excessive aggregate demand, taxation can be used to reduce the money income from the hands of the public.
   b. During a depression, government may try to expand aggregate demand by reducing taxation and using subsidies.

1. Regulation of the economy through effect on investment or production of given activities. Taxation can be used to encourage import substitution and export promotion strategies. Using selective tax rates and or tax exemption to certain activities necessary for economic and social development may be encouraged. Undesirable industries may be taxed highly while the necessary ones are subscribed.
2. Re distribution of income. Tax the haves and provide services or employment opportunities to the have notes. Taxation therefore acts as an instrument of public policy to direct resource flows so as to bring about social welfare and economic stability in the economy.
3. It can act as a means of preventing the consumption of some commodities on moral, social and economic grounds.
4. It is one of the means used to solve the BOP problems. If the government wants t o reduce on level of imports. It can increase tariffs.
5. Taxation can be used to recover society's wealth which individuals have obtained not as a result of their efforts but as a result of other persons efforts e.g. inheritance tax, gift taxes, estate duty etc.

6. Taxation helps a country to avert the burden of borrowing so that instead of borrowing, the government generates revenue from taxation.
7. It increases employment opportunities. If the collected revenue is investor in productive projects, they can absorb more labour force. The government can also use the negative tax (subsidies) so as to encourage people to produce.

PRINCIPLE (CANONS) OF TAXATION

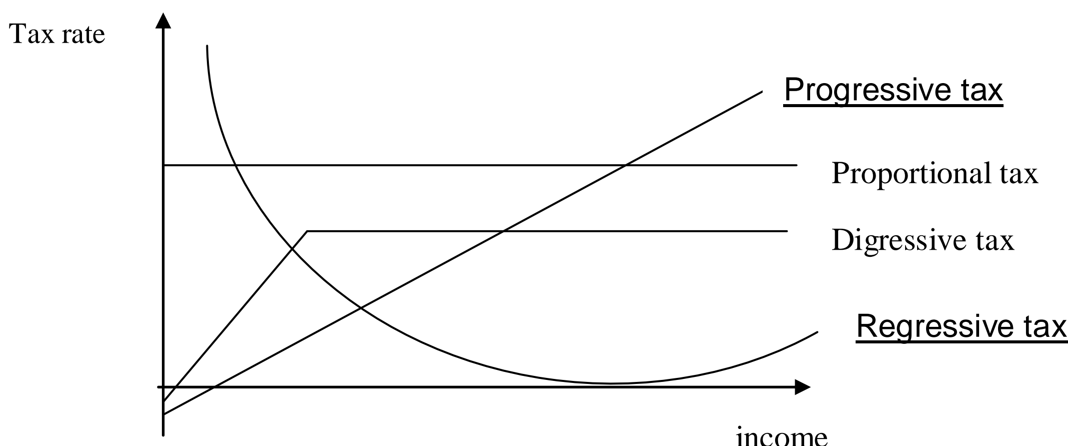
Adam Smith in his book, the wealth of nations published in 1776 laid down the major principles of taxation to ease tax assessment, collection and administration. These principles are still being applied. They include:-

1. Equity (fairness). A tax should be fair enough to everybody. Each tax payer should feel the burden equally. Therefore the rich should pay more and the poor less. i.e. a tax should be progressive in nature.
2. Certainty: A tax payer should be certain of nature, base and amount of the tax without any dought. If there is dought, it would bring about confusion and guarrels between the tax payer and tax collector. Therefore unpredictable tax rates stiffle enterprise or investment and may reduce work effort of individuals.
3. Convenience. A tax should be collected at a time and place which is convenient to the tax payers in respect of time, season and availability of income. In countries where the economy is dominated by agriculture, the tax should be collected when the commercial crops have been sold in the market because that is the time when the farmers will be having cash at hand. With a wage earner, he should pay the tax when he has been paid. Then taxes should also be payable at a place which is convenient to a t ax payer.
4. Cheapness or economy: The cost of tax collection and administration must be lower than the tax proceeds . Collection costs should not exceed 5% of the yield of the tax.
5. Ability to pay: The basic criteria of measuring tax payers ability to pay is to establish whether his disposable income (i.e. income after meeting his tax obligation) can sustain the life style with the economic status of the tax payer. Determination of his ability to pay is his income, other properties and his daily expenses.
6. Elasticity: A tax tends to rise the price of goods. However, if commodities have in elastic demand, the quality demanded does not fall with the tax increase and the government acquires high revenue from the tax. But if demand for commodities is price elastic, the high tax rate will lead to high prices which leads to a fall in demand and collapse of industries. Also tax revenue should change directly with change in tax base.
7. Flexibility: A good tax system should be flexible depending upon the economic circumstances and economic requirement of the state i.e. if there is need. It should easily be raised or lowered.
8. Efficiency: A tax should not be harmful to the economy and the effort of the tax payer. It shouldn't be too high to discourage savings and investment, instead it should be productive.
9. Simplicity: Nature of tax, method of assessment and collection must be understandable to both the collector and the tax payer. A complicated tax leads to misunderstanding, disputes, delayed payments and this in turn leads to high costs of collection both in terms of time and resources.
10. Neutrality: A tax should be neutral with regard to tribe, race, religion or other considerations.
11. Political acceptability: The tax should not cause antagonism between the tax authorities and the public. It should be sanctioned by the political authority (parliament).

TAX RATES OR THE "TAX TO INCOME" RATIO

1. Proportional tax: This is where there is a fixed percentage of a tax on the income of tax payer. E.g. 10%. This tax is fair up to a point but it does tend to discriminate against the lower income groups because the higher income groups will feel the burden of the tax less.
2. A progressive tax: It is a tax whose percentage increases as the level of income increases. The higher the income, the higher the rates. This tax is useful in income redistribution as it is based on the canon of equity. Most income taxes are progressive. E.g. Estate duties, income tax etc.
3. A regressive tax: It is a tax where the percentage rate of tax is higher on low income earners and low on high income earners though the amount paid by the poor and the rich is the same. It is basically a tax charged on commodities we buy.

4. A digressive tax: This is a tax where percentage rate of tax initially increase as income increase but become uniform after a certain point as income increases. All the four classes of taxes can be shown on the diagram below.



TAXABLE CAPACITY

Taxable capacity is the extent to which a tax payer is able to pay the tax assessed on him and yet remains with enough disposable income to enable him live a decent standard of life to which he and his family are accustoned to.

Taxable capacity of a nation is the ability of the government concerned to realize from the tax payers the revenue due to it from the taxes it imposes. If the government is able to realize 75% of the revenue due to it, then its taxable capacity is high but if it realizes 30% of its revenues, then its taxable capacity is low.

DETERMINANTS OF TAXABLE CAPACITY

1. The benefits derives from the government
2. Information as regards one's income
3. Population of the government
4. Types of taxes levied
5. Income distribution
6. Wealth of the country or an individual

CAUSES OF LAW TAXABLE CAPACITY IN LDCS.

1. LDCS have low per capita income due to wide spread poverty hence low revenue collected from taxes.
2. Income inequalities also lead to low taxable capacity for a nation since very few people can be taxed hence leading to less revenue from taxes.
3. There is low level of industrialisation and viable economic activities n LDCS economies hence a narrow tax base which leads to low tax revenue for LDCS.
4. There is low level of commercialization in LDCS economies. Most of the activities are in subsistance sector which reduce the activities to be taxed hence leading to low tax revenues.

5. Low taxable cpacity in LDCS is caused by wide spread unemployment in the economies of LDCS such that since the majority are unemployed they don't pay taxes or they pay very low taxes hence leading to low taxable capacity.
6. There is low levels of tax awareness in LDCS which leads to low tax compliance and high rates of tax evasion hence leading to low tax revenues.
7. In order to attract investment, LDCS usually offer a lot of tax concessions and exemptions to investors which reduces the taxable capacity of LDCS.

THE IMPACT, INCIDENCE AND EFFECTS OF A TAX

Incidence of a tax is the amount of the tax ultimately paid by different individuals or groups . The impact or formal incidence of a tax is felt by the person who directly and immediately bears the burden of a tax as soon

as it is imposed. He may, however be able to shift the burden forward or back word on the shoulders of a third party who in turn may shift it onwards.

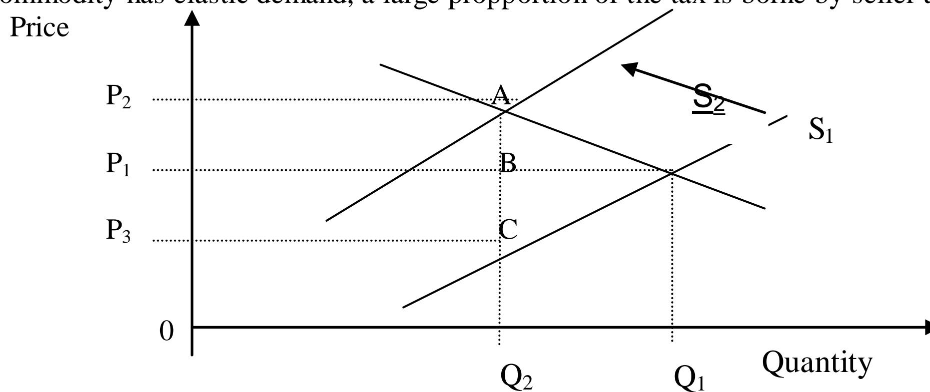
FORWARD SHIFTING OF THE TAX BURDEN: This is where the tax payer shifts the burden to the next party in the distribution chain e.g. a retailer shifting the tax burden on to the consumer in form of increased prices.

BACKWARD SHIFTING OF THE TAX BURDEN: This is where the tax payer shifts the tax burden to the previous stage in the production process. E.g. a processor shifts the tax burden to the raw materials suppliers in form of reduced prices for the raw materials.

The person who ultimately bears the money or real burden bears the "effective incidence of the tax. Persons who try to hide or run away from collectors and those who are taken to prison bears the real burden of the tax.

In case of indirect taxes incidence of a tax is not certain. It may be on the buyer alone or the seller alone or ti may be divided in any proportion between both depending on the elasticities of demand and supply of the taxed commodity.

(a) When the commodity has elastic demand, a large propportion of the tax is borne by seller as shown below.

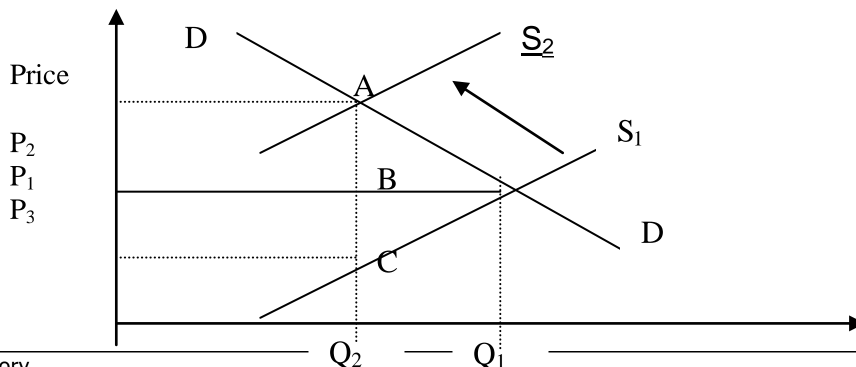


Tax Incidence

1. Total tax	=	P_2 P_3	=	AC
2. Seller	=	P_1 P_3	=	BC
3. Buyer	=	P_1 P_2	=	AB
	BC > AB			

From the figure before the tax, the seller ws supplying OQ_1 at price OP_1. After the tax, the supply curve shift to the left by the same amount as the tax. The price increases to OP_2 and quantity bought and sold reduces by Q1 Q2. The total amount received by the government is P2 P3 out ofthis, the buyer bears P1 P2 (i.e he/she used to pay the price OP1 but after the t ax he/she pays OP2 per unit). The seller P1P3 (i.e. he/she used to sell at OP1 but after the tax, he/she sells at OP2 and pays the tax P3 P2 and therefore receives only OP3. It should be noted that a larger part of the tax (P1P2) finally rests on the seller.

(b) When the commodity has in elastic demand, a large incidence of the tax would be borne by the buyer as illustated below;



Tax incidence

1. Total tax	=	P2 P3	=	AC
2. Seller	=	P1 P3	=	BC
3. Buyer	=	P1P2	=	AB
		BC <AB		

When the commodity is price inelastic the seller would born P1P3 of the tax while the buyer would born P1P2 of the tax. It should be noted that a larger part of the tax (P1P2) finally rests on the buyer.

(c) When the commodity has perfectly inelastic demand, the whole tax incidence goes to the buyer, i.e. the seller would succeed in shifting the whole tax to the buyer in form of higher prices.

(d) When the commodity has perfectly elastic demand curve, the whole tax incidence would be borne by the seller. He/she cannot shift any part of the tax to the consumer in form of higher prices because when price is slightly increased, consumers leave buying the commodity.

(e) When the commodity has unit elasticity of demand, the tax incidence would be shared equally between the buyer and the seller.

TAX BASE

This is an item / activity in which a tax can be imposed to raise revenue. It can also refer to the economic activity or source of income or property on which the tax is being paid. In most developing countries, the tax base is low due to the following.

1. Lack of knowledge about activities hat generates income to the people and other various sources of income.
2. Poor records on income and expenditure
3. Unequal distribution of income. If the income gap between the rich and poor is wide then there will be few individual to be taxed.
4. Low level of individualization which has lead to few production units upon which to impose taxes.
5. General poverty which has led to fewer people pay taxes.
6. Wide spread unemployment. This has led to majority of the population don't pay taxes.
7. Poor investment climate which discharges investment hence few economic activities on which taxes can be imposed.
8. Low level of entrepreneurship such that there are few successful businesses upon which taxes can be imposed.
9. Loop holes in the tax law makes it possible for many potential income earners to avoid taxes e.g. those who attain high incomes at the age below 18 years or students who are rich and yet don't pay taxes.
10. Wide spread political instabilities in LDCS are also responsible for a narrow tax bases for LDCS. Wars disrupt economic activities and discourage investment hence few activities to be taxed

NB A dead weight tax is a tax which when imposed causes the tax payer to abandon the activity which forms the tax base on which the tax is levied.

CLASSFICATION OF TAXES

There are two major ways in which taxes can be classified:

1. According to the final resting (incidence) of taxes: Here we have
   (a) Direct taxes: when the incidence cannot be shifted by the tax payer on to some other persons, the tax becomes direct tax.
   (b) Indirect taxes: when the incidence can be shifted by the payer on to other persons, the tax becomes indirect tax.

2. According to the "tax to income" ratio. Here we classify taxes as progressive proportionate, regressive and digressive taxes.

DIRECT TAXES

These are taxes which are levied upon incomes and property of individuals and companies. The major characteristic of a direct tax is that the incident falls on the unit concerned and cannot be shifted to another economic u nit. The major forms of direct taxes are:-

1. Personal income tax: This is levied on incomes (e.g. rent, profits, salry, etc) of individuals. This tax is usually progressive i.e. it increases with increasing incomes. In Uganda, income tax on salaries is deducted from the payroll and submitted to the Uganda Revenue Authority URA) by the employer in form of pay as you Earn (PAYE).
2. Wealth / property tax: This is a tax on property one has through accumulated saving or capital, where as this tax can be a good method of distributing wealth, it can discourage savings, investment, and accumulation of wealth.
3. Corporate/company tax: This tax is imposed on net or gross profit of a company. It is usually charged as a percentage of profits (at a corporate rate).
4. Super normal profit tax: This is a tax levied on companies that make super normal profits.

5. Capital gains tax: This is a tax levied on gains made by the seller of a certain capital asset whose value has appreciated considerably at the time of sale. Such gains are regarded as unearned income.
6. Capital levy: This is imposed on tax payers by government when there is urgent need for revenue e.g during emergency situations. It can also be levied to reduce the wealth of the very rich individuals in society.
7. Death (Estate) duty: This is levied on the property of the deceased. It is argued that a person cannot command property rights beyond the term of his/ her life which nature allows him/her and therefore society should take part of that property (in form of tax) when the owner dies.
8. Inheritance duty: where as death duty is levied on the property of the deceased inheritance duty is imposed on inheritors who may be many or just one. The greater the wealth inherited, the greater the inheritance duty that would be paid by the inheritor.
9. Gift tax. This is a tax imposed on gifts among the living. Gift tax can be a means of stopping sick people from avoiding death duty by passing the property on to the heirs in form of gifts. It can also be a method of taxing unearned income (if taxed on the received and a method of limiting the giver form disposing off his/her property in a form of gifts (if imposed on the giver)
10. Land tax: This is a tax imposed aiming at breaking land monopoly and on the grounds that “God gave the land to all the people”
11. Agricultural revenue tax: This is imposed on the value of produce realized by the farmer as income after deducting all expenses and costs of production.

ADVANTAGES OF DIRECT TAXES

1. They are a source of government revenue. Taxes imposed on incomes of individuals, companies, etc are collected by the government and the government use this revenue as a public expenditure on public utilities e.g. education, health, etc.

2. It brings equitable distribution of income. This is because most direct taxes are progressive in nature i.e. the higher the income of an individual the more the tax he would pay. The high income earners are taxed very highly and low income earners are tax less so that there is some equitable distribution of income.
3. Direct taxes are based on the canon of certainty. The tax payer is certain of the amount he is to pay.
4. Direct taxes can be used as an instrument to control inflation. This is because during inflation income is unevenly distributed, therefore with the use of direct taxes the rich are taxed more heavily than the poor so that the disposable income reduce and thereby reducing the purchasing power of individuals hence curbing inflation.
5. Costs of collection are low especially among government workers.
6. It is flexible: The government can increase or decrease the rates of direct taxes according to the requirement of the economy.
7. Direct taxes are convenient to the tax payers because they can pay the tax at their convenient time e.g. farmers after harvest.
8. It is easy to estimate revenue from taxation because the tax is fixed for a given period. This facilitates government budgeting.
9. It is simple to understand and easy to implement.

10. People who are unable to pay (armed forces, students and aged) are exempted.

DISADVANTAGES OF DIRECT TAXES

1. There is high possibility of evasion especially if taxes are high.
2. They are difficult to impose because they discourage savings, investments, consumption, etc. This leads to low production and unemployment.
3. It is difficult to determine one's taxable capacity since individuals have different sources of incomes.
4. There is high costs of collection especially in rural areas where infrastructure is not well developed. This makes tax collection uneconomical.
5. Direct taxes may bring about wage push inflation. When direct taxes are imposed the disposable income reduces. Workers may then demand for high wages resulting into wage push inflation.
6. At times direct taxes may not be fair. This is because the local chiefs are the major determinants in accessing the tax. If one is not friendly to local chief, he may pay a high tax even though he is in the low-income groups.
7. Direct taxes are not imposed on all income groups. This is normally true with low income earners. This leads to low tax collection by the government.
8. Tax payers feel the burden directly because this tax is paid directly out of the incomes of individuals.
9. Direct taxes are inconvenient at times since they are payable in advance and in some cases lumpsum. Normally it is paid at the beginning of the year before income is earned.
10. High tax rates can discourage foreign investors in the country.

INDIRECT TAXES

Indirect taxes (Taxes on layouts) are taxes imposed on commodities for sale and the incidence of the tax can easily be passed on to another party. They include the following:-

1. Excise tax: It is a tax imposed on the production of commodities whether meant for local consumption or export. It is a t ax imposed on home produced goods and services. The tax operates as a form of lincence enabling a local producer to carry on production.
2. Customs duty: This a tax imposed on imports or exports of commodities it can be export duty or import duty.

(i) Export duty: It is a tax imposed on commodities exported. It is levied in order to obtain revenue and discourage exports so as to satisfy the local market demand. In this way the whole market price is maintained at the desired level.

(ii) Import duty: It is a tax imposed on imported goods like cars, cosmetics and other imported manufactured articles. This tax is imposed in order to protect home industries and discourage imports so as to save the scarce foreign exchange. This tax can either be advolorem tax or specific tax.

(a) Advolorem tax: This is a tax based on the value of the goods, the higher the value in terms of price, the higher the tax rates.

(b) Specific tax: This is a tax which is imposed on physical unit of output e.g. a tax rate per KG per tone etc.

3. Sales tax: It is a tax, which is imposed on the level of transactions which takes place between the seller and the buyer of a particular commodities. The degree of shift ability of the sales tax from the seller to the buyer depends on the elasticity of demand of the commodity that is being transacted. There are two types of sales tax:
   (i) The single stage sales tax: This is a tax levied once at the first sale and purchase transaction.
   (ii) multi-stage sales tax: The tax which levied every time a sale of a unit of the same commodity takes place.
4. V.A.T: It is a tax on consumer expenditure. It is collected on business transactions and imports. It is a general sales tax which applies to a wide range of goods or services. The tax is charged on the sellers of output and their tax liability amounts to percentage (17%) of the value added at that particular stage of production. The firms engaged in the production of commodity add VAT to the value of their out puts, but they deduct from this figure the amount VAT already paid on their inputs. In other wards, they pay VAT only on the value added by their particular activities.

5. Expenditure tax: This is a kind of tax which is imposed when an individual makes a transaction (buys a commodity). This type of tax is related to an income tax, only that in this case it is imposed on the levels of spending per an individual not on his potential incomes. Expenditure tax is calculated by subtracting from gross income taxes and savings (Y-T-S). This difference would represent expenditure which is taxed according to appropriate rates.
6. Sumptuary tax: Is a tax, which is imposed on consumption of goods in a country. This is usually applied to discourage consumption of particular goods for health, economic and other reasons.
7. Octoroi tax: This is a tax levied on goods on transit from one state through the territory of another state.

ADVANTAGES OF INDIRECT TAXES

1. They are a major source of government revenue.
2. Indirect taxes are useful in resource allocation. This can be done by discriminating taxation of various goods and services.
3. Indirect taxes can be used to protect domestic infant industries. This will create employment, incomes, self efficiency and better living standards of citizens.
4. Indirect taxes can check the consumption and development of harmful goods.
5. Indirect taxes are convenient since the tax payer pays only when he consumes the commodity.
6. Import duty can be used to solve the balance of payment problems.
7. They are more economic because they involve less costs in assessment collection and administration. They are normally collected by businessmen on behalf of the government.
8. They are more flexible because they can be raised or lowered according to what the government intends to do or according to the performance of the economy.
9. Indirect taxes are comprehensive in that case then can nor easily be avoided is the only way they can be avoided by abstaining from the consumption of the taxed goods.
10. Its burden is not felt so much since it is a voluntary tax.

Disadvantages of Indirect taxes.

1. Indirect taxes tend to be inflationary because they lead to increase in prices for the taxed commodities.
2. They discourage consumption which reduced sales for producers and hence discourage production, investment and consequently leading to un employment.
3. They are regressive in nature in that the rich and the poor pay the same amount therefore they do not ensure equity.
4. They can cause diversion of resources . Resources will be allocated to the production of those commodities which are fairly taxed irrespective of the importance of such commodities to the citizens.
5. The incidence of the tax is not easy to determine.
6. Revenue from indirect taxes tends to be un reliable since it is difficult to accurately determine the effect of raising indirect taxes hence inability to determine the tax revenue to be generated which effects planning.
7. Import duties discourage the inflow of goods into the economy leading to scarcity of commodities hence decline in standard of living.

THE STRUCTURE OF TAXATION IN UGANDA

1. In Uganda both direct and indirect taxes do exist. Direct taxes include taxes like income tax, corporate tax while indirect taxes includes taxes like VAT, import duty, export duty, excise duty, and sumptuary tax. However more emphasis is put on indirect taxes than direct taxes (reasons –advantages of indirect taxes over direct taxes)
2. In terms of tax – income ratios, Uganda’s tax system tends to be regressive whereby the poor are more affected (have a bigger tax burden) than the rich.
3. Import duties are more emphasized than the export duties; this is because Uganda is pursuing an export led economy.
4. The tax revenue in relation to GDP is low i.e. Uganda has a low taxable capacity in sub-Saharan Africa which is 15-20% of GDP
5. The principles of taxation which are emphasized in imposing taxes are mainly equity, economy, ability to pay and elasticity of the tax.
6. The levying authorities are mainly two bodies ministry of finance and the District administration (district local councils.

7. The main objective of taxation in Uganda are generation of revenue, income distribution, achieving fiscal policy goals protectionism and improvement in balance of payment position.
8. Low tax compliance

PROBLEMS FACED BY TAX AUTHORITIES IN LDCS

1. There is a problem of determining the taxable capacity. It is difficult to determine how much to be paid by an individual, yet leave him with disposable income, which is enough to enable him to enjoy the desired standard of living.
2. In LDC'S people earn incomes from different sources and it is difficult to recognize these ways hence leading to loss of tax revenue.
3. High tax collection costs and a lot of administrative costs are involved; most of rural areas are remote leading to high transport costs.
4. In LDC's there is poor tax payment culture which leads to how tax compliance and high rates of tax evasion and avoidance hence how tax revenue.
5. Also LDC's lack the necessary facilities for tax collection and administration e.g. computers.
6. There is a serious shortage of man power to collect and assess taxes. This is due to lack of adequate skilled personnel in the field of tax administration.
7. Many people in LDC's charge employment time after time and it is very difficult to follow up such people to change that they pay taxes.
8. There is a problem of inflation usually whenever an economy is hit by inflation by the time the tax is paid the real value of the tax will have declined so that the tax cannot accomplish the purpose for which it was imposed.
9. Due to a high level of illiteracy majority of the population don't easily understand different types of taxes which leads to high costs on tax education and at times it can lead to tax resentment.
10. There is also a problem of corruption, embezzlement and nepotism in tax assessment and collection whereby some tax payers are under assessed and in addition the tax is collected is embezzlement there by discouraging the tax payers.
11. The problem of the big size of the subsistence sector which is not monitised also leads to low tax collection.

HOW CAN UGANDA INCREASE ITS TAX REVENUE

Currently Uganda's taxable capacity is low and there is a narrow tax base. Efforts should be made to increase tax revenue and the following are some of the measures which should be used to increase tax revenue.

1. The tax base should be expanded by introducing many taxes which can be imposed on different economic activities.
2. There should be massive tax education to educate the masses about different types of taxes and purposes of taxation in order to develop tax paying culture in Uganda which would minimize tax evasion and avoidance.
3. Indirect taxes should be more emphasized because they have a broad tax base and reduce the rate of tax evasion and avoidance hence, tax revenue can be generated from the taxes.
4. Facilities to facilitate tax collection should be put in place e.g. computers which will make tax collection easy and more efficient.
5. Since agriculture is the dominant sector taxes on agricultural revenue should be generated from such taxes.
6. Corruption in tax assessment and collection should be eradicated which would lead to genuine tax assessment and encourage payers to willingly pay taxes. If corruption is eradicated would also minimize embezzlement of tax revenue and maximize tax for government.
7. Anti smuggling measures should be put in place to minimize smuggling and ensure that all taxable imports are taxed before entering the country.
8. There should be adequate training of tax officials so that they can use the most efficient tax policies and best means of collecting taxes which do not antagonize tax payers so that tax payers are encouraged to keep paying tax.

OTHER CONCEPTS IN TAXATION

(a) Tax yield : This means the net revenue from tax after the costs of collection have been subtracted from total tax collection.

(b) Tax holiday: It refers to where the tax payer mainly an investor is exempted from paying tax for some time. Usually tax holidays are offered to new investors as a policy to attract investment.
(c) Tax exemption: This is where the tax payer is allowed not to pay tax. It is a tax relief because a tax payer is relived from paying tax.
(d) Tax rebate: This refers to reduction of the tax mainly used as a policy to encourage investment.
(e) Tax concessions: These refers to different forms of tax relief that is where fairer terms of taxation are put in place to encourage investment
(f) Tax cascade: This means the spreading out of the tax such that the tax burden is spread out to several tax paying units.
(g) Turn over tax: This is the tax imposed on sales, a tax imposed on goods or services whether they are intermediate or final products whenever they are sold.
(h) Poll tax: This is the tax whose rate is uniform to all tax payers usually left to the district, local administrations, municipalities and city councils to collect.

MONETARY POLICY

Monetary policy is the management of demand and supply for money together with the rate of interest in order to influence the level of economic activity. It originates from the central bank which collaborates with treasury in formulating and implementing this policy.

OBJECTIVES OF MONETARY POLICY

1. Stimulation of growth of economy
2. Maintenance of domestic price stability
3. Maintenance of full employment and balance of payment stability
4. Ensuring equitable distribution of income
5. Ensuring that government deficits are financed at a low interest rate that is when government expenditure exceeds revenue. The deficit is financed by borrowing from the cheapest source.
6. Attainment of balanced growth and development of the economy.
7. Creating a broad and continuous market for government securities.

TOOLS OF MONETARY POLICY

To attain the objectives of a monetary policy, the central bank can use all or some of the following tools;

1. Bank rate; this refers to rate of interest charged by the central bank on commercial banks when the later borrow from the former as a last resort. It is called the discount rate when the central bank lends cash to the commercial bank as last resort. The central bank can also lend to commercial banks by buying approved short term securities of commercial banks at discount called rediscount rate. When the bank rate (discount or rediscount rate) is increased commercial banks would increase the rate of interest charged on loans. This reduces the demand for loans and money supply and checks inflation. To increase money supply (so as to check on deflation) the central bank reduces the bank rate. This tool has limitation if commercial banks have excess liquidity and do not borrow from the central bank.
2. Open market operations: This refers to the buying and selling of securities to the public by government through the central bank. When the central bank sells securities (Securities are financial assets such as stocks, bonds, treasury bills or precisely a document to establish ownership of these assets) People go to commercial banks to draw money to buy securities. This reduces money available for lending in commercial banks and checks on the ability of commercial banks to create credit. This reduces money supply, aggregate demand and inflation. To increase money supply and aggregate demand the central bank buys securities from the public. This tools is limited in LDC's where there are no well developed security market.
3. Selective credit control: This is where the central bank directs commercial banks to give credits to specific sectors and seal on total domestic credit to various sectors e.g. giving loans to priority sectors only like agriculture. This reduces the number of sectors getting loans and hence reduces money supply.
4. Variable reserve requirement: The central bank can increase or decrease
   a) cash ratio,
   b) the reserved deposited by commercial banks in central banks or
   c) both.

This increase in the order above reduces money availability for lending in commercial banks and therefore reduces money supply. To increase money supply the central bank can reduce the above.

5. Moral Suasion: Here instead of giving directives the central bank gives informal advise and appeal to commercial banks in conduct of credit and lending policies. It is a form of persuasion. Commercial banks have to follow the advice given by the central bank to avoid falling into disfavour.
6. Special deposits or supplementary reserve requirements: The central bank can instruct the commercial banks to make certain deposits above the minimum legal requirement. This reduces the money available for lending in commercial banks and money supply.
7. Margin requirements: The commercial bank does not lend up to full amount of the value of security but lends some thing lower. Assuming that a security is worth Shs 50,000,000 the bank may lend up to 75% and keep a margin of 25%. This margin is supposed to act as a caution against decline in value of the security. The central bank may direct commercial banks to raise their lending margin requirements. A higher margin will reduce the amount of loans given by commercial banks and that may be in times of inflation. A lower margin raises the loanable funds this is favourable in times of depreciation in order to stimulate economic activity.

EFFECTIVENESS OF MONETARY POLICY IN UGANDA.

It has been generally acknowledged that monetary policy can play only a limited role in Uganda. Several reasons can be given.

1. Most of the banking business is concentrated in few urban centers, the rural sector is still under banked this limits the scope of effectiveness of monetary policy.
2. The existence of large non-monetary sector limits the operations of monetary policy.
3. The growing importance of non-financial intermediaries in LDC's posses a serious challenge to effective manipulation of monetary policy so long as these non financial intermediaries are excluded from the control of the central bank.
4. Many commercial banks in LDC's enjoy a high level of liquidity and as such changes in monetary policy do not significantly affect the credit policies of such commercial banks.
5. Foreign owned commercial banks can easily neutralize the restrictive effects of a strict monetary policy. Since many of these banks replenish their reserves through the selling of foreign assets and they can also participate in international capital market.
6. People are ignorant about open market operations hence they do not buy government bond and securities wherever they are declared.
7. Most people in LDC's do not keep their money with commercial banks. This makes it difficult on the part of the central bank to control money which is outside the banking system.
8. The people are ignorant about the availability of credit facilities thus selective credit control favouring a sector like agriculture will not be utilized.
9. In most LDC's there is lack of entrepreneurs who would have used the expanded credit for investment. This is due to low levels of education and entrepreneur ability.
10. Other problems are corruption and bribery, political instabilities. Due to these problems selective credit control as a monetary instrument is almost unworkable.

INFLATION

Inflation is a situation in which there is an increase in average price level in the economy. It is also refers to a situation where too much money is chasing too few goods.

State Of Inflation

This is the degree of intensity, the speed of change in prices. A slowly rising price level is referred to as mild, gradual or creeping inflation. The average price level rises at an annual rate between 1-6%. This state of inflation is un noticeable by the public. It is good state of inflation since it acts as an incentive to producers. Savings, investment, out put and employment opportunities all increase.

A rapidly rising price level is referred to as hyper/run away/galloping inflation. It is an extreme form of inflation. This state of inflation is noticeable and it is a bad state of inflation. It discourages producers since

consumers are reluctant to buy commodities at high prices. Savings, investment, output and employment opportunities all decrease e.g. Germany experienced this kind of inflation in 1923 and by the end of the year, prices are 1 million times greater than pre-war level. In 1923, paper money was loosing half or more of its value in one how and wages were fixed and paid daily. The price of new papers rose to 200,000 marks. Uganda also experienced this state of inflation in 1985, prices rose uncontrollably and at its height prices rose by greater than 200% per month.

Under conditions of hyper inflation, people loose confidence in the currency's ability to carry out its functions. The only solution to this problem is to withdraw the currency and issue new monetary units.

Another type of inflation is described as suppressed inflation. This refers to a situation where demand exceeds supply, but the effect on prices is minimised by the use of such devices as price controls and rationing.

Un Anticipated Inflation

Some times a certain rate of inflation is expected and allowance is made for it. But, with accelerating inflation there is a likelihood that the rate of inflation will be unanticipated. Inflation which is expected can prove less harmful to the economy than one which is unexpected. Therefore the inflation is which is not expected in the economy is one called un anticipated inflation.

Measurement Of Inflation

There are various methods used to measure inflation. The two commonly used methods are:

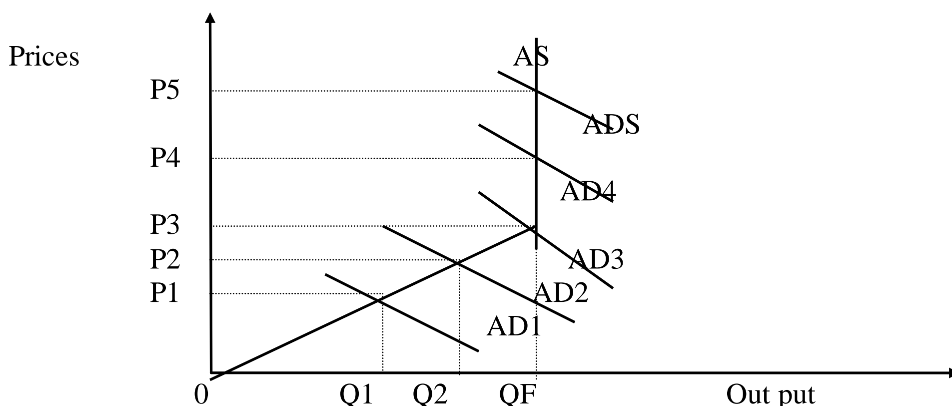
1. Consumer price indices.
2. National accounting deflator. The gross domestic deflator is abroad based measure of changes in the prices of the commodities to which value is added as part of domestic production. It is the ratio of the expected or the nominal income and the real national income.

Types And Causes Of Inflation

1. Demand pull/excessive demand inflation. Demand pull inflation is described as a situation where there is too much money chasing too few goods. It is characterized by aggregate demand persistently exceeding aggregate supply at current prices so that prices are being pulled upwards. It is usually associated with conditions of full employment when the economy is operating at full capacity and no further increases in output could be achieved.

According to this theory, the general price level rises because aggregate demand for goods and services exceeds the available supply at existing prices. This can be illustrated as below.

Demand Pull Inflation



AS = Aggregate supply
AD = Aggregate demand
QF = Output at full employment level.

In the figure, increase in aggregate demand (AD) from AD1 to AD3 are accompanied by higher output as well as higher prices. Increase in aggregate demand beyond AD3 will not increase output but only prices. At AD3 the economy encounters the output ceiling set by full employment and increase in aggregate demand beyond AD3 is what keyness described as True inflation.

Policies For Demand - Pull Inflation

1. Restrictive monetary policy. There should be a decrease in the amount of money in circulation. This can be done with the use of monetary policy instruments, like bank rate, open market operations, selective credit control, moral suasion, etc.

2. Fiscal policy. This can be used in two ways:

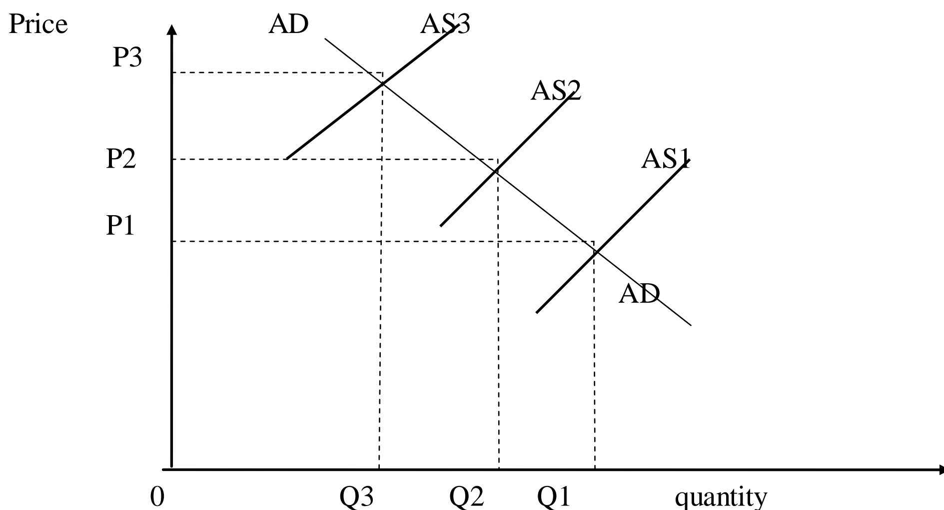
   (a) Decrease in government expenditure: This would mean that people will get lower incomes, employment rates will be reduced and consequently aggregate demand will fall hence reducing inflation.

   (b) Increase in taxes increasing taxes will reduce the peoples disposable income. This will lead to a fall in aggregate demand and inflation rte will reduce.
3. Reduction in tariffs import tariffs would be decreased to allow in more imports so as to increase the domestic supply of commodities. Import quotas should also be abolished so that more goods can enter the country. Dumping may also be encouraged.

4. Price and income policy: This policy is concerned with controlling prices of major commodities and keeping down wags hence increasing production thus controlling inflation.

2. Cost Push Inflation
This originates from the supply side. In the cost push theory of inflation prices are pushed up by increase in the cost of production.

A Diagram Showing Cost Push Theory Of Inflation



In the figure assuming that the economy is at full employment level of output OQ1 and the price level of OP1, aggregate demand (AD) is constant. As aggregate supply (AS) shifts to the left due to increase in the costs of production, out put will decrease and price level will increase hence causing inflation. Inflation of this nature is described as pure supply/pure cost inflation. It may occur in the following forms.

(a) Wage-push inflation. This arises when an increase in wage rate exceeds the productivity. There will be an upward shift in the aggregate supply causing wages to increase, causing an increase in the cost of production which leads to increase in prices of commodities hence causing inflation.

(i) Wage-wage inflation. This occurs due to interceptor comparison of wages among workers. Arise in wages in one section or firm will cause upward revision of wages in similar occupations in the economy. As entrepreneurs increase wages, total cost and prices also increase hence causing inflation.

(ii) Wage-price inflation. This occurs when workers demand for high wages through their trade unions. The increase in wages leads to increase in cost of production and increase in prices hence causing inflation.

(iii) Price-wage (spiral inflation). This occurs when prices are pushed up by increases in commodity prices leading to workers demanding high wages. This increases costs of production and leads to continual rise in prices of all commodities hence causing inflation.

(b) Profit push inflation. If there is a large number of monopolists and oligopolists, then there will be a greater possibility of profit-push inflation, since price determination entirely depends upon them.

Monopolists and oligopolists may raise prices so as to offset any cost increase with the aim of getting greater profits.

NB: The wage-push and profit-push do not explain all the Ugandan's inflation to a large extent but that one caused by raw material cost push.

Policies For Cost-Push Theory Of Inflation

The major policy is to increase the abundancy of commodities in an economy. This can be done in the following ways.

1. Increase in the level of domestic output: The government should increase local production by offering incentives to both local and foreign investors by availing them with credit facilities, tax holidays, tax exemptions, etc.

2. Imports should be encouraged: The government should encourage the importations of commodities that are scarce in the domestic economy. There should be no policies trying to block the important of such commodities. The government should also subsidize importers. This will increase the quantity of goods leading t a fall in prices. However, if the country wants to adopt import substitution strategy, there will be policy conflict as the policy discourages imports.

3. Exports of goods should be discouraged. This can be done by imposing high export taxes and in so doing the quantity of goods in the country will increase and prices will consequently fall hence curbing inflation.

4. Prices and income policies; Here wages and prices should be kept as low as possible to avoid wage-price spiral inflation.

3. Bottleneck Or Structural Inflation

This type of inflation is common in most LDCs. It is explained by the problems originating from within an economy. It is due to structural problems or supply rigidities which keep down the level of out put and hence high prices which causes inflation.

The source of bottleneck inflation are:
1. Reduction in production of the major sector like agriculture due to uncontrollable factors like weather, pests, etc.

2. Structural breakdown in industrial sector causing a shortage of goods and services in an economy. This can be caused of capital for maintenance, spare parts, etc.
3. It can also be due to inadequacy of technical and entrepreneurial skills. This results into a decline in the supply of commodities leading to a sharp increase in price.
4. Insecurity which scares a way both foreign and local investors causes a reduction in the level of output and prices increases hence causing inflation.
5. There may be foreign exchange bottlenecks which are due to poor export performance.

Policies For Structural Inflation

1. The export sector should be improved. This can be done by diversifying the economy.
2. Proper management of the economy resources should be properly allocated into production projects.
3. There should be increase in production of goods and services. The government should offer incentives to private individuals like credit facilities, tax holiday, tax exemptions etc. to encourage industrial development.
4. Agricultural mechanisation should be undertaken to increase on agricultural output. There should be improvement in transport facilities, land reform policy should be put in place, etc.

4. Imported Inflation

This originates from outside the economy. It is caused by:

(a) Importation of commodities from countries already affected by inflation where prices may be exaggerated by costs of taxes freight charges and storage.
(b) Importing intermediate goods at high prices which makes costs of production to be high and eventually making prices to increase.
(c) Importing high priced goods which eventually markets hence causing inflation.

Policies For Imported Inflation

Imported inflation is hard to fight because it is exogenous to the economy. However, there are some weak solutions.

1. Import restrictions: Imports that are imported from countries already hit by inflation should be stopped form entering the country. However, this will make the country to go without certain commodities although prices may be reduced. But in the long-run there will be shortage of those commodities thus forcing prices up wards and eventually causing inflation.

2. Import substitution strategy: This is where the government establishes industries to being producing commodities are being imported into the country. However, some commodities cannot be import substituted e.g. Petroleum products.

3. Subsidization of importers by the government. The problem is that the government may lack funds to subsidize importers.

Effects Of Inflation

<u>Negative effects of Inflation</u>

1. Agriculturalist lose because prices of agricultural commodities tend to lag behind inflation. Their savings, welfare and productivity fall.

2. Workers suffer when there is inflation because wage tend to lag behind inflation. Their real incomes, savings and welfare fall.

3. The standard of living of fixed income earners (like pension earners and those who depend on past savings) fall.

4. It discourages people from saving in financial institutions because of fear that their money would lose value. Financial institution are forced to increase the rate of interest and this increases cost of borrowing and leads to further inflation.

5. It reduces the purchasing power of the majority since it redistribute incomes from the majority peasants and workers to the minority (business people).

6. Creditors lose because they are paid back in an inflated currency. This discourages lending by individuals and financial institutions.

7. Inflation leads to balance of payments (BOP) problems by discouraging imports. Exports reduce because outsiders dislike buying from accounting where prices are high. Imports increase because outsiders like to sell in accounting where prices are high.

8. Inflation may be biased against prices are determined on the world market. Prices remain fixed where as costs of production increase in the domestic currency, people shift to production for domestic markets to fetch higher prices.

9. Where there is hyper inflation, there is need to revise plans, tax structures and contracts to match with the new price structures. This is time consuming and can lead to failure to achieve objectives of plans and programmes.

10. Inflation results into rural-urban migration since it becomes less profitable to grow crops in rural areas people shift to towns to start business. This discourages agriculture in rural areas, and lead to urban unemployment and development of slums in towns.

11. It undermines the external value of the currency which calls for devaluation of the currency. This makes importation of raw materials difficult.

12. It leads to political unrest and demand for high salaries by workers. These increases as people fail to meet the high cost of living, etc.

<u>Positive Effects Of Inflation</u>

Hyper inflation is undesirable in the economy. However, mild inflation may be "healthy" to the economy in the following ways.

1. It increase the profit level of business commercial producers since costs of production rise lower than prices of commodities. This encourages investment.

2. It makes workers and peasant workers to work harder to maintain their standard of living after the increase in prices. In this may, inflation acts as an incentive for people to engage in economic activities.

3. It reduces the level of unemployment since there would be alot of money to spend and stimulate production and invest and create more jobs.

4. It encourages business people to get loans since they would expect money to have lost value at the time of paying back.

5. It encourages people to produce food to sell in the domestic market where prices are high.

6. By encouraging urbanization, it lead to an increase in demand for food which encourages agriculture.

7. During inflation, the government collects more revenue and this enables it to meet its expenditure. This happens when the government applies its tools of monetary and fiscal policies in an effort to combat the problem of inflation

UNEMPLOYMENT

Unemployment is the stock of all those individuals who are not in employment and are actively seeking for jobs at the going wage rates. This excludes those individuals not in employment and not looking for jobs.

More precisely un employment refers to under utilisation of resources in an economy, that is the situation where there is no full utilisation of the level of utilisation of resources in an economy so that un employment is determined by the level of labour utilisation in the economy. Therefore, unemployment is a situation where some members of the labour force working age between 15 and 64 years are idle. It can be distinguished into voluntary unemployment. This is a situation where individuals do not want to work although jobs may be available. This is due to

(a) Money reserves: Some people might be having a lot of money in reserve so that they know that they will keep enjoying this money for the rest of their lives or they begin to work when they exhaust their reserves in future.

(b) The current wage which is un acceptable e.g. they prefer higher wages.

(c) Housewives may decide to remain at home to attend to their families.

(d) Laziness.

(e) Age. Some people may be ageing and decide to apply for retirement before the set age.

(f) Some individuals want to maintain their status.

(g) Target workers: after realising the set target some people can decide to retire before time.

(h) The available jobs could be sub-standard according to their skills and training.

(i) Some individuals could be from well to do families and therefore they want to remain dependants.

Involuntary Unemployment

This is a situation where members of a working group are idle but are willing to work in the existing situation at a current wage i.e. Individuals want to work but there are no jobs.

The existence of voluntary and involuntary unemployment is what is called open unemployment. This type of unemployment is experienced in LDC like Uganda.

Under Employment

This refers to a situation where a person's capacity to work is under utilised. It is due to lack of productive employment and mismanagement of human resources. This can be experienced as under.

(a) People working for fewer hours than the statutory minimum which is 8 hours or fewer hours than they wish to work are said to be under employed.

(b) It may also refer to working in jobs whose requirements are below the skills levels they have obtained through school and training like a doctor going to teach in a secondary school.

(c) It can also be experienced when people are earning much less income than they should however hard they work.

(d) It is also experienced when someone is working full time but in a less productive work and thus may also know as invisible unemployment (disguised under employment).

Types Of Unemployment

1. STRUCTURAL UNEMPLOYMENT: Structural unemployment results from immobility of labour both occupationally and geographically. It is brought about by long term changes in the structure of industry/economy namely:

(a) Change in demand away from the O/P of certain industries due to change in tastes a fashion switching off buyers to competitors' path e.g. plastics replacing clay crops.

(b) Change in production techniques which may reduce demand for labour in the industries concerned (automation) or invention of new machines and this leads to technological un employment e.g. computer replacing statisticians.

(c) Exhaustion in the deposit of raw materials e.g. mining which makes miner un employed.

(d) Structural imbalance between rural and urban areas leading to open-urban unemployment such structural changes cause labour to be un employed for some time especially where labour has been trained for specific purposes. In this case, vacancies are there but the unemployed may not posses the required skills or may not be of the right age and may also be due to wrong geographical positioning.

Policy Solutions To Structural Unemployment

1. Flexibility in production which enables industries to change with change in tastes and fashions.
2. There should be facilities for retraining of workers where skills are no longer in demand. This will enable workers to more to other expanding industries.
3. It also entails physical numerical of labour to place where jobs are found.
4. There should be serious trends in the economy and the necessary adjustments in time.

2. Seasonal Unemployment

This results from the seasonal patterns of work in certain industries. In Agric, people who do the planting may get unemployed during the harvesting period. In construction, the unskilled labour is laid off when the available contracts are terminated. This is common when the labour cannot diversify its skills in order to fit in difficult economic activities.

Solutions

1. Diversification of skills to suit in all the prevailing circumstances.
2. Industrialisation which is not affected by natural factors.
3. In case of Agric which depends of seasons, Agric can be planned in different areas i.e. during the drought it can take place in valleys and swamps and during the rainy season it can take place in the highlands.

3. Frictional/Search Unemployment (Transitional)

This occurs where there are unemployed workers of a particular occupation in one part of the country but a shortage of the same type of workers in other parts. Those unemployed cannot move to where jobs are available. It is also unemployment in the short run where labour leaves jobs in order to look for other jobs.

Frictional unemployment happens when labour has not yet got other jobs. The main reasons for this type of unemployment are:

(i) Ignorance of available job opportunities on the side of unemployment labour.

(ii) It is also due to lack of knowledge on the part of employers of the existence of those unemployed whom they can employ.

(iii) It is also due to geographical immobility of labour.

(iv) Innovation and technical progress in the economy where new techniques of production, which are labour saving are introduced in the economy labour has to be laid off.

Solutions

(i) Employers should be fully informed of the potential supply of labour.

(ii) Un employed workers should be informed of the availability of employment opportunities. This can be done through newspapers, radios, establishment of employment, information centres, etc.

(iii) Barrier to geographical labour mobility should be reduced by either unemployed to move to the jobs or the jobs to move to the unemployed.

4. Residual Unemployment

This is unemployment due to physical or mental inability to work people who are residually unemployed are called unemployable a sometimes are excluded in the number of employed.

solution

1. Provide work which is suitable to them.
2. Train them and engage them in cottage industries.

5. Technological Unemployment

This is a form of structural unemployment. It is caused by changes in production technique/automation which may reduce demand for labour in the industries concerned. The new technologies in production may replace labour with machines e.g. computerisation, labbots have lead to make people land off.

6. Rural Unemployment

This is unemployment common in rural areas of LCD's due to;

(a) Small land to large labour ratio so that there are too many people in a small piece of land.
(b) Small markets for their products.
(c) Lack of complementary factors especially that of capital to allow full exploitation of natural resources in the rural areas.
(d) Political instability.

7. Export Unemployment

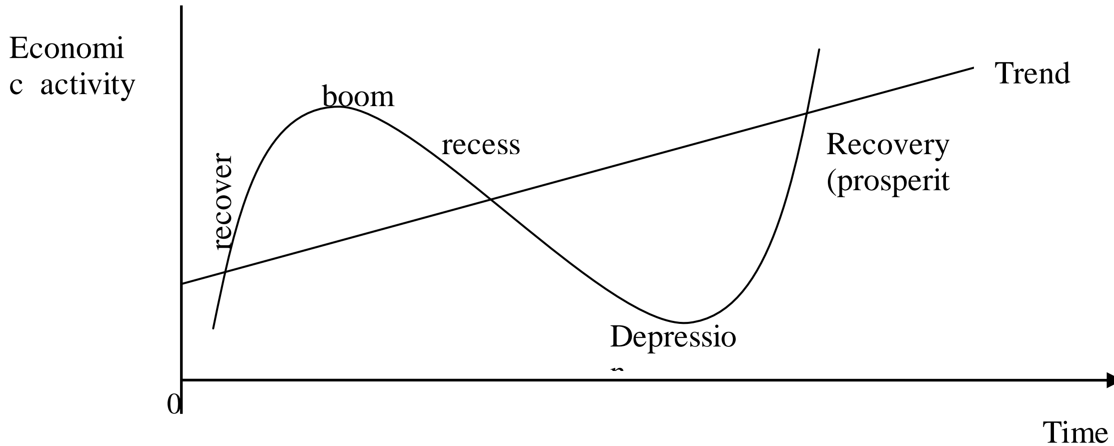
It is unemployment due to loss of export market. It is also called international unemployment. Experts, incomes, O/P, employment levels fall for those engaged in expert business.

8. Speculative Unemployment

This when people refuse present job offers and wage for those expected to be highly paid in the near future.

Causal Unemployment
9.Demand Deficit Employment/Mass/General/Keynesian/Cyclical Unemployment

This is a situation where aggregate demand is to low to support work for all those who are willing to work at the current wage rates. This disregard how well trained labour can be. It is especially true when there is a depression in the economy. This can be illustrated by the trade cycle illustrated below.

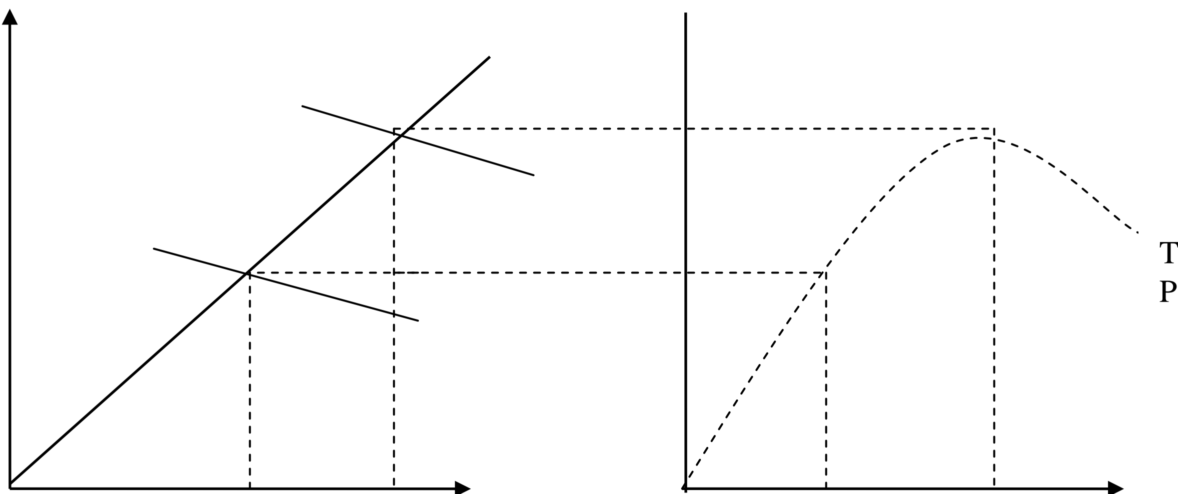


The basic cause of the is unemployment is insufficient level of total spending in the economy i.e. AD is deficient. This has always been the major cause of periodic spells of heavy unemployment that have beset the industrial economies in moser times. It is because these periods of recession have alternated with periods of full employment that we speak of the trade cycle. It is therefore natural to refer to the high employment in those recurring periods of recession as cyclical periodic unemployment.

Since demand for labour is derived demand, it means that insufficient aggregate demand will mean low demand for labour hence fall in employment. Once aggregate demand reduces, businessmen will find themselves with unsold goods (inventory accumulation) they will be forced to reduce investment and consequently lay off workers.

Lord keyness stressed two concept, the marginal propensity to consume and the investment multiplier. If M.P.C is low unemployment is bound to occur since investment multiplier process will be small.

Un Employment Equilibrium



Unemployment can also occur at equilibrium level of income (oye2) where AD2 is equal to AS. The point is called unemployment equilibrium (E2). When AD reduces from AD1 to AD2, equilibrium income decreases from Oye1 to Oye2 and more labour will be unemployed i.e. L1L2 will be unemployed.

Employment Multiplier (EM)

It refers to the number of times change in employment as a result of increased government expenditure will multiply itself to give rise to a final change in total employment.

$$EM = \frac{\text{Change in primary employment and change in secondary employment}}{\text{Change in primary employment}}$$

Example:

Suppose the government increases its expenditure on coffee products, it will create employment in this sector which is referred to as primary employment. Due to increased coffee O/P employment opportunities will be created in other sectors e.g. transport, storage and processing, this is referred to as secondary employment.

Supposing: Change in primary employment = 80
Change in secondary employment = 40

$$EM = \frac{80 + 40}{80} = \frac{20}{80} = 1.5$$

Rate of unemployment:

This is the ratio of the unemployed labour force to the total labour force e.g. supposing act........... has the total labour force of 16m people and 4m unemployed people. The rate of un employment would be:

$$\frac{\text{Un employed labour x 100}}{\text{Total labour force}}$$

$$= \frac{4}{10} \text{ x } 100 = 25\%$$

The rate of un employment is 25%.

POLICY SOLUTIONS TO KEYNESIAN UNEMPLOYMENT

1. **Fiscal policy:**

   Here the government would increase aggregate demand by either increasing government expenditure or reduce indirect taxes or even apply both simultaneously hence increasing consumption which would lead to increased investment thus demanding for more labour.

2. **Expansionary monetary policy:**

   This is where the government undertakes the buying of securities and bonds from the public thereby increasing money in circulation. This would eventually lead to increased consumption, increased investment hence increased employment.

3. **Trade liberalisation:**

The government should encourage the exportation of good and services and discourages importation hence increasing investment which will demand for more labourers thus creating more employment and opportunities.

4. **Wage policy:**

   By increasing the wages of the labourers (Consumers) the government would be encouraging increased consumption thus leading to increased investment which in due turn would lead to more demand for labour as a result of this increase in investment.

LIMITATIONS OF THE KEYNESIAN THEORY OF UN EMPLOYMENT IN L.D.CS

1. In LDCs un employment is from the supply side i.e. due to lack of co-operant factors rather than demand side as suggested by keyness.

2. In LDCs there is lack of resources to expand agriculture industry and services so as to create employment opportunities.

3. Attempt to expand employment by using expenditure (increase aggregate demand) in LDCs would result into inflation because of deficiency in supply of commodities due to lack of cooperant factors.

4. Investment according to keyness is determined by consumption but in LDCs investment is determined by savings.

5. In LDCs people like to keep their money in form of properties like cows, land wives etc. which do not expand employment.

6. In LDCs as you try to increase money supply, some individuals withhold it by keeping it under ground and under mattresses of which will not increase employment.

7. In LDCs production is influenced by natural factors which may limit employment rather than consumption.

8. Keyness did not consider the causes and solutions of other types of unemployment other than cyclical unemployment.

9. Keyness did not consider structured and institutional problems in LDCs e.g. lack of transport, land tenure systems etc. all those can limit production and employment opportunities.

10. LDCs have poor investment climate and because of this increase expenditure may not create job opportunities.

11. LDCs depend on imports. Expanding demand will encourage investment in countries where imports come from.

12. Since most of the industries in LDCs use capital intensive methods of production even if O/P increases many people may remain unemployed.

13. Since LDCs rely on raw materials as their exports an increase in aggregate demand will not lead to increase in employment opportunities because the tertiary and secondary sectors are very narrow.

14. Keyness in his theory was considering wage economies where he assumed that whenever one works he gets money which we will spend and invest.

However, in LDCs there is a large subsistence sector where there are no wages. Therefore the monetary and fiscal policy keyness proposes cannot be very successful in LDCs.

OPEN URBAN UN EMPLOYMENT

This is when members of the labour force are unemployed in the urban area both voluntarily and involuntarily. Open urban unemployment can be explained by the theory of rural-urban migration which means a process whereby individuals move form rural to urban areas due to pus and pull factors. Push factors cause discomfort in rural areas and make people to move in urban areas while pull factors attract people to urban areas.

These factors are both economic and non-economic. They include:

1. Un equal distribution of economic activities where urban areas get more government allocation of development expenditure leaving the city side not considered. This carease Y gap and people always migrate from rural areas hoping to get increased Ys by being employed in urban areas.

2. Un equal distribution of social services between the rural and urban areas e.g. medical case, education etc.

3. Population pressure, land limitation causes unemployment in rural areas and those without access to land move to urban areas to seek for employment.

4. Formal and inappropriate education. This has caused explosion for school drop out who lack any practical skills as they are prepared for white collar jobs. School leavers lack any specific qualification but continue looking for jobs which are limited. Besides people who have gone to school correlate education with urban life.

5. The rural -urban wage gap - wages in urban areas tend towards the living wage and people flock urban centres tog et such wages.

6. The rural population view that the urban standard of living is high and therefore they tend to move in order to enjoy this.

7. Social problems. The fear of traditional practices like witchcrafts, circumcision etc. may make individuals to escape to urban areas where such don't exist.

CONSEQUENCES OF RURAL URBAN MIGRATION

1. Open urban un employment. Those who go to town in search for jobs in most cases do not get them, as a result, they would end up on streets still looking for jobs.

2. Increase of dependence. It leads to an increase on problem of dependence such that those individuals who fail to get jobs in urban areas end up being dependent on a few working relatives. Income which would be saved for investment ends up being consumed.

3. Development of slums. It may lead to development of slums with its associated problems like prostitutions, high crime rates, diseases, etc.

4. Increased cost of living. It may lead to increased cost of living in urban areas due to increase in demand for goods and other social services and if this increase is persistent, it may lead to inflation.

5. Low agricultural O/P. Individuals who normally migrate to urban areas are the youth. These are the energetic people who would have supported agricultural O/P in the country so their movement to urban areas leads to decrease in agricultural O/P.

6. It reduces government taxable capacity due to open urban unemployment. Many people are poor and for that case low rates of taxes are imposed on them.

SOLUTION TO RURAL URBAN MIGRATION

1. Rural development policy which aims at:

(a) Improvement of agricultural sector by provision of credit facilities, transport facilities, prompt payment, market research, etc.

(b) Social services e.g. schools, hospitals, electricity should be extended to rural areas.

(c) Small scale labour intensive industries should be set in rural areas to provide employment.

2. Population control: The government should endeavour to control the high population growth rates so as to reduce population pressure.

3. Education review policy: This calls for the introduction of more relevant practical subjects on the school curriculum.

4. Rural - rural migration should be encouraged.

5. Wage policies. This aims at reducing rural-urban differences in Y earnings. Wages should be fixed at the same level so that people can remain in their area of locality.

6. The land reform policies. These can be used to redistribute land and thus provide incomes and employment to many people.

7. Use of fiscal policy. There should be many forms of taxes in urban areas than in rural areas. The tax rate should also be raised in urban areas relative to those in rural areas which would force people to remain in rural areas and those in town to run to rural areas.

8. Dependence on agriculture alone in rural areas should be reduced. By doing other activities like carpentry, brick laying, cottage industry/craft industries.

9. Some cultures which force people to escape from rural areas should be banned.

CLASSICAL UN EMPLOYMENT

According to classicals, unemployment exists due to lack of co-operant factors of production like capital, land and raw materials. Lack of these factors reduce the volumes of production and labour has to be laid off. This is the major type of unemployment in LDC's as there is severe lack of cooperant factors of production in LDC's economic.

CAUSES OF UNEMPLOYMENT IN LDCs (UGANDA)

1. The rapid population growth which is greater than 2.6% puts much pressure n land and other factors of production which lead to both under and open unemployment i.e. both voluntary and involuntary unemployment.
2. Defective education system. The education inherited from the colonial masters is so defective that it does not produce job makers but rather job seekers.
3. Rural-urban migration leading to open-urban unemployment.
4. Use of capital intensive technics of production which often reduces the level of employment.
5. The IMF policeis/structural adjustment programmes. These aimed at reducing the number of employees so as to reduce government expenditure.
6. Seasonal variations in economic activities e.g. Agric employment. Employment is determined by natural factors which leads to seasonal unemployment.

7. Natural disabilities (vulnerable group) e.g. physical and mental handicapped found on streets and Butabika and other places in Uganda (Residual UE).
8. Deficiencies in demand for some products. These have caused some industries e.g. coffee industry to lay off some workers.
9. Lack of cooperant factors of production.
10. Political instability caused by rebels.
11. Inflation. This discourages investment both foreign and domestic which also leads to unemployment.
12. Export of raw materials that could have provided employment to tertiary and secondary industries.
13. Discrimination and sectarianism in the labour market.
14. The land tenure system.
15. Lack of serious man power plg. I.e. training of labour is not in line with demand for it e.g. theoretical education yet technical education is in demand.

The effects aggregate demand leading to low rate of economic growth and low rate of employment creation.

CONSEQUENCES OF UNEMPLOYMENT IN UGANDA

1. Labourers are exploited by employers in form of low wages since there is surplus labour.
2. Deficiencies in demand - low Y - unemployment.
3. Increased government expenditure.
4. Political instability.
5. Rural-urban migration.
6. Decreased government revenue.
7. Income inequality.
8. Debt burdens and BOP.
9. Dependence burden
10. Brain drain
11. Low standards of living.
12. Reduction in savings disinvestment.

SOLUTIONS

1. Population control policies should be employed.
2. Polices to reduce rural-urban migration e.g. heavy taxation in the urban areas, rural development policies, land reform policies etc. should be put in place.
3. To reduce seasonal UE government should try to fight some problems of nature by use of irrigation schemes, drought resistant crops and to introduce other activities like fishing, hunting, etc. and diversification of agriculture.
4. The unemployable (residually UE) should be trained for some jobs such that they are employed in cottage industry.
5. To deal with friction unemployment, policies to promote geographical mobility of labour should be pursued. Jobs/vacancies should be well known b y employees through mass media and establishment of employment bureau's where people can always go to get information about the availability of jobs in various sectors of the economy.
6. Structural unemployment can be solved by adopting flexibility in production so as to cope up with changes in demand for labour due to change in tastes and preferences.
7. Need for diversification and retraining of labour where skills are no longer in demand is important.
8. Workers should also be trained not to do one specific job but many jobs.
9. Modifying the link between education and employment to avoid preparing labour for only white collar jobs. More technical and agricultural institutions should be set up.
10. Encouragement of rural to rural migration.
11. Diversification of export market.
12. Localisation of industries should be encouraged.
13. There should be increase in the level of small scale labour intensive industries.

NATIONAL INCOME

National income is the monetary sum of the flow of goods and services in the country per period of time (usually per year) from this definition, we note that:

a) National income is measured per period of time and therefore, is a flow and not a stock.
b) National income is measured in money terms. However, we are interest in the value of commodities produced and not money itself.
c) We measure both goods and services. Services are included because they also give satisfaction.

SOME TERMS USED IN NATIONAL INCOME

1. Gross Domestic Product (GDP)

This is a measure of the flow of goods and services produced within the country irrespective of who produces them. Therefore it includes output produced in the country by both national s (residents) and foreigners. Foreigners include investors and expatriates.

GDP = C + I +g
where c is hold income
i is the contributions by firms
g is the contribution by the government

2. Gross National Product (GNP)

GNP measures the flow of goods and services produced by nationals of a country irrespective of where they produce out put from. Therefore, GNP includes output produced by nationals within the country and outside the country. It excludes income earned by foreigners from the country.

GNP = GDP + Net factor income from abroad.
GNP = c + i + g + (x-m)
where (x-m) is Net factor income from abroad. Net factor (property) income from abroad is equal to income earned by nationals from abroad minus income earned by foreigners from the country. Such earnings may be in form of salaries, rent on properties, dividends, profits, etc. When nationals earn more income from abroad then what foreigners earn from the country, net property income earned form abroad is positive, making GNP greater than GDP. When nationals earn less from abroad than what foreigners earn from the country, net property income earned from abroad is negative, making GNP less than GDP.

Most countries and Uganda in particular use GDP because of inadequate information about the income earned by nationals from abroad.

3. Net National Product (NNP):
NNP = GNP - Depreciation

METHODS OF MEASURING NATIONAL INCOME

There are three methods of measuring national income namely:-

1. The income approach
2. The expenditure approach
3. The product/value added (output) approach.

THE INCOME APPROACH

In this approach, we measure the income received by various sectors of the economy which contributes to the production of goods and services. Therefore we add up the following:

a) Household income: This is the income of individuals in form of rent, wages, salaries, interest, dividends, etc.

b) Business income: this includes retained profits of business which are not distributed to the share holders. Such profit is retained for investment and for meeting future commitments. Retained profits belong to share holders through it remains within the business. Household income and business income constitute private income.

c) Government income: This includes profit or surpluses retained by publicity owned enterprises and property income (rent) of the government (central and local authorities).

d) Net income earned from abroad: This is the difference between what nationals earn from abroad and what foreigners earn from the country.

When we use the income approach, we include only the income received in exchange for services rendered. So there should be aquid-proquo (income received in exchange for goods and services) for income to be included. Therefore all transfer payment are not included. Transfer payments are incomes received not in exchange of commodities e.g. gifts, pensions, grants, sick benefits, famine reliefs, etc. These transfer payments are excluded to avoid double counting because they are money flows from those who can afford to the recipients and therefore are already considered as income of those giving them out.

Also all illegal activities such as smuggling, stealing, gambling and prostitution are excluded because they belong to underground economy.

Subsistence output or output which is produced and consumed at home should be included. It should be assumed that the producer sold himself/herself such out put through he/she did not pay him/herself.

Input which are provided by the farmer e.g. family labour, land, etc. should also be given value and be treated as if the farmer sold (hired) them to himself/herself.

The work of the housewife is excluded from the calculation of national income because she is not earning a salary and yet that of a housegirl is calculated since she earns a salary.

THE EXPENDITURE APPROACH

In this approach, we add up expenditure on final commodities. Expenditure must be on final commodities to avoid double counting e.g. expenditure on bread and expenditure on wheat which was used to make bread would involve double counting of wheat and therefore we should consider only expenditure on bread (final good). To get total expenditure, we add up expenditure by all sectors in the economy which is represented by an identity $E = c + i + g + x$. Implying that nationals may receive the income through expenditure by private consumers (c), through expenditure by firms on capital goods produced (i), through expenditure by government (g) and through expenditure of overseas buyers (x).
(G) refers to the provision of services like health, education, defence, etc.

Exports are included because they form part of the economy's output and create income at home. Imports are excluded because they create income for outsiders. If these expenditures are summed up. We shall have the expenditure approach given by
$E = c + I + g + (x-m)$ where
$(x-m)$ = Net exports (x)

The above approach gives up gross national expenditure at market prices. When the indirect taxes are deducted from gross national expenditure at market prices, we get gross national expenditure at factor cost. It is called gross because allowance has not been made for depreciation.

NB: For expenditure to be included in the computation of national income by expenditure approach, there should be aquid-proquo.

THE PRODUCTION/OUTPUT (VALUE ADDED) APPROACH

In this approach, we add up “value added” on output by all sectors per year. Value added includes only what was added on output during the year, e.g. raw materials all produced in previous years are not included in the value added.

ILLUSTRATION ON HOW VALUE ADDED APPROACH OPERATES

			Value added
Farmers sell cotton to ginneries at	10/=		10/=
Ginneries sell cotton to LMB at 14/=		4/=	
LMB sell cotton to Nytil at	16/=		2/=
Nytil sell cloths to Ugil at	10/=		3/=
Ugil sell clothes to consumers at 25/=		6/=	
	84/=		25/=

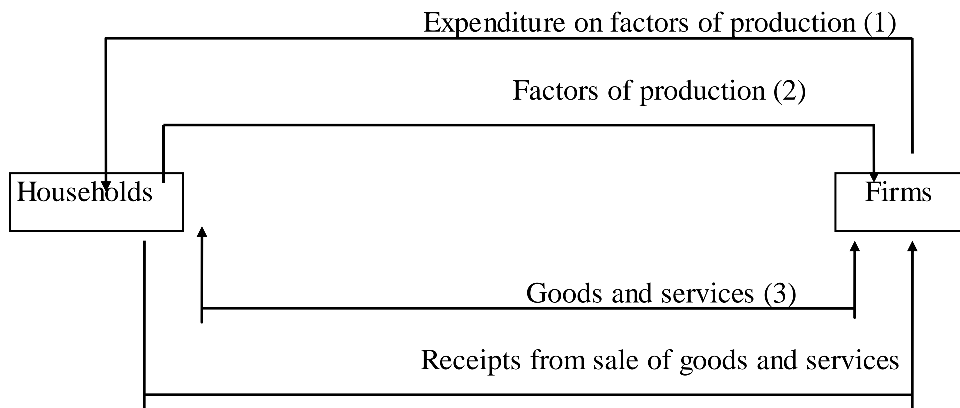
Therefore national output is not sum-total of the economic process which is 84/= (10+14+16+19+25) in the above example. We shall only add the value added at every stage of production which is 25/= (10+4+2+3+6). If this value added is taken in all economic processes and in all sectors of the economy and summed up gives the figure of national income.

MEASURING NATIONAL INCOME IN UGANDA

The product approach is the method used to estimated GDP at factor cost. Value added by various sectors of the economy like agriculture, mining and quarrying, manufacturing, electricity and water, construction, retail and wholesale, transport and communication and community services are added. Where services are provided at subsidized prices by the government, the cost (expenditure) of providing such services is considered. To cater for non-monetary (subsistence) sector, figures are computed to include value added by subsistence agriculture, fishing and construction.

CIRCULAR FLOW OF INCOME

This shows the flow of resource and commodities (real flow) and flow of expenditure and income (money flow) between households and firms. In a closed economy, when there is no government intervention, the circular flow of income would appear as illustrated in the figure below:



From the figure:-

(a) Firms buy factors of production from households (2) and pay for these factors of production to produce goods and services which they sell to households (3). In turn, households pay for these goods and services (4).

(b) Arrow (2) and arrow (3) show real flows i.e. the flow of factors of production and commodities respectively.
(c) Arrow (1) and arrow (4) show monetary/financial flows i.e. flow of income and expenditure respectively.
(d) The value of goods and services (output) is equal to households expenditure on their (expenditure approach). Receipts by firms from sale of goods and services are spent on buying factors of production. These receipts would constitute income for households (income approach). Therefore the 3 approaches for measuring national income should give equivalent results if there are no errors i.e. $0 \equiv Y \equiv E$.

RELATION BETWEEN NNP AT MARKET PRICES AND NNP A FACTOR COST

The NNP at market prices is always higher than the NJP at factor cost. This is because the market price of goods comprise of a number of items where as the NNP at factor cost equals the cost of production. There is income which the producers receive when no taxes are included in it.

Hence $NNP_{fc} = NNP_{mp}$ - indirect taxes. It can also be true that the government can subsidize producers so that they sell their products at lower price. To find out the cost of product, the amount of subsidy is added to the market price. Thus $NNP_{fc} = NNP_{mp}$ - indirect taxes + subsidies . but indirect taxes - subsidies = Net indirect taxes. Then $NNP_{fc} = NNP_{mp}$ - Net indirect taxes.

DETERMINANTS OF NATIONAL INCOME

(a) The level of investment. The level of investment which includes both foreign and domestic will determine the level of national income. If the level of investment is high, it will lead to more goods and services produced in the country hence leading to increase in national income and vis-versa.

(b) National resources (Land, minerals, vegetation, climate, etc.). If all those are available and are well utilised, they lead to higher output hence leading to high national income and vis-versa.

(c) The size and quality of labour force. The bigger the size of the marking population (i.e. between the age of 15-65) if put to work, the greater will be the output. Their efficiency/productivity at work will also depend on their skills, education, etc. The more of these (skills, education, etc.) labour force is, the higher will be the level of productivity and the higher will be the national income and vis-versa.
(d) Capital stock: This can be inform of machinery and equipment. Since capital is a cooprant factor for labour in the production process, the more available they are, the more output will be and so is national income and vis-versa.

(e) Technological advancement. If there are better techniques/methods of production, it implies increased production as a result of reduced costs of production of use of better cheap methods which will lead to increased income and vis-versa.

(f) Economic and political stability of the country. Conducive political atmosphere makes it possible for investment and production to take place in a country hence leading to the growth in the size of the country's national income.

(g) Availability of markets both domestic and foreign. If the market for goods and services is available, investors will be encouraged to increase on the level of output to meet the market demand hence leading to increase on the level of national income and vis-versa.

(h) Entrepreneurial ability. If the factors of production are well organised by entrepreneurs, it may lead to increase in output hence leading to increase in national income and vis-versa.

(i) The availability of foreign loans/resources: loans from abroad help boos GDP (National income) even though the foreigners will want to receive financial returns on their loans.

Converting Nominal Income to Real Income

Normal or money income is the value of commodities produced in a given period of time when expressed in some monetary units e.g. dollars, shillings. It is based on current market prices.

Real income (National income at constant prices): This is the value of commodities produced during a period of time when valued at constant prices. It measures the producing power of income by removing the effect of inflation form nominal income.

$$\text{Real income} = \frac{\text{Nominal income of the year}}{\text{The price index of that year}} \times 100$$

The price index measures changes in the general price level. In economic analysis, we use real income figure which reflect the actual production situation rather than nominal income which is influenced by inflation.

OTHER IMPORTANT CONCEPTS RELATED TO NATIONAL INCOME

1. Per capita income: This is the average income of individuals of accounting in a particular year.

   $$\text{Per capita income} = \frac{\text{National income for the year}}{\text{Total population of the country for the year}}$$

2. $$\text{Nominal per capita income} = \frac{\text{Nominal national income for the year}}{\text{Total population of the country for the year}}$$

3. $$\text{Real per capita income} = \frac{\text{Real National income for the year}}{\text{Total population of the country for the year}}$$

DIFFICULTIES IN MEASURING NATIONAL INCOME IN LDCs

1. double counting; There is a possibility of counting some commodities more than once, e.g. consumers can spend many times on a durable commodity. It is also difficult to determine a final product. At time inventories (stock of inputs and unfinished goods) are counted as final good and later counted again when counting final products which were made from inventories.

2. Non-monetary output. National is measure in monetary terms, and there are some things which are difficult to measure in monetary terms e.g.

a) subsistence output. It is difficult to get the value of out put which is not taken to the market. Usually, available is "imported" on such output but this may not be realistic. There are things which are difficult to measure e.g. bringing up a child by a parent, a teacher teaching his/her child, etc.

b) Work done by a house wife. Such work is difficult to measure since house wives do not get salaries for the work they do.

c) Leisure foregone when income is earned. This is difficult to determine and to measure.

3. Lack of information: This is especially on

a) Private expenditure and private income on which very little data is available.

B) illegal activities like prostitution, stealing, smuggling, etc. Little or no data is available on income received from such activities (underground economy). Through such activities fulfil the needs of the people, income

from their sale or purchase is not included in GNP. They are treated as socially undesirable activities and it is even difficult to tell when such activities took place.

4. Price changes: These changes affect the value of GDP (National income) such that when the price in the country rises (inflation), the national income will show an increase even though the real production of goods and services might have reduced and vis-versa. It is difficult to adjust and define the effects of inflation and deflation.

5. Net income from abroad: This is difficult to determine since imports and exports are carried out by many people or groups of people with little data available to verify the amount imported and exported by private firms and individuals. At times, it is difficult to distinguish between smuggling and legal international trade. Besides some nationals are outside illegally and others do a number of jobs making it difficult for the government to determine their contribution to national output.

6. Timing of production. It is very difficult to determine out put produced in a country during the year e.g. second hand items are not included in measuring national income figure because it is difficult to determine when they were produced within the country.

7. It is difficult to value the actual value of government utilities because they are usually subsidized.

8. It is difficult to measure depreciation so as to determine net income because firms use different methods to measure depreciation which makes national income not exact but an estimate. Depreciation can also refer to a situation where there is a fall in the free market value of domestic currency in terms of foreign currencies. This also creates a problem of failure to determine the demand and supply condition of currency hence a problem to estimation.

9. The use of income approach to value services can be misleading e.g. during peace periods army men are idle and yet they receive salaries for almost no services rendered.

10. Defining the boundary of production i.e. what to include in determination of national income methods to use in the valuation of some items e.g. whether to include subsistence output or not.

IMPORTANCE OF NATIONAL INCOME STATISTICS

National income data is of great importance for the economy of a country. The national income data is regarded as accounts for the economy which are known as social accounts. Social accounts tells us how the aggregates of a nation's income, output and product result from the income of different individuals, products or industries and transactions of international trade. Thus the national income data is of the following importance:

1. National income data form the basis of national policies such as employment policy because these figures enable the government to know the direction in which the industrial output, investment and savings etc. change and proper measures can be adopted to bring the economy to the right path.

2. National income statistics show the distribution of income among the various factors of production and sectors of the economy namely the household, business and the government sectors. This is important in planning for taxes and government expenditure.

3. They show the rate of resource utilization. The increase in national income may be the result of increased utilization of national resources.

4. They are important in estimating the level of international transactions and the degree to which an economy depends on other economies. This can be estimated from the figure of imports and exports.

5. They are used for international comparisons which are necessary if improvement in economic performance is to be achieved.

6. National income data are significant for a country's per capita income which reflects the economic welfare of the country. The higher the per capita income, the higher the economic welfare and vis-versa.

7. It shows us the contributions made by different sectors of the economy as seen through output approach. It helps to tell us which sector is redundant and which one contributes more.

8. They show the patterns of expenditure. This is shown by figures of private and public expenditure. This is important in the making of national budget where there is need to estimate private and public expenditure.

9. It is important in attracting foreign investment/aid. The figure can be an indicator to the outside world about the performance of the economy. This encourages them to invest in the economy of high performance. Donor countries, institutions also base on national income statistics to give foreign aid/grant.

10. National income date is made use of by the research scholars of economics. They make use of the various data of the country's inputs, output, income etc. which are obtained from social accounts.

11. They measure the size of various economic sectors i.e. agriculture, industry and infrastructure or monetary and subsistence sectors.

12. They show regional performance and improvements. Income of different regions in the country can be compared so as to make plans on how to improve backward regions.

THE PROBLEMS ENCOUNTERED WHEN COMPARING GNP FIGURES OF TWO COUNTRIES

1. Boundary of production. Different countries have different boundaries of production e.g. what one country may include in its estimation, another country may exclude it. E.g. prostitution services, gambling etc. The country which includes such services will have a higher figure than that one which excluded them.

2. Statistical information. In some countries where there is a general lack of qualified statisticians, economists, equipment such as computers, calculations etc. there will be inaccurate figures for national income hence making it difficult to compare GNP between countries.

3. Price level. Different countries, have different price levels and therefore cannot compare their national income properly. Countries with high prices (inflations may have higher figures indicating a high GNP than those with low prices which is not true.

4. Cost of production: Some countries incur higher costs of production than others. A country operating at higher costs will have its process inflated which will lead to an over estimation of GNP figures. Comparing of GNP figures cannot be easy unless countries are operating at the same costs.

5. Requirements are not the same in different countries and therefore different goods and services are produced.

6. Different currencies. Different countries use different currencies and thus GNP figures appear in different values in different currencies converting one to another may be inaccurate e.g. Uganda shilling to United States dollars or Kenya Shillings to Pound Sterling which could be taken as standard currency for comparison. This is due to changes (fluctuation) of exchange rates in the foreign exchange market.

7. Countries use different methods to measure national income. These methods are equivalent but not equal thus making comparisons difficult.

NATIONAL INCOME AND STANDARD OF LIVING

Standard of living is the social-economic welfare enjoyed by an individual or society. It is reflected in terms of the basket of goods and services consumed and the freedoms enjoyed.

Since income per capita shows the volume of goods and services available to an average individual in one year, it is often used as a measure of standard of living of the citizens of a particular country. It is also used to compare standards of living between or among countries. This income per capita is a measure of standard of living.
However, there are many limitations in using the figures of per capita income to compare the standard of living between countries.

1. It does not consider the types of good produced per capita income may be high in the country which produces many capital goods which do not improve welfare directly.

2. It does not take into account leisure which contributes to welfare. Per capita income maybe high in a country where people work hard and forego leisure which maybe on top of their scale of preferences.

3. Per capita income figure do not reflect some factors which influence the welfare of the people e.g. it may be high in a country where there are wars, accidents, disease, pollution, etc.

4. It does not show the level of employment in the country. Per capita income may be high in the country as a result of using capital intensive methods of production. This implies low levels of employment and low standard of living.

5. Per capita income may increase as a result of inaccurate population figures being under estimated or may decrease as a result of over estimating population of which does not show an increase or decrease thus making per capita income unreliable.

6. Per capita income may be low in a country where there are omissions in measuring GNP e.g. due to a large fraction of subsistence sector, high non-monetary output, etc.

7. Countries use different concepts and definitions of national income e.g. some countries value subsistence out put while others do not, other use GNP at factor cost while others use GNP at market price, etc. thus making comparisons difficult.

8. Income distribution; Accounting may have high income capita figures when income is in hands of few people while the majority of the population is suffering.

9. Price structures; Figures of national income may be high because of inflation and this does not mean that people are well off. Also a commodity may be cheap in one country and expensive in another.
10. Different tastes. Tastes of people in different countries differ because of age, tribal, cultural, religion, etc. differences. Per capita income figures may be high when commodities produced or imported in the country do not fit the tastes of the majority.

11. Countries have different requirements e.g. in a cold country income per capita figures may be high because of heating expenses. This does not mean that people in those countries are well off than those who live in hot countries where it is not necessary to heat rooms.

12. Differences in availability of social services like education, health, transport, accommodation, etc. A high per capita income figures without the presence of the above is tantamount to low standard of living.

Question: USA had per capita income of US$ 13,000 in 1989 while Uganda had a per capita income of US$ 230. Does it man that the standard of living of an average American was 60 times higher than an average Ugandan?

INCOME DISTRIBUTION

Income distribution refers to the way in which goods and services are made accessible to the various social groups in a particular community. In a society where the distribution of income is uneven, then it is referred to as income disparity (income inequality). In case where income disparity is reduced to a minimum, the situation is referred to as one with an equitable income distribution.

The disparities can be shown by the use of the **Lorenz curve**. The Lorenz curve shows the relationship between the population groups and their relative income shares. This can be illustrated in the figure below:

The diagonal live OJ in the figure drawn form point O to J shows that at every point on the diagonal, the percentage of income received is exactly equal to the percentage of income recipients (what the population gets) i.e. the point half way along the length of the diagonal represents 50% of the income being distributed to exactly 50% of the population. Therefore the diagonal line is the representative of "perfect equality" in the size of the distribution of income.
However, in reality perfect equality had never existed even in socialist countries. Point X shows that the bottom 10% of the population gets only 4% of the total income and Y shows that the bottom 50% of the population who get only 20% of the total income.

The more the Lorenz curve lies away from the diagonal (perfect equality) the greater the degree of inequality. This estimation is where one person gets more of the income and the rest get very little. In the diagram, country B is at a higher degree of inequality than A.

CAUSES OF INCOME INEQUALITY

1. Natural resources.
2. The problem of rural-urban imbalance.
3. Some people are born in families which are rich as such inherit a portion of that wealth.
4. Political situation
5. Some people are endowed with natural talents and abilities.
6. Level of education
7. Access to finance, contracts and economic resources.
8. Differences in sex: females are generally poorer than males because of low education and lack of access to land and credit.
9. Government policy which determines regional distribution of natural resources.
10. Different in employment.

DISADVANTAGES OF INCOME INEQUALITY

1. Income inequality between regions leads to rural-urban migration which may lead to open-urban unemployment, creation of slums with all its evils, low agricultural output, etc.

2. It leads to production and importation of luxurious goods which are highly demanded by the rich and necessities/essentials which are for the poor are neglected.

3. Income inequality leads to an increase in government expenditure since the poor have to be provided with essential services (schools, hospitals, roads, etc.).

4. Since the rich have much to spend, they normally pay for goods and services without bargaining which may lead to inflation and this worsens the problems of the poor.

5. Income inequalities may lead to social and economic conflict which may result into political instabilities, thereby disrupting economic activities and bringing the economic development to the stand still.

6. Income inequality can also bring social tension like robberies, high crime rates, etc.

7. Absolute poverty is likely to set in sale the majority of the population are poor. This will lead to the reduction in welfare of the poor.

8. It leads to loss in government revenue since the majority of the people are too poor to be taxes.

9. It leads to exploitation of the poor by the rich. The rich through their economic power may exploit the poor through over pricing their products, paying low wages and salaries, etc.

POLICY MEASURES TO REDUCE INCOME INEQUALITY

1. Setting minimum prices for agricultural products. The only source of income for the majority of the rural dwellers is either through the sale of their cash crops or through selling the surplus of their food crops. Through pricing policies for agricultural output the government should ensure that the farmers are adequately rewarded for their output.
2. Minimum wage legislation.
3. Decentralisation of industries.
4. Population control.
5. The rich should be taxed highly (progressive tax) and then the poor be subsidized.
6. Land reclamation and settlement scheme should be done by the government.
7. Government should put in place inheritance laws and introduce high taxes on inherited properties.
8. Land return polices should be put in place.

ARGUMENTS IN FAVOUR OF INCOME INEQUALITY

1. The government gets alot of revenue by taxing the rich (progressive tax) more than the poor.

2. It is generally argued that, the rich (capitalists) have a high marginal prosperity to save (mps). These savings can be used for investment purposes increased investment may lead to increased employment and increase output which will then promote incomes which then goes to low income groups.

3. The supply of professionals (Economists, accountants, engineers, etc.) is limited especially in LDCs. A high reward is necessary so as to encourage them work harder and thus avoid a possible brain drain to the developed countries.

4. Income inequality encourages the poor, lazy to work harder so as to compete with the high income groups.

5. Income inequality determines the distribution of power and privileges in societies. The more income you have the more the respect and political power you will have i.e. America is a super power simply because of its income.

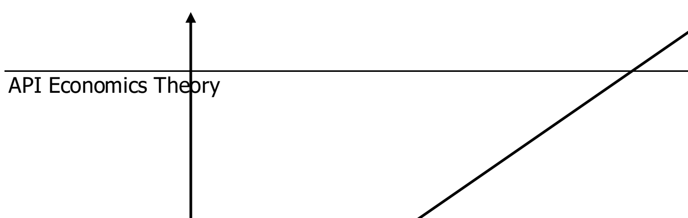
6. It guarantees labour supply to unattractive jobs like toilets cleaning, sugar cane cutting, sweeping of roads, etc. It is mainly the poor who do such jobs.

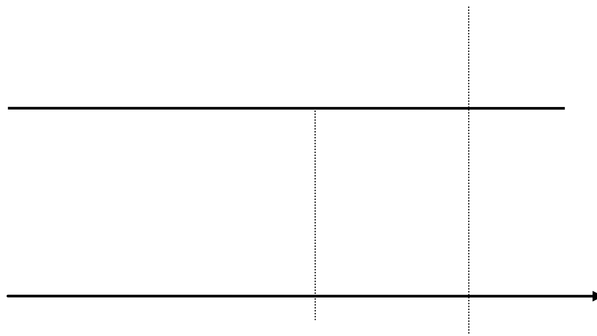
7. It leads to better working relations where the poor workers respect their rich bosses. If there was equality, such working relations would not prevail.

DEFLATIONARY AND INFLATIONARY GAPS

The deflationary gap; This is a situation where aggregate supply exceeds aggregate demand at less than full employment level. Realised investment is greater than the actual demand which leads to inventory accumulation. It is caused by deficiency of demand.

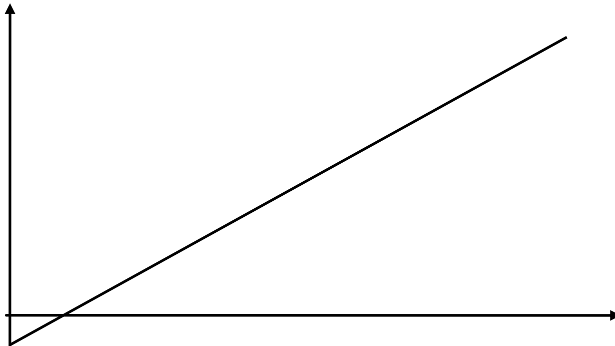
A figure showing the deflationary gap





Point E is at equilibrium level of income but since it is less than yf (income at full employment level), it means that some resources are idle (unemployed). This point can also be called unemployment equilibrium. The region above point E (a-b) is referred to as deflationary gap where AS>AD.

A deflationary gap can be reduced by increasing aggregate demand. This will shift aggregate demand curve upward. This can be illustrated as below:



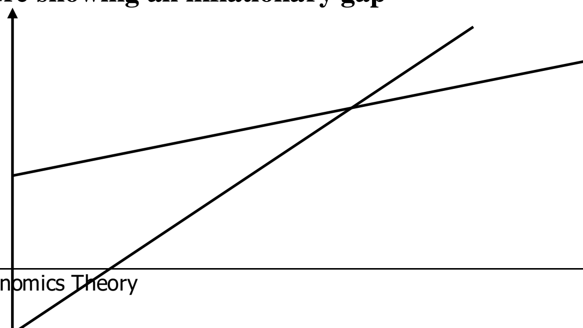
This figure above shows an increase in aggregate demand (i.e. from AD1 to AD2) to close the deflationary gap. The shift of the aggregate demand curve leads to an increase in equilibrium level of income (i.e. from Ye to Yf) or from E to Ef. Thus at point Ef, AS = AD at full employment level. In order to attain this, the following polices have to be employed.

1. The government should reduce taxes so as to increase disposable income and hence increasing aggregate demand.
2. Wage policy: wage should be increased thus leading to an increase in income of workers hence increasing their actual demand since wage to workers are for consumption according to Keyner.
3. Government should increase its expenditure on transfer payments, unemployment allowances, social security payments, etc. so as to increase aggregate demand.
4. Trade policy: The government should encourage exports and discourage imports. This will lead to an increase in net exports which will result into an increase in aggregate demand.
5. Use of expansionary monetary policy to increase aggregate demand.

THE INFLATIONARY GAP

This is a situation where aggregate demand (AD) exceeds aggregate supply (AS) at full employment level. Realized investment is less than the actual demand. This leads to inventory deccumulation (supply is not enough). This forces prices and money income to rise.

A figure showing an inflationary gap



In the figure (a-b) is an inflationary gap where AD>AS and Ye>Yf.

This gap can be closed by reducing ht AD as shown below:

The inflationary gap in the figure (a-b) can be closed by reducing AD i.e. AD1 to AD2. This gap can be reduced by;

1. The government should increase taxes so as to reduce disposable income and hence reducing AD.
2. Wage policy. Wages should be reduced. This leads to a reduction in incomes of workers hence reducing their actual demand.
3. The government should reduce its expenditure so as to reduce AD.
4. The government should discourage exports and encourage imports.
5. Restrictive monetary policy to reduce the amount of money in circulation should be put in place.

CONCEPTS OF CONSUMPTION, SAVINGS AND INVESTMENT

Consumption: It is the act of using goods and services to satisfy wants. The consumption function refers to the income consumption relationship. It is a functional relationship between two aggregates i.e. the total consumption and gross national income

i.e. $c=f(y)$

where c = consumption

y = income

f = functional relationship between consumption and income.

SAVINGS

The proportion of the income which is not consumed is saved. Therefore at low levels of income, savings are low and vis-versa. There when an income (y) is earned, part of it is consumed (c) and the remaining portion is saved (s) thus $y = c+s$.

Determinants of Savings

1. Rate of interest: Arise in the rate of interest would call for the more savings.
2. Deferred purchase; This is saving up to buy something in the future such as a car, house, TV, etc.
3. Precautionary motives: Most people will, if they can, put some money aside for un foreseen circumstances e.g. sickness, wife's delivery, etc.

4. The level of income. The higher the income the higher the level of savings keeping other factors constant and vis-versa.

5. Age: People tend to save and dis-save at different times of their lives. Young people tend to save less and borrow more while old people will be saving for their retirement hence their saving rate is high.

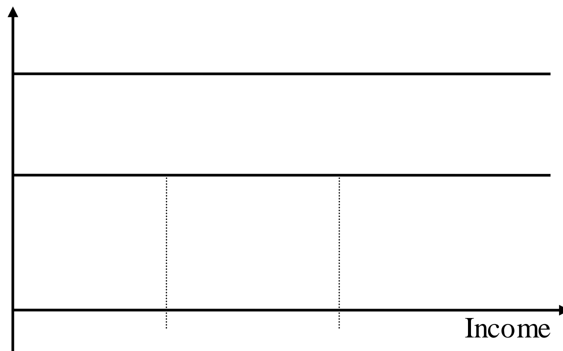
INVESTMENT

It means making an addition to the stock of goods in existence. It may include acquisition of new physical capital such as buildings, machines, construction of public works like dms, roads, etc.

Real investment is the addition to the capital assets and finance investment in existence.

TYPES OF INVESTMENT

1. Autonomous investment: This is the investment that is independent of the level of income and thus income is inelastic. It is influenced by exogenous factors such as a war, weather changes, growth of the population, labour force, etc. So it is not influenced by changes in demand but if influences demand. This kind of expenditure excludes expenditure on buildings, roads, dams, schools, hospitals, etc. Since investment on these projects is associated with public policy then its is regarded as public investment.

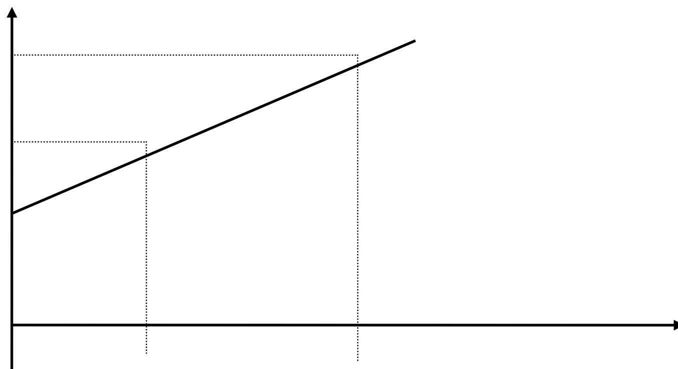


The diagram indicates that at whatever levels of income, the amount of investment OIo remain constant. The shift upwards or downwards indicates a change in the steady flow of investment at a constant rate at all levels of income.

2. **Induced investment**:

Induced investment is that type of investment that varies with the levels of income and profits. Factors like price, wages and interest changes which affect profits influence induced investment. When income increases, consumption demand also increases and to meet this, investment increase, it thus follows induced investment is a function of income i.e. I = f(y)

ILLUSTRATION



The figure above shows induced investment at various levels of income when income is OY1 investment level is OI1. As income increases to OY2, investment increases to OI2 and vice versa.

Determinants of Investment

1. Consumer demand. The present and future demand for products greatly influences the level of investment in the economy. Investment will be low if demand is low and vice-versa.

2. Level of income. If the level of income raises in the economy through raise in money wage and other factors the demand for goods will raise which will in turn raise the inducement to invest and vice-versa.

3. Inventions and innovations: if inventions and technological improvements leads to more efficient methods of production which reduce costs, the marginal efficiency of capital of new capital assets will rise which will lead to an increase in the inducement to invest.

4. Growth of population: A rapidly growing population means growing market to all types of good in the economy. To meet this demand, investment will increase in all types of consumer goods industries and vice-versa.

5. State policy: If the government policy is in favour of investment, the inducement of invest will be high and vice-versa. This can be by establishing institution that are geared towards investment attraction e.g. providing credit and other facilities, subsidisation, etc.

THE CONCEPT OF THE MULTIPLIER

Multiplier is the ratio of the change in national income to the change in autonomous expenditure that brought it about.

TYPES OF MULTIPLIERS

1. Investment multiplier: This shows the number of times change in investment expenditure multiplier itself to generate a change in income. The additional income generated is equal to the multiplier times the change in investment. It is given as

Investment multiplier = 1/1-mpc

The multiplier depends on mpc, the higher the mpc, the greater the national income to be consumed. E.g. given that the change in investment is 100,000 and mpc is 80%, what additional income is being created.

M= 1/1-mpc = 1/1-0.8 = 1/0.2 = 5
Income generated (y) = Ixm
= 100,000 x 5
= 500,000.

Thus investment multiplier

$$= \frac{\text{Change in income (y)}}{\text{Change in investment expenditure (I)}}$$

2. Income multiplier: This shows the number of time a change in total expenditure multiplies, itself to give a final change in income.

   $$\text{Income multiplier} = \frac{\text{Change in income (Y)}}{\text{Change in total expenditure}}$$

3. Government multiplier: This shows the number of times the original change in government expenditure multiplier itself to give a final change in income

   $$\text{Government multiplier} = \frac{\text{Change in income (y)}}{\text{Change in government expenditure (g)}}$$

4. Foreign trade multiplier:
   Export multiplier: This explains the ratio of the change in income to the change in net export earnings.

$$\text{Export multiplier} = \frac{\text{Change in income (y)}}{\text{Change in export earnings (x)}}$$

THE ACCELERATOR PRINCIPLE

The accelerator principle explains the process by which a change in consumption expenditure leads to a change in investment on capital goods.

The accelerator coefficient is the ratio between induced investment and an initial change in consumption expenditure.

$$A = \frac{I}{C}$$

Where A = accelerator
I = change in investment
C = net change in consumption expenditure.

Example
If the increase in consumption expenditure of Shs 10,000 leads to an increase in investment expenditure of Shs 30,000 then accelerator coefficient.

$$= \frac{I}{C}$$

$$= \frac{30,000}{10,000}$$

Therefore accelerator (A) = 3

INTERNATIONAL ECONOMICS

International trade refers to the buying and selling of commodities between or among nations. It can be carried out by individuals, private companies or governments. The purchase of commodities from another country is called import trade and the selling of commodities to another country is called export trade. The trade in goods is called visible trade while trade in services is called invisible trade. When 2 countries trade together, it is called bilateral trade and when trade takes place among more than 2 countries, it is called multi-lateral trade.

International trade arises out of specalisation which results into surplus commodities and the need for exchange. The basis for international trade is explained by:

1. The principle of absolute advantage
2. The law of comparative advantage

THE PRINCIPLE OF ABSOLUTE

ADVANTAGE

The principle of absolute advantage was put forward by Adam Smith to show the advantages of international trade. He was opposed to mercantilists who believe that free trade leads to loss of gold (wealth of a nation).

The principle of absolute advantages refers to where a country is able to produce more of a commodity than other countries. In other words a country is said to have absolute advantage over other countries if it can produce a commodity at less in put costs.

Example:

Country	Coffee ('000 tones)	Cotton ('000 tones)
Uganda	5	10
Congo	1	5

The table shows that using one unit of labour, Uganda can produce either 5,000 tonnes of coffee or 10,000 tones of cotton while Congo can produce 1000 tones of coffee or 5,000 tones of cotton using one unit of labour. Therefore Uganda can produce both coffee and cotton more efficiently than Congo. Therefore Uganda has an absolute advantage over Congo in the production of both coffee and cotton.

THE LAW OF COMPARATIVE ADVANTAGE

This was put forward by David Richards in 1817 to improve on Adam Smith's principle of absolute advantage.

The law of comparative advantage states that even if a country has absolute advantage in the production of 2 commodities, it should produce that commodity where it incurs less real cost (opportunity cost).

Illustration

Country	Coffee ('000 tones)	Cotton ('000 tones)
Uganda	5	10
Congo	1	5

Opportunity cost = $\frac{\text{Alternative foregone}}{\text{Actual production}}$

Opportunity cost for producing coffee

Uganda: 10/5 = 2 tones of cotton

Congo: 5/1 = 5 tones of cotton

Opportunity cost for producing cotton

Uganda: 5/10 = ½ tones of coffee

Congo: 1/5 = 1/5 tones of coffee

By producing 1 tonne of coffee, Uganda foregoes 2 tonnes of cotton, while Congo foregoes 5 tonnes of cotton by producing 1 tonne of coffee. On the other hand, if Uganda process one tonne of cotton, if foregoes ½ tonne of coffee, while Congo foregoes 1/5 tonne of coffee when it produces 1 tonne of cotton from the above analysis, it should be noted that Uganda incurs less opportunity cost in producing coffee than Congo while Congo incurs less opportunity cost (real cost) in producing cotton than Uganda. We say that Uganda has a comparative advantage over Congo in the production of coffee while Congo has a comparative advantage over Uganda in the production of cotton. A country has a comparative advantage over others if it can produce one or more commodities at less real cost (opportunity cost) than others.

CRITICISMS OF THE LAW OF COMPARATIVE ADVANTAGE

1. The assumption that there are 2 countries producing 2 commodities is unrealistic since modern international trade is multi-lateral and countries.

2. According to this law, less developed countries should specialize in the production of primary products where they have a comparative advantage. However, this would lead to unfavourable terms of trade since prices of primary products are always lower than prices of manufactured products.

3. It assumes a country cannot exploit more resources and improve on efficiency in the production of a commodity where it incurs more real costs.

4. It assumes that technology is constant and a country cannot reduce production costs in the long run after technological changes and after reaping economies of scale.

5. It does not take into account the need for diversification and self reliance which tend to disagree with specialization.

6. It assumes there is free trade but in practice there are restrictions and trade barriers.

7. It does not take into account transport costs which increase costs and reduce benefits of international trade.

ADVANTAGES OF INTERNATIONAL TRADE

Free trade (international trade without restrictions) has the following advantages.

1. It enables countries to get what they cannot produce due to lack of technology, man powder and other resources.

2. It enables people in one country to have a variety of goods which are imported.

3. It encourages specialization which lead to increased output and decrease in prices.

4. It allows domestic industries to compete with foreign industries and improve on the quality of their products.

5. It provides market for surplus products and encourages countries to exploit their resources.

6. It increases opportunities for employment e.g. in export promotion industries, transportation, etc.

7. It generates government revenue in form of import and export duties.

8. It encourages the exchange of ideas, and values on an international level.

9. Where there are shortages, for instance after the war, people can survive on imported commodities.

10. It enables the country to import raw materials, capital good and man-power.

NB: The gains from international trade are explained in 2 broad approaches.

1. On the supply side, we have the advantages of specialization and benefits of comparative advantage.

2. On the demand side, we have the vent-for surplus theory. According to this theory, employment of idle resources to satisfy foreign demand increases national income. International trade encourages the exploitation of idle resources to produce surplus products which can be exchanged for other products.

TRADE RESTRICTIONS (PROTECTIONISM)

In practice, there is no free trade. Trade restrictions are barriers imposed on imports to reduce their volume of flow in the country.

TOOLS OF TRADE RESTRICTIONS

1. Quotas: This includes the fixing of physical quantities or value of commodities to be imported in the country.

2. Tariffs: These are taxes on imported or exported commodities. Import taxes increase the prices of imported goods and this restricts their demand in the country. These import duties can either be advalorem (on value of commodities) or specific on volume of commodities.

3. Foreign exchange control: The government can reduce foreign exchange allocated for importation of some commodities. The government can also avail foreign exchange cheaply for priority sectors and at a higher price for other sectors e.g. in Uganda in early 1980's we had window one for priority sectors and window two for other sectors. These measures were intended to reduce the importation of non-essential commodities.

4. Deflationary policy: This involves the reduction of liquidity in public hands which checks on the domestic demand. This can be done through fiscal policy (by increasing taxes and reducing government expenditures) or by monetary policy.

5. Devaluation: This refers to the reduction of the value of the currency in terms of other currencies. This makes foreign exchange more expensive and hence leads to increase in prices and reduction of imported goods.

6. Total ban: This refers to the prohibition of importation of some commodities by law e.g. importation of fire arms, opium, western films in socialist countries, etc.

7. Import licences: These may be given to few importers or may be issued at a high price for importation of certain commodities.

ARGUMENTS FOR RESTRICTING TRADE

International trade is always restricted in order to check on its disadvantages. The following are arguments for restricting trade:

1. Protection of "infant" industries:

Infant industries need to be protected from competition until they reach a stage where they are large enough to enjoy economies of scale. The criticism on this argument is that in less developed countries, tariffs remain permanent and consumers suffer from domestic high prices instead of getting cheaper imported commodities.

2. Anti-dumping argument:

Dumping means selling surplus commodities in foreign markets at a price lower than that at home. Countries do this in order to dispose off surplus commodities and yet preserve stable and high prices at home. Such cheap commodities discourage industries in countries where they are dumped. They also bring about instabilities in prices and supply because they are not constant. That is why tariff should be imposed on such dumped commodities. For example in Uganda the imported used clothings have killed the growth of textile industry.

3. Employment argument:

Imports like savings, are leakages which have a negative impact on aggregate demand, production and employment. Therefore, imports should be reduced so that money which would be spent on imports is spent on domestically produced goods to stimulate production and generate employment. The criticism against this argument is that other countries may also restrict importation of a country's commodities and hence effect demand for exports.

4. National security argument:

Restrictions are necessary for security purposes especially if trade involves some strategic goods e.g. importation of fire arms.

5. Source of government revenue:

Tariffs imposed on imported commodities are sources of government revenue.

6. Checking on imported inflation:

The reduction of imports from countries affected by inflation reduces imported inflation.

7. Improvement of balance of payments position:

The reduction of imports means reduction of foreign exchange expenditure which may result into improvement in BOP position of the country.

8. Reduction of dependence:

Reduction of imports may be aimed at encouraging the investors to set up import substitution industries so as to reduce dependency on imported goods.

9. Health purposes: e.g. restriction on importation of animal products from countries affected by animal diseases.

ARGUMENTS AGAINST PROTECTION

1. It enables inefficient (high cost) industries to remain in business. This leads to resource misallocation.

2. It shelters industries away from competition and as a result they do not improve on the quality of their products.

3. It can lead to retaliation, i.e. other countries can also impose tariffs on the exports of the country. This reduces exports and employment.

4. Some economists have looked at protectionism as a tool of beggar-my-neighbour policy i.e. a measure taken by a country to improve its domestic conditions (normally to reduce unemployment) which has adverse effects on other economies. The benefits attained are at the expense of other countries. This encourages retaliation and a tariff war.

5. Tariffs on imported raw materials end up increasing costs of production and increase of commodities. Eventually, domestic producers (industrialists) end up not being protection.

6. Some countries use protectionism as a political weapon for bargaining for other benefits from other countries.

7. Protectionism by use of high tariffs encourage smuggling and loss of government revenue.

8. The tools used for protectionism may have other unintended effects e.g. devaluation can lead to increase in cost of production.

TERMS OF TRADE

This is a measure of import – purchasing power of exports. It is the amount of a commodity which is obtained from a unit of another. It can be expressed in 2 ways:

1. Barter (commodity) terms of trade: This is the ratio of the price index of exports to the price index of imports.

$$\text{Barter terms of trade} = \frac{\text{Price index exports (Px)}}{\text{Price index imports (Pm)}}$$

i.e. Barter terms of trade = Px/Pm

when this ratio is greater than one $\left(\frac{Px}{Pm} > 1\right)$, it means that one Unit of exports buys more than one unit of imports. In such a case, a country is said to experience favourable terms of trade. When terms of trade is favourable year after year, there is improving terms of trade which may result the increase in prices of exports and or the fall in prices of imports.

When the ratio Px to Pm is less than one, it means that one unit of exports cannot buy one unit of imports. A country is said to experience unfavourable terms of trade when terms of trade is unfavourable year after year, there is deteriorating terms of trade which may result from the fall in prices of exports and or the increase in prices of imports.

2. Income terms of trade: This is the ratio of the value of total exports to the price index of imports.

$$\text{Income terms of trade} = \frac{\text{value of exports}}{\text{Price index of imports}}$$

$$= \frac{\sum(Pm x Qx)}{Pm}$$

This ratio shows how much a country can import using income from exports. In otherwords, it is a measure of import purchasing capacity of exports.

BALANCE OF PAYMENTS (BOP)

BOP shows the relationship between a country's total expenditure abroad with total income from abroad in a given time (usually a year).

BOP ACCOUNT

BOP account is a systematic record of all international transactions between the country and the rest of the world in a given time. BOP figures of most countries are expressed in dollars though transactions may be carried out in different currencies. The BOP account is composed of the following:

This is a summary of trade in goods and services, and transfers. It is a record of international transactions in:

a) Visible trade: This is trade in goods. It is called visible because it can be verified by customs officials. The difference between foreign exchange from goods exported and expenditure on goods imported is called visible balance or trade balance when there is a surplus on this account, a country is said to have favourable trade balance and when there is a deficit, the country would have unfavourable (adverse) trade balance.

b) Invisible transactions: These include intangible services which do not pass through customs ware houses. They include: transport, insurance, tourism, travel, etc. the difference between foreign exchange received and foreign exchange spent on these transactions is called invisible balance.

c) Transfers: This includes donations i.e. official grants and private transfers which also involve foreign exchange expenditure and receipts.

2. Capital account

This records capital movements (both private and government). Capital flows may be in form of buying securities (outflows) and selling securities (in flows) or short-term, medium term or long-term basis.

Balance of payments = Balance on current ac count + balance on capital account.

3. The monetary account

This is otherwise called the balancing item or official settlement or financing account. It shows t he surplus or deficit in BOP accounts; and shows how the imbalance can be run down to balance the account. The monetary account therefore, shows:

(a) In case where there is a deficit in BOP accounts, it shows how such a deficit can be financed e.g. using previous foreign exchange reserves, selling of gold, borrowing from friendly countries, borrowing from IMF, selling securities abroad e.g. bonds) etc.

(b) In case of surplus, it shows how this surplus can be disposed off to attain BOP equilibrium e.g buying of gold, lending to other countries, investing abroad, etc.

4. Errors and omissions: This can be added or subtracted on an account for balancing purposes.

BALANCE OF PAYMENTS (BOP) PROBLEMS

When a country experiences BOP deficit year after year and the sources of financing it are exhausted, a country is said to experience BOP problems meaning that foreign exchange expenditure is greater than foreign exchange earnings year after year. In other words BOP problems imply tat there is a persistent shortage of foreign exchange.

A persistent BOP surplus also implies that there is BOP disequilibrium. However, this is not a national economic problem. Therefore when we talk of BOP problem, it means persistent BOP deficit.

CAUSES OF BOP PROBLEMS

In broad terms, BOP problems are caused by factors which reduce exports and increase imports, increase capital outflows, and reduce capital inflow. These factors include inter alia.

1. National calamities: These lead to agricultural failure and decline in exports e.g. drought, frost, etc.

2. Inflation: This discourages exports by making them expensive and encourage import. Imports are encouraged because outsiders are willing to selling a country where prices are high.

3. Protectionism: Restrictions on exports of a country by other countries reduce the amount of exports to those countries and reduce foreign exchange earnings.

4. Increase in cost of production: This leads to high price for exports and reduces foreign demand.

5. High exchange rate: When the value of the currency in terms of other currencies is very high (over valued), outsiders would find it expensive to buy the overvalued currency so as to buy the commodities from that country. This reduces exports.

6. Decline in world demand: Demand for exports may reduce due to a depression, instability in markets, reduction on population, discovery of synthetic fibres, fall in incomes, change in tastes, etc.

7. Capital outflow: e.g. people wishing to invest in other countries e.g. buying securities abroad. This may be due to political instabilities or how interest rate in the home country.

8. Increase in prices of imports: This results into increased foreign exchange expenditure e.g. increase in prices of oil products.

SOLUTIONS TO BOP PROBLEMS

Persistent BOP disequilibrium (deficit) can be reversed using a deliberate BOP policy. Such a policy should lead to: increase in exports, reduction in imports, increased capital inflow and a reduction in capital outflow.

Solutions therefore include:

1. Export promotion: This is a deliberate policy to increase export production through giving subsidies to producers, increase in producer prices, etc. Such a policy should also encourage foreigners to buy the commodities e.g. by reducing or abolishing export duties.

2. Import substitution: This is a deliberate policy to produce commodities formerly imported. It includes setting up import substitution industries and protecting them from competition through protectionism.

3. Devaluation: This is the making of the currency cheaper in relation to currencies of other countries. It encourages exports by making them cheaper. It reduces impost by reducing the demand for foreign exchange (which is made expensive).

4. Encouraging foreign investors: This can be done by paying high interest on securities, establishing companies where foreigners can buy shares, fair laws, etc.

5. Import restrictions: This is achieved through fixing import quotas, increasing tariffs, foreign exchange control, deflation, etc. All those reduce imports and therefore reduce the demand for foreign exchange.

6. Economics integration: This increases exports.

7. Tourism: This brings in foreign exchange.

8. Political stability: This encourages foreign investors and tourists. Peace also leads to reduction of foreign exchange expenditure on defence.

9. Seeking for donors to give the country (government or individuals) money.

THE THEORY OF EXCHANGE RATES

Exchange rate refers to the rate at which one currency is exchanged for other currencies. It is necessary to have such rates because each country has to be paid in its own currency in international transactions since there is no international currency.

Some currencies are easily converted into other currencies e.g. Vs dollars, British pound Sterling, German Mark, Japanese Yen, etc. Such currencies are called Hard currencies. Other currencies are not easily converted

into other currencies because they are not acceptable in many countries international transactions. Such currencies are known as soft currencies e.g. Uganda Shilling.

EXCHANGE DATE DETERMINATION

Exchange rate can be determined by:

1. The gold standard
2. Fixed exchange rate
3. Floating exchange rate
4. Mixed (managed float) system

THE GOLD STANDARD

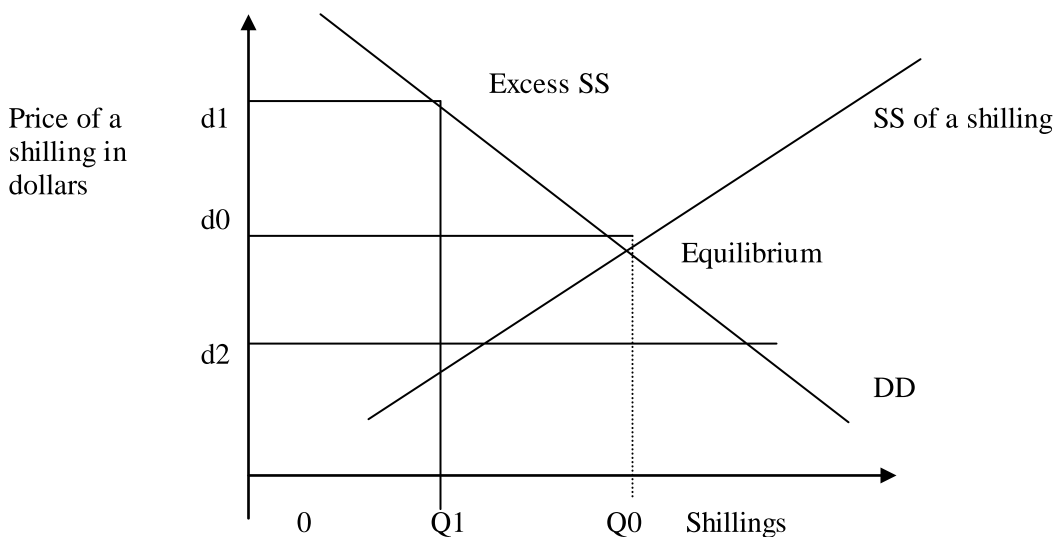
Before 1914, countries could issue money according to the gold they had on reserve. The value of the currency in terms of gold depended on the gold content of the monetary unit of a country. At first people could melt gold to make coins and vice versa until when monetary authorities debased gold into coins with seals to ensure purity of gold. Paper money was also used basing on gold a country has on reserve so all currencies were as good as gold and gold was used as an international currency. Exchange rates between currencies was fixed according to the gold standard.

Whenever a country experienced a BOP deficit/demand for foreign currency exceeding supply, it could finance it by exporting gold. This could bring the trade back to balance. The gold standard system broke down in the first world war of 1914-1918. Attempts to revive it in 1920's and 1930's failed because of the depression and appearance of Keynesian economics. Also countries refused to follow the rules of deflating or inflating at the time of an outflow or inflow of gold respectively.

THE FIXED (PEGGED) EXCHANGE RATE SYSTEM

Under fixed or pegged exchange rate, all the exchange transactions take place at an exchange rate that is determined by the monetary authorities (government). Here the monetary authorities set/fix the rate at which the local currency should be exchanged for other currencies and this rate can be maintained by constant intervention in the exchange markets by the central bank or by legislation.

THE FLOATING EXCHANGE RATE



From the figure we note the following:

(a) Supply of a shilling – Uganda supplies the shilling when it is buying the dollar to buy (import) goods from America.

(b) Demand for a shilling: Americas demand the Uganda shilling when they want to buy (import) goods from Uganda.

(c) When supply of a shilling (imports) is greater than demand for a shilling (exports) the value of the shilling would fall from Od1 to Od2 because of excess supply. When the price of the shilling falls down, it makes commodities in Uganda cheaper. This increases the demand for the Uganda shilling and increases demand for commodities from Uganda. The excess demand could push the price of the Uganda shilling up to Od1. The trend of increasing and falling prices (exchange rates would continue until equilibrium exchange rate Odo is reached. In otherwards, BOP equilibrium is attained automatically.

(d) Equilibrium exchange rate: This is where the demand for a currency is equal to its supply. In otherwards, imports and exports are equal and BOP is in equilibrium.

(e) Appreciation: This refers to the rise of the value of the currency in terms of another. It occurs under floating exchange rate system.

(f) Depreciation: This refers to the fall in the value of the currency in terms of another. It occurs under floating exchange rate system.

(g) Depreciation: This refers to the fall in the value of the currency in terms of another. Is also occurs under floating exchange rate system.

THE MIXED SYSTEM ("MANAGED FLOAT")

This is when the exchange rate is flexible within variable margins. The value of the currency is not allowed to go beyond or below certain rates. The central bank intervenes from time to time to alter the rate from its free-market level e.g. selling foreign exchange to bring the market rate down. The system is also called dirty float because it interferes with forces of demand and supply.

BAKING SYSTEM

FINANCIAL INTERMEDIARIES

Financial intermediaries are financial institutions which bring together the deficit – spending units (borrows) and surplus –spending units (lenders) together. Generally they are supposed to play the following roles:

1. To stand between lenders and borrowers and to satisfy the interests of the two.

2. To facilitate the pooling of risks.

3. To increase liquidity of the financial system through giving loans, investing in treasury bills, bonds and shares, etc.

<u>TYPES OF FINANCIAL INTERMEDIARIES</u>

1. Banking financial intermediaries e.g. commercial banks and central banks.

2. Non-bank financial intermediaries e.g. development banks, insurance companies, building societies, post office savings banks, etc.

Differences between banking and non-banking financial intermediaries.

Banking financial intermediaries	Non-banking financial intermediaries
1. Create credit which is considered as money (deposit money)	1. Do not create credit. Just lend funds got from surplus spending units.
2. Usually lend short term	2. Lend/invest long term
3. Maintain short term deposits	3. Maintain long term deposits
4. Undertake less investment risks	4. Undertake more investment risks
5. Pay lower rate of interest on deposit	5. Pay higher rate of interest on deposits

COMMERCIAL BANKING

Commercial banks are essentially dealers in credit or borrowed funds. Like other businesses, they seek to maximize profits. They earn profits through:

1. Paying low interest to lenders (those who deposit money in commercial banks) and charging high interest on borrowers (deficit-spending units).

2. Charging commissions on services they render.

3. Investing in short term and at times medium term undertakings.

FUNCTIONS OF COMMERCIAL BANKS

1. They accept deposits and keep them safely.

2. They maintain different accounts on behalf of customers i.e. current account, savings accounts, and fixed deposit account.

3. They keep valuable articles and documents in safe custody on behalf of clients e.g. wills.

4. They exchange currencies for customers.

5. Giving loans and overdrafts to customers. The loans may be short term, medium terms or loan at short call and short notice.

6. They facilitate easy and quick payments of debts through the use of cheques or standing orders.

   A standing order is a form from the customer authorizing the bank to pay regular payments to creditors e.g. payments for rents, insurance, etc.

7. They facilitate international trade by selling travelers cheques to customers wishing to travel to other countries e.g. P.T.A travelers cheques.

8. The look after the property of the deceased customers and distribute their assets as laid down in the will.

9. They give financial advice to customers on business and money.

10. The create deposit money through credit creation.

CREDIT CREATION

This is the process by which money lent out by commercial banks using the cheque facility expands to result into greater volume of credit than the amount originally lent out. The expanded credit is only in form of book entry.

Commercial banks are usually required to keep a certain portion of their reserve inform of cash (cash ratio) to meet the day-to-day requirements of their customers. Any amount in excess of the cash reserve (excess reserve) may be invested or lent out to customers.

Illustration

We assume one commercial bank in which:-

1. Cash ratio is fixed at 20%

2. Initial deposits fixed at Shs 1,000

3. When people get loans (in cheque form) they deposit them to the ban k which gave them the loans. We assume there are several persons, A,B,C, …………..

4. The public is able to and willing to borrow money from the bank and the bank is willing to lend.

Person	New deposit	Cash reserve	New loans
A	1,000	200	800
B	800	160	640
C	640	128	512
D	512	102.40	409.60
▪	▪	▪	▪
▪	▪	▪	▪
▪	▪	▪	▪

The table shows that A deposited Shs 1000 in the bank. The bank kept 20% (Shs 200) as cash reserve and gave out 80% (Shs. 800) in form of cheque as a loan to person B. Person B deposited the cheque to the same bank which gave him/her a loan. Then out of shs 800, the bank keekps 20% (Shs 160) as cash reserve and lent out Shs 640 to person C who deposits the Shs 640 cheque to the same bank. The process continues to infinity.

Total deposits = 1,000 + 800 + 640 + 512 + ………….
= $1{,}000\ (1+(4/5)^1 + (4/5)^2 + (4/5)^3 + \ldots\ldots\ldots$
= 1,000 x 5
= 5,000

So from the initial deposit of Shs 1,000, the total deposits of Shs 5000 have been created. The number of times the initial deposits (Shs 1,000) multiply to give the final deposits (Sh 5000) is called the credit multiplier.

Credit multiplier = $\frac{\text{total final deposits}}{\text{original deposit}}$

= $\frac{5{,}000}{1{,}000} = 5$

= 1/Cash ratio

When the cash ratio is increased, the credit multiplier reduces, a reduction in the cash ratio leads to an increase in the multiplier.

SOME IMPORTANT TERMS

1. Liquidity ratio:

This is the measure of the ability of the business to pay debts and remain operating. It is usually expressed as the ratio of liquid assets to current liabilities. Liquid assets are assets which can easily be converted into cash, money at short call and short notice, and short term securities. Current liabilities refer to debts which have to be paid in the immediate future e.g. short term loans and money on accounts of customers (in case of banks).

2. Reserve ratio:

In banking, this refers to the fraction or percentage of total bank deposits that is not lent (remains on reserve). Depending on banking laws of each country, the reserve ratio may appear in two forms.

(a) Cash ratio (cash reserve): This is the fraction of total deposits which remains in the ban k in cash form to meet the cash demands of depositors.

(b) Legal reserve requirements: This refers to the fraction of total deposits that commercial banks are required to deposit with the central bank. The central bank can fix the maximum of (a) or (b) or both; and this affects the lending powers of commercial banks.

LIMITATIONS OF COMMERCIAL BANKS TO CREATE CREDIT

1. One bank is limited because it keeps on losing deposits to other banks. The theory assumes that lenders deposit the cheques they get in the same bank, and that when those lenders give cheques to their customers, those customers also deposit the cheques in the same bank. The assumptions are not practical.

2. The central bank can limit the powers of commercial banks to create credit by using the tools of monetary policy e.g.

    a) Increasing the minimum legal reserve requirement

    b) Increasing the bank rate, i.e. rate of interest charged on commercial banks by the central banks, when the latter lend the former.

    c) Instructing commercial banks to give loans to specific sectors i.e. selective credit control.

    d) By using open market operations, where the Central Bank sells securities (e.g. bonds) to the public. People go to their commercial banks to withdraw money for buying securities. This reduces money available for lending in the commercial banks and reduces the ability of commercial banks to create credit.

3. In LDCs there is lack of credit worthy borrowers because of lack of securities and few entrepreneurs. When there is limited borrowing, there is excess liquidity in commercial banks and the power of commercial banks to create credit is reduced.

4. The central bank may encourage commercial banks to have more non-cash assets which reduces money available for lending.

5. Low demand for loans because of poor investment climate e.g. insecurity, poor infrastructure.

6. In LDCs, people prefer hoarding money than depositing it in banks. So funds in banks available for lending and creating deposits are less.

ASSETS AND LIABILITIES OF A COMMERCIAL BANK

Assets of a commercial bank are the possessions of the bank plus its claims on other financial institutions and its claims on its clients. They include:-

1. Cash in hand and reserves with the central bank.
2. Money at short call and short notice.
3. Deposits with other banks and non-banks.
4. Loans, advances and over drafts to customers.
5. Fixed assets and long term investments, etc.

Liabilities of a Commercial Bank are the claims against the asset of the bank by the creditors and depositors.

They include:

1. Money on current, fixed and savings account. This money belongs to the customers who would eventually come for it.
2. Deposits by other banks and non-banks.
3. Government funds deposited in the bank.
4. Reserve funds.
5. Dividends payable due, etc.

THE DILEMA FACING COMMERCIAL BANKS IN THEIR LENDING POLICY

The bank usually faced wit the problem of achieving the objective of liquidity, security and profitability. These objectives contradict each other when it comes to lending. For example, long term loans are risky but profitable, the bank has to keep liquid assets so as to meet the cash demand of its customers but it would not make much profit because the more liquid the asset is, the less profitable it becomes. To solve this dilemma, commercial banks do the following:-

1. For security: The bank has to secure a collateral security from the borrower. It can also leave lending when there is a great risk of loss.
2. For liquidity and profitability: The commercial bank divides its assets into liquid and less liquid assets. Liquid assets are less profitable while less liquid assets tend to be profitable.
3. The lend money on short term basis.
4. Regulate withdrawals especially savings account holders may not withdraw more than once in a week and withdraws are limited to a given amount, beyond that limit t he bank has to be notified in advance.
5. They lend money in phases such that all the time there is some money to meet the needs of the customers.

CENTRAL BANKS

A central bank is a financial institution whose aim is to control the quantity and use of money in such away as to facilitate the implementation of certain monetary policy. It controls all other financial institutions in the country. A central bank is not profit making and is not supposed to compete with commercial banks for business.

FUNCTIONS OF A CENTRAL BANK

1. It has the right to issue and renew coins and notes.

2. It acts as a banker to the government by:-

    i. Keeping government funds.
    ii. Paying interest on the public debt
    iii. Marketing government securities
    iv. Advising the government on economic policy.

3. It acts as a banker to commercial banks in the following ways.

    a) It acts as a last resort lender of commercial banks.
    b) It is a clearing house for all commercial banks, i.e. they settle their indebtedness through the central bank.
    c) Every commercial bank must keep a certain percentage of its deposits with the central bank.

4. It is the manager and custodian of foreign currencies.

5. It maintains the stability of the internal and external value of currency.

6. It keeps the funds of international institutions working in the country e.g. IMF, Red Cross, etc.

7. It uses the tools of monetary policy to influence the level of economic activity.

MONETARY POLICY

Monetary policy is the management of money demand and supply of money together with interest rate so as to stimulate the level of economic activity.

Objectives of Monetary

- To stimulate the level of economic activity in order to attain the level of economic.
- To stabilize prices so as to encourage the level of investment
- To bring about improvement in BOP position of the country
- To create employment opportunities
- To solve the problem of income inequality

NON-BANK FINANCIAL INTERMEDIARIES

There are financial institutions which do not deposits. They only lend money got from surplus spending.

Non-bank financial intermediaries include:

1. Development banks. These are development plan oriented. They give medium, long term and at times risky loans for development enterprises especially in LDCs where commercial banks concentrate on short

term lending. To play those functions successfully, development banks are usually established by governments and at times with the assistance of international financing and development agencies. Examples are African Development Bank, the E. African Development Bank and the Uganda Development Bank.

2. Building societies and Housing finance institutions. These receive deposits and lend for long term housing.

3. Co-operatives: These receive deposits and accept shares. They lend to members and carry out other activities like marketing, transport, agriculture, etc.

4. Stock Exchange markets: These are markets of shares and bonds where governments, companies or individuals buy and sell these financial assets to make capital gains. In Uganda these markets are not well developed. The Kampala stock exchange (KSE) existed as legal entity in November 1989 to deal in buying and selling of shares. Presently the business of stock exchange is conducted by Uganda Securities Exchange, a limited company registered by Capital Markets Authority (CMA).

5. Insurance Companies: These accept premiums. They also invest in short term investments e.g. buying bonds. They can also lend to the government by buying treasury bills. The accumulate long term savings of individuals who save for their families' survival after their death.

6. Post Office Saving Banks. Those received deposit on savings account. They do not operate current account, and therefore cannot create deposit money using cheques.

7. Pension funds: These are managed by insurance companies or social security institutions. They receive savings from workers and invest in long term investments. They pay the benefits to the employees on retirement.

PROBLEMS FACED BY COMMERCIAL BANKS IN UGANDA

1. There are many poor customers who are scattered. So there are problems of savings mobilization.

2. There are few credit worthy customers. Lending is also limited by lack of collateral security by most borrowers.

3. Most of the customers are illiterate. Others do not even keep books of accounts and therefore it is difficult to assess their credit worthiness.

4. Inflation. This discourages lending and leads to loss f real value of money.

5. Commercial banks are concentrated in urban areas and hence they compete for business.

6. Political instabilities lead to loss of money and property. Also because of economic uncertainty people do not borrow for investment and therefore funds remain lying idle in commercial banks.

7. The rate of interest used to be fixed by the government and it was sometimes high. This discouraged people form borrowing money from banks. However, interest rates have been liberalized but is still high.

8. Lack of communication facilities e.g. unreliable telephone and telegraph communication.

9. Lack of trained manpower and lack of funds to finance manpower development and staff training.

10. Foreign commercial banks are at times faced with the problem of unfavourable government policies e.g. taxation nationalization, etc.

INTEREST RATE DETERMINATION

Interest is a payment for the use or service of capital. There is interest charged on the borrower by the lender and interest paid to the saver (depositor) by the financial institution.

WHY INTEREST PAID?

Interest is paid to the depositor or to the financial institution for the following reasons:

1. Reward for saving: Interest is paid to reward those who postpone consumption to the future.

2. Time preference: This is the extent to which people prefer to enjoy goods in the present than in the future. It is believed that people have a positive rate of time preference (i.e. prefer consumption today than in future) and therefore interest is paid to reverse this time preference.

3. Payment for parting with cash. According to Keynes, interest is paid as a reward for parting with liquidity of cash i.e. to break liquidity preference.

4. Price for use of credit. According to neo-classical economists, interest is paid for use of loanable funds. This refers to interest charged by lenders on borrowers.

5. Reward for management: Interest is paid to the lender so that he/she can meet the expenses of the lending business e.g. files, stationary, manpower, legal charges, licences, security, etc.

6. Reward for risk taking: Parting with cash involves the risk of losing it. Gross interest includes reward for risk bearing.

7. Reward for inconvenience: The lender parts with money which he/she cannot use for personal or business purpose. This opportunity cost of lending has to be paid for.

   Pure interest is what remains with the lender after deducting the reward for risk-taking, management and inconvenience from gross interest.

FACTORS DETERMINING THE RATE OF INTEREST

1. Time preference theory: according to the preference theory, the rate of interest depends on the extent to which the community prefers income at present than in future. If the time preference is high, the rate of interest must be high to reward savers for shifting consumption to the future. Time preference r educes with increasing income.

2. Demand and supply for capital: Capital is demanded by investors depending on its marginal productivity which diminishes as more capital is used. So the demand curve for capital (like the demand curve for any other factor of production) slopes down wards from left to right.

   Capital is supplied by savers who part with their money to earn interest. Other factors remaining constant, the higher the rate of interest, the greater the savings. So the supply for capital slopes upwards from left to right.

   Equilibrium for the natural rate of interest is reached when the demand for capital (investment) is equal to savings.

   This theory was put forward by classical economists.

3. Demand and supply of loanable funds. According to neo-classical economists, interest is determined by demand and supply of credit. Credit is demanded by consumers, the government and business people for consumption, government expenditure and investment respectively. The lower the interest rate, the greater the aggregate demand for loanable funds (credit).

   Supply of loanable funds mainly comes from savings, dishoardings, and bank credit supply for loanable funds increased with increase in the rate of interest.

4. Liquidity preference: According to keyness, interest is paid for parting with liquidity i.e. to break the liquidity preference. This implies that interest is determined by demand and supply of money. He assumed that the total supply of money is fixed by monetary authorities. The demand for money is the desire to hold cash for transaction, precautionary and speculative motives. The higher the liquidity preference, the more the rate of interest is to be paid to cash holders to part with liquidity. At the liquidity trap, interest is too low to break the liquidity preference.

INTEREST RATE DETERMINATION IN UGANDA

Interest rate in Uganda used to be fixed by the government but with economic liberalization, the forces of demand and supply now determine the rate of interest. Interest rates on deposits are increased when there is inflation to encourage savings but the rate of increase in interest on deposits has always been less than the rate of inflation. The rate of interest charged on loans is greater than the rate of inflation. This has discouraged people to borrow form banks.

THE VALUE OF MONEY

The value of money refers to the amount of commodities a unit of money can purchase. This depends on the general price level. The higher the general price level, the lower the value of money.

ECONOMIC GROWTH AND DEVELOPMENT

Economic growth is the persistent quantitative increase in the volume of goods and services produced by the economy.

Development on the other hand is the quantitative and qualitative change in society. Development is a multi-dimensional process involving increase in real per capita income and change in economic, social political and institutional frame work of the society. In other words development = Economic growth + fundamental changes in society.

DIFFERENCES BETWEEN ECONOMIC GROWTH AND DEVELOPMENT

A country may achieve high rates of economic growth yet without achieving development. This is because economic growth is different from development in the following respects:-

1. Economic growth is a quantitative change which is concerned with increase in supply of goods and services. On the other hand development is both quantitative and qualitative change which is concerned with increase in the volume of goods and services as well as improvement in quality of these goods and services.

2. Economic growth is concerned with the material economic aspect of society where as development is a multi-dimensional process concerned with economic changes as well as socio-political and institutional changes in society. In other wards development is broader than economic growth.

3. Development is achieved after every long period of time where as economic growth is achieved in a relatively short time.

4. Economic growth is concerned wit increase in GNP without looking at how GNP is distributed. However, development is concerned with how the increase in GNP is distributed among the people e.g. housing, health conditions, literacy rate, death rate, etc.

5. Development includes structural transformation of the economy e.g. changing from agricultural production to industrial production. However, economic growth is not concerned about structural transformation of the economy.

MEASURING ECONOMIC DEVELOPMENT

1. Using real income per capita: In this methods, development is measured by looking at the increase in real income per capita of the economy over a given period of time. This is done by dividing real national product (GNP) over the total population. This measure emphasizes that the rate of increase in real income should be higher than population growth rate.

PROBLEMS OF USING REAL PER CAPITA AS A MEASURE OF DEVELOPMENT

(a) The method does not consider the type or composition of goods and services which bring about increase in real income per capita. Increased real income per capita may be due to capital goods which do not improve people's standards of living directly.

(b) The increased real income may not be well distributed where the majority of the population may still be poor living under very low standards when real income per capita is high.

(c) The method does not consider the quality of the commodity consumed by the population. The real per capita income may be high while people are consuming low quality commodities.

(d) Using the real per capita income to measure development ignores the structural framework of the economy. The real income per capita may be high while the economy is still dominated by backward structure like traditional belief backward ideas inefficient institutions.

(e) There is always a problem of in accurate national income and population figures. This limits the use of real per capita income to measure development.

(f) This method ignores the non-economic indicators of development e.g. the degree of freedom. Leisure time, mortality rate, wars and social costs suffered by the society.

2. Using the real consumption per capita

In this method, development is measured in terms of the amount of goods and services consumed by an individual on average in an economy. The higher the level of consumption the higher the level of development. Things considered here include: food consumption per capita, protein consumption per capita, electricity, etc.

3. Using the social indicators

In this method of measuring development, social indicators like health, education (literacy rate), employment, mortality rates and infant mortality rate are used. This method is more concerned with maximization of social welfare

GOALS OF DEVELOPMENT IN UGANDA

The basic and universal goals of development in Uganda is improving human welfare of all members of the society through providing better housing, adequate and quality food, medical care, education, etc. Development goals are achieved in the long run. On other hand development objectives are measures designed to achieve development goals. Development objectives are achieved in short run.
Uganda's development goals include

1. Raising the standard of living of people by providing the basic necessities of life like food, water, housing etc.

2. Bridging the widening gap between the developed countries and the under developed countries. This can be achieved through transforming the economy from agricultural based to industrial based economy.

3. Achieving a high level of employment where all resources can be fully utilized.

4. Raising income per capita. This can be raised by improving productivity of the economy.

5. Achieving quality in the distribution of income and productive resources like land.

6. Achieving favourable terms of trade and balance of payments. This can be achieved by improving quality of output and increasing output in the economy.

7. Ensuring controlled population growth in order to have optimum population size.

8. Achieving economic stability of ensuring that inflation is controlled.

9. Consolidating political independence and sovereignty as well as ensuring political stability, political freedom and ensuring national unity.

UNDER DEVELOPMENT

It refers to when an economy has low per capita income due to under utilization of the available resources. Under development includes low levels of resource utilization, wide spread poverty, low standards of living, poorly organized political structures and lack of political freedom as well as social backwardness.

CHARACTERISTICS OF UNDER DEVELOPED COUNTRIES

Today the world is divided into more developed countries (MDC's) and less developed countries (LDCs). The more developed countries refer to with economically strong and technological advanced countries of Western Europe, North America, Austria and Japan. The less developed or third world countries refer to countries which are under developed economically, use poor technology, have low income per capita and are trapped in the various cycle of poverty. General characteristics include:

1. The general standard of living in LDCs is very low which are explained by malnutrition due to lack of food in terms of both quality and quantity. Poor health conditions, poor housing facilities, high infant mortality rates and low life expectancy.
2. LDCs are characterized by low income per capita. About 83% of the world's output is produced by the developed countries only about ¼ of the world population live in developed countries and about ¾ of the population which is about 75% of the world population live in third world countries. Therefore income per capita is low.

3. Economies of LDCs are characterized by inequalities of incomes. The gap between the rich and the poor is very wide.

4. There is wide spread of poverty in LDCs. Majority of the population live below the poverty line so that they cannot afford basic need.

5. There is wide spread of unemployment and under employment. Most of the labour force in LDCs is not utilized. Those who are able and willing to work do not find jobs and there is under employment where the employed work for short hours or highly skilled labour is employed on jobs below their qualification. Its estimated that about 30% of labour force in LDCs is under utilized.

6. There is low productivity in the economies of LDCs. This is due to misuse of human resources and use of poor technology.

7. Low developed countries are also characterized by high population growth rates and dependence burdens. High population growth rates have resulted into a population with a big portion of children who do not produce but consume more hence dependence burdens.

8. Economies of LDCs are trapped in the vicious circle of poverty. This refers to how poverty is continually re-inforced by low incomes, low savings, low investments, low capital accumulation and hence low incomes thereby completing the circle.

Supply side vicious circle of poverty.

SUPPLY SIDE VICIOUS CIRCLE OF POVERTY

Low productivity

Low capital accumulation Low income

Low investment Low saving

Demand side vicious circle of poverty Low income

Low productivity Low aggregate demand

Low capital accumulation Low investment

9. There is significant reliance on primary production like agriculture, fishing, mining, forestry, etc.

10. LDCs experience unfavourable terms of trade and balance of payment deficits. This is due to over reliance on primary low value exports and low productivity in LDCs.

11. Third world countries are also characterized by dominance by developed countries and they are vulnerable internationally in that they do not have influence in international decisions. LDCs over dependence on developed countries is for economic and political assistance and are easily affected by international changes.

12. LDCs are also characterized by social and cultural backwardness e.g. conservatism, backward beliefs and anti developmental cultures.

13. Most economies of LDCs are dual economies with the traditional subsistence sector existing side by side with the modern sector.

14. There are wide spread political instabilities in LDCs. This is partly due to poverty, dictatorship and oppression which are common in LDCs.

FACTORS INFLUENCING ECONOMIC GROWTH

Economic growth involves increasing the production capacity of an economy. Economic growth can be determined by the following factors.

1. Natural resources: The volume of existing natural resources and the level of economic growth where there are a lot of natural resources and are fully utilized it will lead to economic growth.
2. Technological progress. Improvement in methods of production leads to more output hence economic growth. Technical progress can be achieved through inventions and innovations, which lead to efficiency in production and increased output hence stimulating economic growth.

3. Capital accumulation where there is a big stock of physical productive assets it will lead to more out put hence economic growth.

4. Better organization frame work where there better management of the economy and better policies in place, it can lead to economic growth.

5. Availability of market. W here there is market for the produced output, it will encourage producers to produce more out put hence economic growth in both domestic and foreign markets.

6. Increasing the quality and quantity or productivity of labour. This can be achieved through education and training, improvement in health and nutritional standards of labourers etc. All these lead to increase in the level of output hence causing economic growth.

7. The level of entrepreneurship in the economy where the entrepreneur abilities are high there is high output and economic growth.

8. The level of investment where the level of investment is high. It leads to establishment of more production units leading to more output hence economic growth.

9. Economic growth can be achieved through structural transformation of the economy where the inefficient structures are replaced with efficient structures and institutions.

10. Better distribution of resources where resources are well distributed most especially land; it will lead to more out put hence economic growth.

11. Ensuring economic and political climate conducive for economic growth. This can be achieved through stabilizing prices, putting in place good tax system, improving efficiency of financial institutions and ensuring political stability.

12. Social factors. These include peoples attitude towards work and beliefs where people have positive attitude towards work, it leads to more output hence economic growth.

13. Specialization where there is specialization, it improves efficiency of factors of production and lead to more output hence economic growth.

BENEFITS OF ECONOMIC GROWTH

These are advantages, which are enjoyed by individuals and the society as a whole as GNP increases and different commodities are produced in an economy.

1. Economic growth leads to increased volume of goods and services and this improves the standards of living of the society.

2. Economic growth leads to production of more exports and this ensures favourable balance of payment for a country.

3. Economic growth increases government revenue through taxes. This revenue can be invested in social services like education and health hence improving the general standards of living.

4. Economic growth leads to utilization of resources i.e. more is employed in industries and other production units that are set up.

5. Economic growth can lead to improvement in economic, social and political conditions of a country e.g. there will be price stability and the country can afford to build a strong army to maintain peace and defend the country.

6. As a result of economic growth a variety of commodities are product within the economy, which increases consumers' choice.

7. With economic growth there is breakdown of over dependence on import and the economy becomes self-reliant.

8. Increase in GNP as a result of economic growth leads to increased per capita income and material prosperity as well as eradication of poverty.

9. Economic growth leads to establishment of many industries in which labour can be employed. Labour employed in industries will acquire training and skills thereby increasing labour productivity.

10. Economic growth improves the status of activity internationally which increases her credibility in acquiring loans and increases her bargaining power.

COST OF GROWTH

These are disadvantages which individuals or the society as a whole suffer as a result of economic growth that has been achieved. In other words these are opportunity costs of growth or side effects of economic growth. They include:

1. It can lead to social costs like pollution, noise, traffic congestion, etc.

2. Economic growth leads to quick exhaustion of resources and environmental degradation e.g. construction of roads, clearing of forests, draining of swamps, etc.

3. It require hard work therefore people give up their leisure time.

4. If only economic growth is emphasized without equity it will lead to income inequalities with their associated problems.

5. It involves heavy taxation of nationals, which reduces their disposable incomes hence reduction in economic welfare. In order to achieve economic growth, other harsh policies may be imposed e.g. cost sharing.

6. Usually capital intensive methods are used in modern industries and this leads to technological unemployment.

7. Economic growth foregoing present consumption and investing most of the incomes in order to increase out put in future. This leads to deteriorating standards of living.

8. Economic growth leads to rural-urban migration. This is because most of the industries are located in urban areas which attract massive labour movement from rural areas to urban areas in search of job.

9. In LDCs most of the investment is done by foreigners, therefore economic growth may lead to increased foreign influence in the economy and associated problems like profit repatriation.

THEORIES OF ECONOMIC GROWTH, ROSTOW THEORY OF GROWTH

Rostow explained the path of growth in a historical perspective using capital accumulation as the engine of growth he identified five stages through which all economies must pass in order to achieve economic development.

1. TRADITIONAL STAGE

This stage is the lowest in economic growth and its characterized by the following:

(a) There is low productivity due to sue of backward technology and lack of scientific knowledge

(b) There is subsistence production where output is for own consumption and any surplus is exchanged by barter system.

(c) There is predominance of agricultural production at a big proportion of labour is employed in the agricultural sector.

(d) There is no international trade.
(e) The rate of savings is around zero percent due to subsistence production and very low incomes.

(f) There is a lot of superstitions and backward traditional values.

(g) Resource allocation is according to the traditions. Resources are in the hands of lords who posses both political and economic power.

(h) There is no development taking place at this stage the economic growth rate is around zero percent.

2. THE PRECONDITIONS FOR TAKE OFF (TRANSITION STAGE)

In this stage Rostow proposed that due to exposure of the traditional society to international trade. Some conditions for economic growth start coming up in the economy. It's a transitional stage in which traditional systems are overcome so that the economy can start developing due to influence of modern science and technology. The characteristics of this stage include:-

(a) The society breaks the ties of traditionalism and there is change in attitudes where by people start adopting new consumption patterns and use technology techniques of production.
(b) There is arise in investment rate of about 5% of national income.
(c) Entreprenual abilities start developing in the economy.
(d) There is investment in social over head capital e.g. roads, school, dams, hospitals etc.
(e) The commercial sector begin to emerge and savings start increasing due to established financial institutions.
(f) Industrialization starts taking place. Agriculture is still a dominant sector.
(g) The economy is engaged in international trade within primary products dominating the exports.
(h) At this stage the society is characterized by dualism where traditional society co-exist with modern society.

3. THE TAKE OFF STAGE
(BEGINNING OF ECONOMIC GROWTH)

This is the most important stage where the economy become self sustaining and there is reduction in foreign dependence. All obstacles of development are removed and there is a very high rate of economic growth. It is characterized by:

(a) There is increased net investment of 5-10% of national income.
(b) There is introduction of new technology and there are a lot of framework of the economy to aid development.

(c) There is high level of industrialization with all types of industries. Industrialization takes a substantial share of national income and agriculture is highly mechanized.
(d) There is a high level of industrialization with all types of industries. Industrialization takes a substantial share of national income and agriculture is highly mechanized.
(e) There is a high level of productivity due to use of modern science and technology.
(f) A high proportion of labour force is employed in the industrial sector.
(g) Production is market oriented.
(h) There is emergence of leading sectors which have big rate of growth that can spear head development. A leading sector is a sector with a high rate of growth and a lot of linkages so that this sector should develop faster than other sectors so as to help other sectors to develop through backward and forward linkages.

4. THE DRIVE TO MATURITY STAGE

This is achieved after a long period of sustained growth. In this stage the means of production and the way of life are controlled by science and technology characteristics of this stage include:-

1. There is a high level of investment of about 10-20% of N.Y.

2. There is improvement in technology and development of new industries with new techniques of production.

3. New commodities are produced in the economy and goods formerly imported are domestically produced.

4. The economy gains international recognition and has influence in inter-trade.

5. A big proportion of labour is employed in the industrial sector in white collar jobs.

6. The economy becomes well integrate d and self sufficient in terms of skilled labour, foreign exchange, capital and technology.

7. There is increased urbanization with a substantial proportion of the population living in urban areas.

8. Economic problems of inflation, unemployment and income inequalities are eradicated from the economy.

9. There is emphasis on improvement on the social welfare of people e.g. Singapore, Taiwan, S. Korea, Austria, etc.

5. HIGH MASS CONSUMPTION (STATE OF ECONOMIC DEVELOPMENT)

According to Rostows this is the highest stage of economic growth. Economic problems are already solved and there is a very high standard of living.

Characteristics of this state include:-

1. Attention is on ensuring maximum social welfare to the people. The economy is more concerned about consumption rather than production. Production shifts from capital goods to consumer goods.
2. There is use of advanced technology in all sectors.
3. A big proportion of labour is employed in the tertiary (services) sector.
4. There is a lot of time for leisure and recreation as people enjoy their high incomes.
5. The economy has high figures of GNP and real income per capita figures.
6. All economic problems of unemployment, inflation and income inequalities are competent eradicated from within the economy.
7. The country has much influence in inter-trade and inter-decisions.
8. The country has a fluent population with all necessities and comforts of life e.g. electricity, transport means, telecommunications etc. examples of countries which have reached this stage are USA, Japan, German, France, UK, etc.

CRITICISM OF THE THEORY

1. Rostow looked at growth as from historical perspective yet growth does not necessarily follow these stages as stipulated by Rostows some countries have jumped some stages e.g America.

2. Rostow was biased in his analysis, he looked at growth in capitalistic context yet there are some countries which have developed through the socialist product.

3. He assumed that traditional societies are static and that there is no exchange in such societies/economies yet it is not true. The traditional societies were developing through at a low value.

4. He considered capital accumulation to be the engine of growth and ignored other economic and non economic factors which determine growth.

5. He ignored intra-sectional linkages and spread effects of one sector to other sectors.

6. In this theory Rostow did not consider the limitation of market where by there is narrow domestic market and lack of foreign markets. In this case economic growth will be limited and lack of foreign markets. In this case economic growth will be limited.

THE BALANCED GROWTH THEORY

In this theory, it's believed that development can be achieved through simultaneous and harmonious development of all sectors of the economy. According to the theory there is need for massive investment in all fronts of the economy and this requires a certain minimum level of investment which is referred to as critical minimum effort.

ARGUMENTS FOR THE BALANCED GROWTH THEORY

1. There is complementary between different sectors in the economy. An integrated and self sustaining economy can be established.
2. The forward and backward linkages between sectors lead to faster economic growth. Forward linkages is where a sector provides raw materials to another while backward linkage is where one sector products to another sector.
3. It ensures full utilization of the available resources.
4. An economy can easily achieve economic growth since all sectors are developed simultaneously.
5. There is break down of the vicious circle of poverty which s the major obstacle of development in LDCs e.g. increased investment lead to more income and more savings.
6. Massive investment in all sectors increases employment opportunities and solve the problem of unemployment.
7. It leads to improvement in standards of living because there is a balance between consumer goods and capital goods.

8. It improves balance of payment pros……………….of the economy since there is balance between domestic and foreign sectors more exports will be produced thus leading to favourbale BOP.
9. It ensures equal regional development must especially rural and urban sectors. This solves the problems of rural-urban migration.

ARGUMENTS AGAINST BALANCED GROWTH THEORY

1. It is very expensive because it needs a lot of resources to invest in all sector yet LDCs lack resources. There is lack of critical minimum efforts.

2. It does not consider disproportionality of factors of production countries have resources in differing proportions e.g. LDCs have more of labour their capital.

3. Balanced growth theory leads to quick exhaustion of resources.

4. Since it involves heavy investment in all sectors of the recovery, in case of failure at lot of resources will be lost.

5. There is a problem of lack of market. Investment in all sectors leads to mass production and fall in prices yet there is competition for factors of production which leads to increase in factor costs.

6. It may lead to over dependence, where acting has to depend on other countries for factor inputs.

7. It requires a high level of management and planning which are lacking in LDCs.

8. Harsh policies may be imposed on people in order to implement the policy e.g. forced savings and high taxes.

9. Balanced growth theory may lead to inflation due to massive investment expenditure within the economy.

THE UNBALANCED GROWTH THEORY

This theory emphasizes that growth can be achieved through developing the leading sectors of the economy and then other sectors of the economy would follow. Development of the leading sectors which would bring about economic growth of the whole economy.

The leading sectors are the key sectors of the economy which have backward and forward linkages in the economy e.g. by first investing in agriculture it would later lead to industrialization as agriculture provides raw materials and market to industry.

ARGUMENTS FOR THE UNBALANCED GROWTH THEORY

1. This theory can be pursued using little resources. It is most suitable for LDCs.

2. It makes use of the backward and forward linkages in the economy and in the longrun, it can lead to building of an integrated and self sustaining economy.

3. It is easy to control and manage.

4. Since it needs little resources, some resources can be reserved for future use hence there is resource conservation and preservation.

5. There is less dependence on foreign resources because there is not a lot foreign borrowing.

6. It takes into account the principle of comparative advantages. A country can start with a sector in which it enjoys comparative advantage in otherwards. It encourages specialization which ensure efficiency and boosts production.

7. There is less resource wastage as the country produces according to demand.

ARGUMENTS AGAINST UNBALANCED GROWTH THEORY

1. It emphasizes specialization which has disadvantages like lack of market and fluctuation of prices leading to instability in the economy.

2. The theory may lead to unemployment because one or two sectors cannot fully employ resources most especially labour.

3. One sector may not be enough to provide enough commodities before other sectors have been developed. This creates scarcity in the economy. It may result into inflation.

4. It leads to dependence since a country cannot meet all her needs and thus depends on imports.

5. This theory leads to a slow process of economic growth.

6. In most cases priority is given to industrial development which is usually urban based hence leading to rural-urban migration.

7. The theory may lead to income inequalities those engaged in the priority sectors will receive more incomes which those engaged in non priority sectors will receive less savings.

8. This theory promote economic dualism along side development where the leading sector does not help other sectors to develop.

9. The backward and forward linkages are ignored in the initial stages of development.

THE BIG PUSH THEORY

This states that for developing countries to develop into self-sustaining economy, there is need to under take massive investment programme to promote rapid industrialization and building of gradual process of economic growth through stages as proposed by Rostow. According to this theory there is need for massive investment which is referred to as critical minimum efforts' to develop a country into self sustaining economy.

ARGUMENTS FOR BIG PUSH

1. The big push theory promotes quick industrialization of the economy. This is achieved through massive investment in industry and infrastructure.

2. There is establishment of infrastructure which leads to improvement in the peoples standard of living.

3. Economic growth is achieved in a short time.

4. Industrialization leads to more manufactured exports leading to favourable TOT and BOP.

5. More employment opportunities are created

6. There is breakdown of the vicious circle of poverty.

LIMITATIONS OF THE BIG PUSH THEORY IN LDCs

1. The theory assumes that there is enough and favourable market, yet LDCs have narrow domestic market and unfavourable foreign market. The theory is limited by market.

2. The theory does not consider the structural and institutional problems in LDCs e.g. poor land tenure system, backward cultures, etc.

3. It implies that LDCs should borrow heavily to expand investment yet borrowing brings about problems of investment yet borrow brings about problems of debt servicing, dependence and resources out-flow.

4. It assumes economies of scale in all sectors which is not the case in some sectors e.g. the consumer good industries.

5. The theory propose massive investment programme yet LDCs lack capital and foreign exchange to undertake the programme.

6. Industrialization in LDCs tend to concentrate in urban areas hence promoting rural-urban migration.

DEVELOPMENT PLANNING

THE MEANING OF ECONOMIC PLANNING

Economic planning refer s to deliberate government attempt to influence and direct economic choices and activities towards specific objectives, within a specified period of time.

These objectives are: increase in national income, increase in employment, fall in income inequalities, increase in agriculture and industry out put, achievement of balanced region development, self reliance, maintenance of balance of payments stability, to defeat ignorance, poverty and sickness, etc. It should be noted that not all forms of government intervention in economic affair is planning. Planning just improves government intervention in making of economic decision.
Note: The broad term “development planning” means planning for the whole society so as to achieve various economic, social and political objectives. Therefore “development planning” is wider than economic development planning.

CHARACTERISTICS/ELEMENTS OF A GOOD PLAN

1. It should be as comprehensive as possible i.e. it should cover almost all the sector of the economy taking into account linkages between the sector.

2. Economically feasible. It should be based on the availability of resources. It should be possible to be practically implemented given the economic stand of a nation. The plan should not be exaggerated. Planned programmes should not exceed available resources in order to realize the objectives.

3. It should encourage the people to participate in the development effect. In otherwords, a plan should be in line with the people’s aspirations if it is to be socially relevant.

4. It should be in line with the socio-economic system of the country which should be one of the strategies if the intended goals are to be achieved.

5. It should fit in the physical and technical conditions in the country. E.g. when planning is to increase agricultural output by introducing tractors, the land tenure system, relief, nature of soil, and incomes of people are to be considered.

6. A plan should be politically and administratively feasible if it is to be implemented easily.

7. A plan should be internationally relevant i.e. it should take into account issues like prices on the world markets, policies of financing bodies, etc.

TYPES OF PLANS

1. Classification of plans by time element
   a. Annual plans. These cover one year
   b. Medium term plans. These cover 3-7 years
   c. Long-term (perspective) plans. These cover more than 20 years.

2. Classification of plans by coverage

   a. Comprehensive plan. This covers all sectors of the economy and all resources, taking into account sectional interdependence and determining sectional priorities. Such a plan covers t he public and the private sector, agriculture, industry and services.

   b. Partial planning (sectional planning): This covers one sector of the economy e.g. public sector plan covering specific areas, agricultural plans, etc. The two major forms of partial planning are:

      i. Project-by-project planning: This is a form of partial planning which covers only the public sector. It includes identification of projects some of which may not be directly related to the national development plan.

      ii. Integrated public investment plan. This is an advanced form of planning where the government estimates national resources and allocates them among sectors and projects which are ranked in order of priority.

3. Classification of plants according to socio-economic system.
   a. Socialist plans. This is where there is no market mechanism. Resources are owned by the state which allocates them by administrative directives. Most economic are owned and controlled by the state.

   b. Capitalist planning. In market economies, they use indirect policies like monetary policy. Fiscal policy, foreign exchange policies, etc, to influence economic activities. Much emphasis is put on the private sector. The government just provide incentives and information to individuals economic units without influencing their decision directly (i.e. “indicate” planning).

4. Classification of plans according to the hierarchy of planning.

   a. National Economic Planning. (Macro-economic plan). This is planning at the national level. Such a plan should be consistent with the national resources.

   b. Sector plan. This is a plan for individual sectors e.g. agriculture, industry, infrastructure, etc. Such a plan can be made as part of the national plan or by various ministries.

   c. Project plan. This is undertaken by agencies e.g. parastals bodies, peasants, NGOs, etc. In such a plan, output to be provided is estimated taking into account of resource availability.

THE PLANNING PROCESS

Planning is supposed to be a continuous process which involves the following major steps.

1. Identification of goals and objectives of planning i.e. to define what is to be achieved.

2. Plan formulation: This refers to setting up of plans where ways of attaining objectives are formulated taking into account interdependence and conflicts between the various activities, programmes and projects.

3. Plan implementation. This refers to transforming the plan into actual work. It is the practical part of planning where programmes and projects are started and evaluated at all stages to make sure that they are in line with the attainment of the intended objectives.

4. Plan evaluation: This is an attempt to find out whether the plan is fulfilling the intended objectives. Its takes place at all stages of planning. A plan can be revised to fit the circumstances prevailing in the economy if objectives are to be achieved.

SOME INGREDIENTS OF A DEVELOPMENT PLAN

1. Objectives of a plan. These should be clear before planning is started. Where possible, such objectives should be measurable. Objectives may be economic growth, income distribution, employment creation, price stability, balance of payment stability, etc.

2. Planning machinery: This includes institutional framework within which the plan is formulated. National plans in Uganda are formulated by Ministry of Finance, Planning and Economic Development. There is need to coordinate the plans of various ministries so are to make the national plan.

3. Plan co-ordination and consistence. Because of intersectional linkages. One economic activity influences other activities. Therefore, planners must keep their decisions in a coordinated and consistent manner. E.g. the establishment of a fertilizer factory should follow an extensive agricultural policy; a plan to increase output should be followed by a plan to widen markets.

4. Regional planning. Regional distribution of various physical targets must be considered so that,
   a. It becomes clear on what role each region is expected to p lay towards the overall development.
   b. It becomes easy to involve the ordinary people in each region in plan implementation.
   c. It becomes easy to avoid the dangers of politicians who concentrate all the development efforts in their home areas.

5. Planning project. Each major project in the plan should be examined in details in terms of economic and social costs and benefits. Evaluation of projects is the best ground work in formulating the national plan.

6. Policies and strategies. These should be clearly stated. They should also be linked to the expected goals and outcomes.

THE NEED FOR PLANNING

1. Scarcity of resources. There is need to allocate the scarce resources efficiently so as to get as much output as possible. Planning also eliminates competition which is at times wasteful and unnecessary.

2. To correct the defects of the price mechanism planning can be used to check on unemployment, income inequalities and private interests.

3. To distribute economic opportunities between individuals and regions in a fair way.

4. To reveal future economic opportunities basing on present economic activities which may change in future.

5. To harmonise the economy and utilize resources in a systematic way.

6. To balance the public sector and the private sector and to determine the size of each sector depending on the nature of socio economic organization.

7. To enable the government to invest in large and risky projects where business people may not invest because of lack of capital and fear to take risks.

8. It is easy to mobilize foreign resources after presentation of the plan to friendly countries and financing bodies like the World Bank, Development banks, etc. Also to encourage foreign investors.

9. To make population growth keep pace with economic growth.

10. To create interest among the people and to enable them to know the part which they are supposed to play in national development.

11. To remove price instabilities to attain balance of payments equilibrium.

LIMITATIONS OF COMPREHENSIVE PLANNING IN LDCs

1. Lack of information. There are reliable statistics and therefore, it is difficult to tell what is happening in the economy now so as to forecast what may happen in future.

2. Lack of control: Agrarian economies are subject to natural hazards like drought, earthquakes, plagues, locusts, etc. which are beyond the control of planners. There is also fluctuations of prices on the world market, increase in oil prices, trade policies of developed countries and reliance on finance from foreign sources. All these are difficult to predict and control.

3. Lack of planning machinery. The administrative staff is weak and the available staff at times does not carry out careful research. Sometimes there is no careful collaboration between the private sector and government. In some cases there is lack of co-ordination between the ministry of planning and local officers who may not be interested in the foundation of the plan. Planning requires the use of sophisticated mathematical exercise like capital output ratios, depreciation rates etc, which need experts to compile them.

4. Lack of caution: Most governments in LDCs attempt to do too much at ago because of the desire to have a great “leap forward” in living standards. This at times leads to failure to achieve the desired goals which results into disappointments. Most governments also look at the plan as secret and rigid, a situation that makes implementation a difficult task.

5. Lack f political stable administration. This is due to changes in regimes which are at times accompanied by changes in goals and objectives. Political instabilities also make plan implementation very difficult.

6. Resistance to change. Planning implies something new (changes). It is well known that people resist change which may limit planning.

7. Dependence on foreign resources. LDCs depend on foreign resources and base their resources on these, yet these resources do not flow steadily.

ECONOMIC INTEGRATION

Economic integration refers to the co-operation of countries in order to rise economic benefits from international trade and enhance social, political harmony among these countries. Usually it’s countries with similar economic aspirations and problems that come together into regional integration. Examples of economic integration in LDCs include: E. African Community (EAC), Kagera Basin Organisation (ICBO), Economic Organisation for West Africans States (ECOWAS), Association of South East Asian Nations (ASEAN), etc and those of developed countries include European Union.

TYPES OF INTEGRATION

Economic integration is classified according to its level of development as follows:-

1. A Preferential Trade Area: This is where countries reveal the need for integration. They reduce tariffs between or among themselves on selected code. An example is the Preferential Trade Area for Eastern, and Southern Africa.

2. A Free Trade Area: At this stage countries eliminate all tariffs between or among themselves but continue to charge different tariffs on goods that are imported from the "third countries" or countries that are not members of integration.

3. A Customs Union: All elements of a free trade area are embodied. In addition, countries adopt a common tariff on all goods from the "3rd countries".

4. A common market: All elements of a customs union are embodied. In addition, factor services e.g. capital and labour, are free to move within the region.

5. Economic Community (Union): All elements of a common market are embodied. In addition, countries in the community institute joint ownership of certain enterprises e.g. roads, railways, etc. All economic policies of countries are harmonised and a common currency may be established.

CONDITIONS NECESSARY FOR THE SUCCESS OF ECONOMIC INTEGRATION

In order for economic co-operation to be successful the following conditions should prevail.

1. Countries coming together into economic co-operation should be geographically close to each other, they should be neighbours in order to effect preferential treatment to each other.

2. Countries in the integrated regions should be at the same stage of development, otherwise resources would flow from less developed countries to more developed countries in the region. Countries with good infrastructure favourable for investment would attract most of the resource leading to economic imbalance in the region.

3. It is important that countries in the economic co-operation have the same ideology otherwise if countries have different ideologies it would lead to failure to harmonise.

4. Also countries should have the same broad strategy for development. If its development through agricultural modernisation then it should be a general strategy for countries in the region to ensure harmonisation of policy.

5. Countries should preferably be of equal size. Countries coming together into an economic co-operation should have almost equal resources.

ADVANTAGES OF ECONOMIC INTEGRATION

Economic integration accelerate the development of member countries by boosting the volume of international trade between countries. When countries form economic integration they enjoy the following advantages.

1. There is trade creation effect where countries within the region which used to import expensive commodities from non-member countries can now obtain these commodities cheaply from the region.

2. Economic integration permits specification where member countries concentrate on the production of commodities in which they have comparative advantage. This boots production hence more volume of exports.

3. It leads to expansion and extension of market. Economic integration provides a sufficiently wider export market since member countries have to import from within the region. This boosts productions and promote rapid economic growth.

4. Economic integration increases the bargaining power of countries within the region therefore it will increase benefits for member countries from international trade.

5. There is increased competition which leads to high productivity. Producer from member countries compete which leads to high productivity and more O/P.

6. It enhances factor mobility which redistributes income and wealth between countries. This is because factors of production most especially labour and capital are allowed more between countries without any ban. This will promote equal development in region as well as a rapid economic growth and development.

7. It reduces the costs of duplicating goods and services in LDCs. These countries produce similar or related goods and there is danger of lack of market with economic integration different countries will produce different goods and reduce the costs of duplication of goods.

8. Economic co-operation reduces BOP deficits. This is because it saves foreign GXD and increases exports.

9. It increases consumers choice since a variety of commodities are pre................ within the region hence consumers will get more commodities at low price and maximise economic welfare.

10. Economic integration enhances political harmony and stability in the region. Comm political problems can be solved through consultation and there is sharing of ideas.

DISADVANTAGES OF ECONOMIC INTEGRATION

1. Economic integration may create the problem of trade diversion. This is trade is diverted from low cost production outside the integrated region to high costs producers within the region. In addition countries might continue using low goods from within the region when could have second high quality goods form outside the region.

2. It lead to loss of revenue which could have been got from far countries having their main source of revenue as customs duties or face problems in financing their expenditure.

3. There is unequal share of benefit. Some countries are endowed with resources and benefits more than others from the wider market created. Si.......... the movement of goods may tend to be directed to one country. This can bring about different levels of de......... and create regional imbalance in integrated region.

4. There is un equal distribution of individual project. It can happen that industries are .... countries in the region due to certain advantages. Such as resource endowment, political stability, direct access to sea e.g. in the E. African Community most industries were established in Kenya.

5. When there is political instability in one country it may affect the whole integrated region because all countries depend on each other.

6. It reduces political sovereignty of member countries. It interferes with political and economic policies of the countries whereby member countries may not pursue their independent policies to achieve full employment.

7. It may lead to quick resource exhaustion, as resources are over utilised to serve the wider market that has been created.

8. Most LDCs produce almost the same commodities therefore there is need to trade with the developed countries in order to acquired capital goods, spare parts and manufactured goods which are not produced by LDCs.

Home work on Regional Groupings

- **State the challenges of the East African Community**
- **The economic objectives of COMESA**
- **What is SADC and explain the challenges of its membership**
- **What is ECOWAS**

EUROPEAN UNION (EU)

It was formed as European Economic Community (EEC) in 1957 by the treaty of Rome which was agreed upon by Belgium, France, German Federal Republic, Italy, Luxembourg and Netherlands.

Eventually they were joined by Denmark, UK, Portugal, Spain and other European countries. Member countries having seen the benefits of co-operation, they moved on the last stage of economic integration, the economic union hence adopting the name European Union. Under European Union, all members have adopted the common currency - the Euro.

The main objectives and achievements of EU are:

1. Removal of all tariff and non-tariff barriers among member countries.

2. Harmonisation and standardization of trade and customs procedures.

3. Adoption of common agricultural policy (CAP) for internal price support and variable import levies arising at protecting the farmers in the community from foreign competition.

4. Adoption of a common transport policy regarding development and regulation of road, rail, and inland water transport.

5. Establishment of a common link with developing countries e.g. the European Union - African Caribbean and Pacific (ACP) where countries are benefiting from the generously endowed EU development fund and non-reciprocal trade preferences.

6. Establishment of a bank (European Investment Bank) to finance economic development.

7. Introduction of the Euro to harmonize the value of the currency so that all member countries benefit equally from trade amongst themselves.

THE WORLD TRADE ORGANISATION (WTO)

WTO was formed after SATT and UNCTAD failed to achieve their objectives. The WTO aims at promoting free trade throughout the world by eliminating trade barriers globally. This is more in line with globalization rather than regionalism. If the WTO achieves its aim then it means that the markings of regional groupings will be under mined since all African states have ratified the WTO. It means that if a member country of a regional groupings opts to trade with a non-member they can always justify it by arguing that they are following the principle of the WTO. Therefore WTO posses a threat to regional groupings.

International Monetary Fund (IMF)

It was formed towards the end of the 2nd world war at the Brettonwood Conference of 1944. Each member was to contribute an agreed percentage of the aggregate amount of the fund in form of gold, hard currencies and its own currency. Its headquarters are in Washington. It has the following aims.

1. To regulate a control foreign GXD values of member nations currencies since 1971, this roles has changed as many countries moved from fixed to flexible GXD rate system.
2. To give loans to member countries which experience BOP difficulties. These loans are for paying debts. Assistance is given to a country when it accepts certain conditionalities.
3. It operates the special drawing rights (SDR) scheme where each country is allocated SDRs in proportion to its existing quotas in the fund. The value of SDR in terms of other currencies depends on the share of such currencies in the world trade. This scheme increases international liquidity and encourages international trade.
4. It assists debtor countries to purchase currencies through SDR scheme or directly so as to pay debts.
5. It gives advice to member countries on currency stability, and attainment of BOP equilibrium.
6. It operates the following funds among others.

a) Compensating financing facility for compensating countries experiencing shortage of experts due to natural calamities.
b) Oil facility: This is to assist LDCs facing BOP difficulties due to increase in prices of oil.
c) Stand by arrangements: Here IMF assists the country to get loans from financing agencies to finance projects for programmes approved by IMF.
d) Structural adjustment facility (SAF): This was set up in March 1986 to assist poor developing countries to implement structural adjustment program (SAP).

Objective of SAP include

1. To inched GDP.
2. To expand the private sector so as to improve efficiency.
3. To encourage investment especially in the private sector.
4. To reduce the role played by the government so that most of economic activities are guided by forces of dd and ss.
5. To reduce the government deficit budget.
6. To reduce BOP deficit and the public debt.
7. To increase savings and strengthening financial institutions.
8. To strengthen the value of the shilling, internally (checking on inflation) and externally (stabilizing the GXD rate).
9. To increase employment.
10. To strengthen the agricultural sector.
11. To develop infrastructure.
12. To improve people's welfare and assist those who are "by-passed" by development e.g. the .... orphans and rural women.

The International Bank for Reconstruction and Development (IBRD) or the Work Bank

This was founded at the same time as IMF in 1945. Reconstruction was necessary at that time to replace economic resources which were damaged during the 2nd world war. Today its roles are:

1. To give loans for the purchase of capital goods. The world bank mobilizes funds for giving these loans by issuing bonds. Therefore it does not lend its own funds which were subscribed by member countries of the United Nations.
2. To give long term loans to large projects at low interest rate.
3. Through its affiliate, the international finance corporation (IFC) it encourages the development of the private sector in LDCs.

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