refers to income perhead/person in a country usually a year.

Percapita income= GNP or National Income for the year.
Total Population for the same year.

3. **Real income percapita.** This refers to average income of the population in terms of quantity of goods and services that it can purchase in a year.
4. **Nominal income percapita.** This refers to average income of the population in monetary terms/ units in a year.
5. **Personal income.** This refers to the amount of money income received by the households from all sources in a given period of time.
6. **Disposable income.** It is income available to individuals and households for spending and saving after personal income taxes and other compulsory payments have been deducted. This is the income of the household available for spending and saving after direct taxes and other compulsory payments have been deducted.
7. **Nominal or money income.** This refers to income that is measured in monetary terms or units. For instance in shillings, dollars and pounds.
8. **Real income.** This is the purchasing power of nominal or money income expressed in terms of goods and services.

Or

It refers to the amount of goods and services which one's nominal or money income can purchase.

UNEB 2005, 2001

i) Distinguish between real income and nominal income. (02 marks)

ii) Mention any two determinants of real income ion your country. (02 marks)

DETERMINANTS OF REAL INCOME

a) Quantity of goods and services supplied.
b) Size of nominal income.
c) General price level.
d) Level of direct taxes
e) Size of subsistence/monetary sector.

9. **Nominal gross domestic product.** This is the total monetary value of all goods and services produced within a country during a given period of one year valued at current year prices.

Or

It refers to gross domestic product valued at current year prices.

10. **Real gross domestic product.** This is the total monetary value of all goods and services produced within a country during a given period of one year valued at base year prices (constant prices).

Or

It refers to gross domestic product valued at base year prices.

UNEB 2015

(i) What is meant by the term Real Gross Domestic Product? (01 marks)

(ii) Given that nominal Gross Domestic Product is Shs 150,000,000,000 and the consumer price index is 105, calculate the real Gross Domestic Product. (03 marks)

11. **Nominal gross national product.** This is the total monetary value of all goods and services produced by only nationals within and outside the country for a period of one year valued at current year prices.
12. **Real gross national product.** This is the total monetary value of all goods and services produced by only nationals within and outside the country for a period of one year valued at base year prices (constant prices.)
13. **Net domestic product (NDP).** This is the total monetary value of all final goods and services produced within the territorial boundaries of a country usually a year excluding the cost of depreciation.

UNEB 2006.

i) Differentiate between Gross National product (GNP) and Gross Domestic Product (GDP). (02 marks)

ii) Given GDP at market price is £500 billion subsidies is £200 billion. Calculate GDP at factor cost. (02 marks)

UNEB 2012

i) Differentiate between nomal and real gross domestic product (GDP). (02 marks)

ii) Given that a country's GDP is shillings 400 billion, net income from a broad is shillings 40billion and depreciation is shillings 20billion. Calculate Net National Product. (02 marks)

UNEB 2004.

Given that the country's stock of machinery is valued at shillings 100 billion at the beginning of the year, total output from the machinery during the year is shillings 500 billion, depreciation cost during the year was 20%.

Calculate the,

(i) Value of depreciation.
(ii) Net output during the year.

UNEB 2000.

i) Distinguish between Gross Domestic Product and Gross National Product (02 marks)

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ii) State any two uses of national income statistics for your country. (02 marks)

1) Given GDP at factor cost is shillings 2,500million, net income from abroad is shillings 800million, and depreciation of capital equipment is shillings 50million, calculate Net National Product (NNP).

NNP=GNP- depreciation of capital.
NNP=GDP +Net income from abroad- depreciation cost.
NNP=2,500M+800M-50M.
3300m-50m
NNP=Shillings 3,250 million.

2) Given that GDP at factor cost is $300 billion for a given country, indirect taxes is $100 billion, subsidies is $150billion. Calculate the country's GDP at market price.

GDP at market price= GDP at factor cost+ indirect taxes – subsidies.
$400b+$100b-$150b
$400b-$150b
GDP at market price = $250 billion.

3) Given GDP at market price is €500 billion, indirect taxes amount to €155 billion, subsidies is €200 billion. Calculate GDP at factor cost.

GDP at factor cost= GDP at market price + subsidies – indirect taxes.
€500b+€200b-€155
€700b-€155b.
GDP at factor cost= €545 billion.

4) Given that the Gross National Income is shillings 275,000,000 million and net income from abroad is shillings 15,000,000 million. Calculate Gross Domestic Income.

GDY= GNY- net income from abroad.
275,000,000m- 15,000,000m.
GDY=shillings. 260,000,000 million.

5) Given that the country's stock of machinery is valued at shillings 100 billion at the beginning of the year, total output from the machinery during the year is shillings 500 billion, depreciation cost during the year was 20%.

Calculate the,

a. Value of depreciation.

Value of depreciation = stock of machinery X rate of depreciation.

100billion x 20/100.

Value of depreciation = shillings.20 billion.

b. Net output during the year.

Net output = total output – depreciation value.
500 billion – 20 billion.

Net output during the year= shillings 480billion.

UNEB 2011

a) Differentiate between Gross Domestic Product and Net National Product . (04 marks)

b) Explain the factors that influence the level of national income of a country. (16 marks)

DETERMINANTS OF NATIONAL INCOME FIGURES IN AN ECONOMY

(Factors that influence/affect the size of national income figures in an economy)

NB. Neutral factors must be presented showing a positive side that leads to expansion of production leading to high national income figures and a negative side that limit production levels leading to low national income figures in explanation.

1. **Availability of natural resources and their level of exploitation.** Large quantity of natural resources and of high quality such as minerals, water resources that are well exploited expand production hence high national income figures while limited natural resources and of low quality limit the amount of output leading to low national income figures.
2. **Political atmosphere.** Favourable political atmosphere encourages all forms of investment due to certainty for property which increases production and output thus high national income figures while unfavourable political atmosphere creates business uncertainty which discourages investment and therefore low national income figures.
3. **Government policy on investment/investment climate.** Favourable government policies in form of high subsidies, tax holidays, tax exemptions lead to high production and output hence high national income figures while unfavourable government policies such as high taxes on producers, limited subsidies discourages production hence low national income figures.
4. **Level of technology used in production.** Improved level of technology increases utilization of resources leading to high output hence high national income figures while low level of technology limits production hence low output and national income figures.
5. **Labour skills/availability of skilled labour.** High labour skills stimulate more labour productivity, leading to high national income figures compared to limited skills and training which lead to low national income figures.
6. **Level of entrepreneurial ability or size of entrepreneurship class.** High level of entrepreneurial skills imply high level of organisation of other factors of production which increases investment in risky but highly profitable ventures leading to high output and national

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figures but low level of entrepreneurial skills reduce production hence low output and national income figures.

7. **Size of existing capital stock.** A large size of capital stock implies that more natural resources areturned into final goods and services thus high output leading to high national income figures while limited and inefficient existing capital stock reduce the level of production hence low national income figures
8. **Population growth rate.** High population growth rate increases dependence burden, limits savings and investment hence low national income figures but low population growth rate stimulates savings and later investment thus high national income figures
9. **Market size for a country's output.** A large market size both at home and abroad for goods and services produced increases more investments thus high national income figures while a small domestic and foreign market for a country's output discourages more production thus low national income figures.
10. **Level of infrastructure development.** High level of infrastructure development in form of roads, railways help to coordinate production in all sectors hence high output and national income figures while underdeveloped infrastructure in form of limited power supply, poor roads limit production and national income figures.
11. **Level of monetisation/size of subsistence sector in an economy.** Low level of monetization hampers growth since there is low output hence low national income figures but a highly commercialized economy increases economic activities which expands production hence high national income figures.
12. **Rate of inflation/economic climate.** High rate of inflation discourages production due to high costs and business uncertainty hence low national income while low rate of inflation leads to increased investment leading to high national income figures.
13. **Level of savings.** High level of savings increases production and investment leading to high national income figures while low level of savings limits investment levels leading national income figures.
14. **Level of accountability.** Proper accountability in resource allocation encourages more production leading to high national income while poor accountability limits investment leading to low national income figures.
15. **Degree/level of conservation.** High degree of conservatism limits introduction of modern technology which limits production leading to low national income while low level of conservatism stimulates more production leading to high national income figures.

UNEB 2014

a) Explain the importance of computing national income in an economy. (10 marks)

b) Account for the low level of national income in developing countries (10 marks)

FACTORS WHICH LIMIT THE SIZE OF NATIONAL INCOME IN UGANDA

NB. These are one sided points which are responsible for low production, low output and finally low national income figures.

1. **Unfavourable/poor investment climate.** At times government policy is not favourable to investment inform of high taxes, limited subsidies, high cost of trade licenses which discourages production and thus low output and national income.
2. **High rate of inflation/economic instability.** Persistent inflation discourage increased production due to high production costs thus low national income.
3. **Limited entrepreneurial ability.** There are few entrepreneurs which leads to poor organization of other factors of production thus low output and national income as well.
4. **Poor infrastructure.** The infrastructure network is not properly developed in form of poor roads, limited
5. **Low levels of technology.** Technology used in most production sector such as agriculture, industry, mining is still poor thus limited output levels and low national income.
6. **Small market size.** The domestic market is small due to low incomes among consumers while the foreign market is highly competitive which limits large scale production thus low national income.
7. **Poor/unfavourable political climate.** Political instability in some parts of the country has been discouraging increased investment and takes high government expenditure instead of investing it in productive investments thus low production levels and national income.
8. **High population growth rate.** Population grows at a high rate per annum which increases dependence burden and limits savings thus reduced investment, low output and national income as well.
9. **Low levels of monetization/existence of large subsistence production.** Production in some sectors is not highly geared for commercial purposes which leads to low output especially in rural agriculture thus low national income.
10. **Limited capital stock.** A small size of capital stock limits large scale production in most investments thus low output national income as well.
11. **Low levels of exploitation of natural resources.** The existing natural resources are underutilized in form of land, minerals leading to low output hence low national income.
12. **Poor land tenure system.** This discourages meaningful production leading to low national income.

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UNEB 2003.

a) *Distinguish between national income valued at factor cost and national income valued at market price. (04 marks)*

b) *Suggest the steps that should be taken to increase the level of national income in your country. (16 marks)*

UNEB 2005.

i) *Distinguish between national income at market price and national income at factor cost. (02 marks)*

ii) *Given that Gross National Income is shs 275,000,000million and net income from abroad is shs 15,000,000million. Calculate Gross Domestic Income. (02 marks)*

Solution.

i) National income valued at factor cost. This refers to national income valued at what factors of production are paid in production process usually a year.

Or

It refers to the total money value of all goods and services produced in a country in a given year valued at factor prices.

National income valued at market price. This refers to national income valued according to prices of final goods in the market usually a year.

Or

It refers to the total money value of goods and services produced in a country in a given year valued at prices paid by final consumers of the products.

ii) Gross domestic income= gross national income- net income from abroad.

GDY=275,000,000m- 15,000,000m

GDY= Shillings 260,000,000millio.

MEASURES THAT CAN BE TAKEN TO INCREASE THE SIZE OF NATIONAL INCOME IN UGANDA.

These are intended to increase production, output and finally high national income.

- **Improve on existing level of technology.** This can be done through increased research and technological transfer to increase the rate of

resource exploitation and increase output thus

income.

- **Equip labour with appropriate skills/training** *labour is* ***require necessary skills.*** *Labour needs to be equipped wit* *investment skills and this should be done through* *growth so as to promote labour efficiency and productivity* *investment and national income.*
- **Expand market both local and foreign market.** *Market* *should be expanded to stimulate more production throug* *regional integration which encourages large scale investmen* *to increased national income.*
- **Improve and develop necessary infrastructure** *Ex* *infrastructure should be rehabilitated and new ones establish* *form of power supply, roads, railways, airfields and baking facil* *stimulate more production and increase national output.*
- **Ensure and maintain political stability.** *This is a key compone* *investment and can be done through holding peaces talks with re* *groups and ensure good governance so as to enable* *concentrate on productive activities and attract more investment* *increased output leading to an increase in national income.*
- **Provision of a conducive investment climate/offering investm incentives to investors.**

Attracting both local and foreign investors should be emphas through provision of subsidies, tax holidays and tax exemptions wh leads to increased output.

- **Ensure and maintain economic stability.** This can be done by us effective, sound fiscal and monetary policies appropriate for a coun to attract various investments and increase production and natio income.
- **Control population growth rate.** There is a need to con population growth to keep pace with economic growth and this sho be done by putting more emphasis on family planning to ensure t population growth matches with the existing resources and avail m savings for investment leading to increased national income.
- **Promote modernization and commercialization of agricultu** Agriculture contributes greatly to GDP in Uganda, therefore, it sho be improved through increased funding to facilitate mechanizat extension services, market research, providing modern inputs a training farmers on modern production techniques for increa agricultural output hence high national income.
- **Increase the level of exploitation of natural resources.** Reso such as minerals, forests, water resources should be u productively through changing the land tenure system, resou

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ensuring sustainability in the use of **water resources**, minerals and forested areas. This leads to **increased investment** leading to high national income.

- **Further privatization of public enterprises.** More public enterprises should be privatized to **attract various local and foreign investors** in production to increase **resource utilization and output** leading to high national income.
- **Encourage further diversification of the economy**. This helps to reduce dependence on a few **sectors which increases** output and national income.
- **Improve entrepreneurial skills.** This helps to increase the level of investment and organization of other factors of production leading to high output and national income.
- **Ensure appropriate economic planning.** This helps to ensure proper plan implementation, ensures efficiency in production which increases resource utilization and national income.

WHY IS GNP/GDP OF U.S.A IS HIGHER THAN THAT OF UGANDA YEAR AFTER YEAR?

- U.S.A has more and better skilled labour than Uganda.
- U.S.A has better and advanced technology than Uganda.
- U.S.A has more capital stock than Uganda.
- U.S.A has well developed infrastructure than Uganda.
- U.S.A has a low population growth rate than Uganda.
- U.S.A has a large market size than Uganda.
- U.S.A is more politically stable than Uganda.
- U.S.A is much more industrialized than Uganda.
- U.S.A has favourable investment policies than Uganda.
- U.S.A has a high level of entrepreneurial ability than Uganda.
- U.S.A is highly monetized while Uganda has large subsistence sector.
- U.S.A is more economically stable than Uganda.
- U.S.A has more resources which are highly exploited than Uganda.

UNEB 2015

a) How is national income measured in an economy? (06 marks)

b) Explain the problems faced when compiling national income in an economy (14 marks)

UNEB 2004

a) Describe the three approaches used in measuring national income. (06 marks)

b) What problems are encountered when compiling national income. (14 marks)

APPROACHES/METHODS USED TO COMPUTE/COMPILE/MEASURE NATIONAL INCOME STATISTICS.

These are three approaches used in measuring national income figures.

A. INCOME APPROACH.

Using the approach, national income is obtained by adding up all the total money value of all incomes earned by individuals in an economy which contributed to the production of goods and services in a year. We add up the incomes earned in form of profits, rent, wages, salaries and interest less transfer payments.

Income approach= wages + salaries + rent + interest + profits-transfer payments.

National income = W+S+R+I+P – Transfer payments.

NB.

Using this approach, transfer payments such as gifts, pocket money, pension funds, grants, sick benefits,school fees, unemployment benefits and famine relief should not be included in national income. Also, incomes earned form illegal activities such as prostitution, murder, robbery, smuggling and theft should not be included in national income.

Therefore, there should be quid-proquo (income received for exchange of goods and services) for income to be included in national income.

The value of subsistence output should be estimated and included in national income because it forms part of the producer's real income.

Transfer payments.

These are payments made without corresponding the exchange of goods and services. They are referred to as non-quid pro quo payments.

Subsistence output/non marketed output.

This refers to output for producer's own consumption.

UNEB 2014

(i) Differentiate between transfer earnings and transfer payments. (02 marks)

(ii) Give any two examples of transfer payments in your country. (02 marks)

UNEB 2003

i) Distinguish between transfer earnings and transfer payme(02 marks)

ii) Mention any two sources of transfer payments in your country. (02 marks)

Sources of transfer payments.

- Government (local and central government).
- Institutions in form of firms and nongovernmental organizations.
- Individuals.
- Foreign economies and donors.

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B. **EXPENDITURE APPROACH.**

Using this approach, national income is obtained by adding up all the total amount of money spent on final goods and services by all sectors of the economy in a year. We therefore add up expenditure made by all sectors of the economy in form of-

Consumption expenditure by households (C)

Investment expenditure by business firms (I)

Government/public expenditure on goods and services (G)

Net foreign expenditure. It is equal to exports minus imports (X-M) this excludes expenditure on output from other countries by nationals

National income= C+I+G+(X-M).

NB.

Expenditure must be on final goods and services in order to avoid the problem of double counting.

However, using this approach, expenditure made on transfer payments and illegal activities should be excluded.

The value of inventories should be estimated and included in national income.

Inventories.

Inventories refer to goods produced but not yet sold in the course of the year.

C. **OUTPUT/VALUE ADDED/PRODUCT APPROACH.**

Using this approach, national income is obtained by adding up the total value added on output of all sectors of the economy at each stage of production process in a given year. We add value added in order to avoid the problem of double counting.

NB.

Value added refers to the difference between the value of the final output and the value of intermediate input at each stage of production.

Or

It is the difference between the value of material input and output at each stage of production. It is the utility added to the commodity at different stages of production.

For example, if farmer produces and sells maize to firm B at shillings 1,000 per kg, firm B packs it and sells at shillings 1,800 per kg to firm D and firm D packs it and later sells to consumers at shillings 2,200 per kg.

Value added will be= 1,000 + 200+600+400

National output=shillings 2,200.

NB total value added should be equivalent to the final price of commodity.

SUMMARY OF THE THREE APPROACHES OF MEASURING NATIONAL INCOME.

a) Income approach presents difficulties to use in developing countries because of lack of enough information on all incomes earned since the people are self employed and it is hard to value their services in terms money, makes it hard to estimate value of subsistence output, there difficulty in collecting data from incomes because of scattered business units.

b) Output approach is the most appropriate in developing countries as output is tangible unlike income and expenditure. With this method problem of valuing subsistence output and double counting are easily overcome. It is more direct and easy to sum up value added by sectors of the economy.

THE CIRCULAR FLOW OF INCOME.

This refers to the flow of income and expenditure among different sectors of the economy. These sectors include.

(i) The household sector (C)
(ii) The business sector (I)
(iii) The government sector (G)
(iv) The foreign sector (x-m).

THE CIRCULAR FLOW OF INCOME IN A TWO- SECTOR MODEL.

This is a model that shows the flow of resources, commodities (real flow) and the flow of expenditure and incomes (monetary flows) between households and firms in an economy in a given time.

Assumptions of the circular flow of income in a two sector model.

- There is existence of only two sectors that is household sector and business sector.
- Assumes a closed economy.
- No government intervention.
- Household sector consists of owners of factors of production.
- The household sector consists of consuming class.
- There is full employment of all factors of production.
- All incomes earned by all sectors is spent i.e. no savings.
- All production takes place in business sector and no consumption in this sector.

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The circular flow of income in a two-sector model.

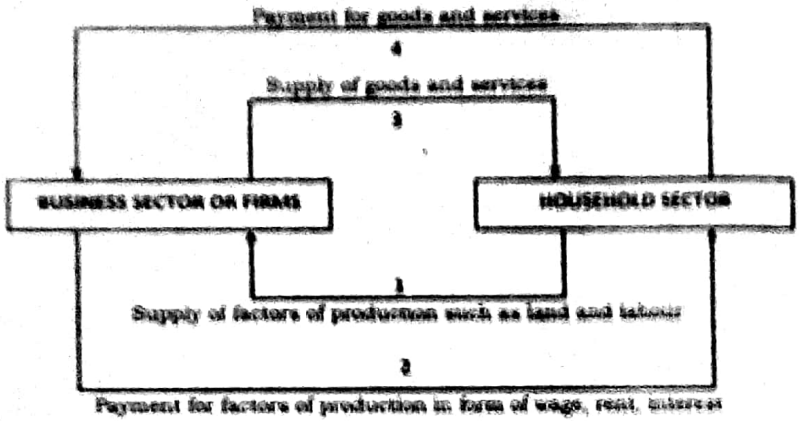

Figure 4.1: the circular flow of income in a two sector model

- Arrow 1 indicates that in order to produce goods and services, firms must acquire factors of production from the household sector.
- Arrow 2 indicates that firms pay for factors of production acquired from the household sector.
- Arrow 3 indicates that after acquiring factors of production, firms produce goods and services that are supplied to the household sector.
- Arrow 4 indicates that the household sector pays for the goods and services supplied to them by firms.
- Arrows 1 and 3 indicate or show real flows. These show the flow of goods, services and factors of production and does not involve money.
- Arrows 2 and 4 indicate or show monetary flows/financial flows. These show payment for goods, services and factors of production.
- It is noted that the value added on goods and services by firms is equal to the household expenditure on such goods and services, therefore, O=E.
- Output by firms from factors of production is equal to income obtained from the sale of such goods and services, therefore O=Y.
- All income earned by households is spent on goods and services, therefore expenditure is equal to income E=Y

Therefore, if O=E, O=Y, E=Y, then it follows that O=Y=E. this follows/means that the three approaches of measuring national income yield the same results if there are no statistical errors made in calculation.

NB. An open economy is one which carries out international trade transactions. In an open economy, national income=C+I+G+(X-M).

A closed economy is one which does not have international trade transactions. In a closed economy, national income=C+I+G.

UNEB 2008.

a) Explain the importance of computing national income in an economy. (10 marks)

b) What are the problems faced while computing national income. (10 marks)

IMPORTANCE OF MEASURING /COMPILING NATIONAL INCOME.

1) **It is a basis of economic planning and analysis.** National policy analysis on economic issues such as unemployment, inflation basing on the level of output, income, expenditure and investment through making necessary research is revealed by the size of national income.
2) **It is used to measure percapita** income and **show the trend of development.** This can only be obtained when national income is in place which helps to show the trend of development.
3) **It identifies leading sectors and** weak sectors of the **economy/it shows relative importance of** various productive sectors **of the economy.** This is interms of their productivity and **their total** contribution to the total national output helps to identify weaknesses in the structure of the economy.
4) **It show income/resource didtribution.** Its applications is a basis of analyzing how income is spread Among the various sections of thew population, thus a basis of **ensuring fair** income distribution by taking appropriate actions.
5) **It indicates the rate of economic** growth over time. High national income implies high level of economic growth between given years abd low National income implies low rates of economic growth which helps to show annual growth rate.
6) **It is helpful in soliciting foreign aid. Bi lateral** and multi lateral donors require national income figures as a basis of determining the capacity of the country to repay or which sectors tp sponsor before channeling their resources in form of foreign aid.
7) **It shows patterns of national expenditure by both the public and private sectors.** Expenditure approach is a basis of determining of the modes of expenditures by different sectors of the economy.
8) **Its used for international comparisons between countries.** Copperative analysiss especially using pre capital income helps to determine the standard of living of a given country in relation to other countries.
9) **It is used for comparison purposes over time with in a country.** For instance standard of living with in a country.

UNEB 1999

a) Distinguish between gross national product (GNP)and gross domestic product (GDP). (04 marks)

b) Why is it necessary to compute national income statistics (16 marks)

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UNSB 3007

a) Why is it necessary to measure national income (08 marks)

b) Explain the problems encountered in measuring national income (12 marks)

WHY IS IT NECESSARRY TO COMPILE/COMPUTE NATIONAL INCOME OR REASONS FOR COMPILING/MEASURING NATIONAL INCOME.

- For economic planning and policy analysis
- To measure per capita income
- To resource/income distribution.
- To solicit for foreign aid.
- To analyse paterns of national expenditure by both the public and private sectors.
- For international comparisons between countries.
- To identify relative importance of various productive sectors of the economy/identify leading and lagging sectors of the economy.
- To measure the rate of economic growth over time.
- For comparison purposes with in a country over time.

PROBLEMS/CHALLENGES/DIFICULTIES ENCOUNTERED WHEN MEASURING / COMPILING NATIONAL INCOME STATISTICS.

LDCs face both statistical and conseptial problems while compiling anational income.

Statistical problems are practical problems which orrigate from the difficulties/failure of collecting necessary information. These are problems related to handling statistics of national income.

Conceptual problems.

These are difficulties originating from the failure to define properly the concept of national income. They originate from the difficulty on what to include ane exclude in national income.

1. **Problem of double counting.** Thts is the act of estimating the value of the commodity more than once. This arises from the failure to distinguish between intermediate and finished goods for instance baking flour and sugar are both intermediate goods and finished goods and are likely to be counted twice.
2. **In adequate statistical data/information.** There is limited data on private incomes in self employment, private consumption and data that relate to various necessary variables.
3. **Problem of valuing subsistence output/non marketed output.** Output if such production is very difficult to measure in monetary terms and yet it has value which should be include in national income.

4. **Errors of omission and commission.** In the process processing and analyzing data, statistics are likely to be for instance, shillings 9,000 may be written as Sh 900 the error of omission and shillings 900 may be written as and this becomes the error of commission. Such errors due to lack of skills and this give wrong national income figure
5. **Difficulty in calculating net income earned from abroad.** a countrywho are abroad are difficult to determine how much during data collection and it not easy to measure what foreigners the country.
6. **Difficulty in valuing government output/services.** It is very determine the monetary value of public schools, roads, public security services and yet they have value which must be national income.
7. **Problem of calculating depreciation cost.** The cost of during production process is not easy to estimate and yet revealed to calculate net national product.
8. **Problem of changes in price level/inflation.** National measured in monetary terms, but money changes value whenever change and this gives exaggerated figure of national income
9. **Problem of illegal activities.** Income from illegal activities prostitution, theft, smuggling, and black marketing is very diffi know since it is not supposed to be included in national income
10. **Difficulty in determining the boundary of production.** The problem of determining what to include or exclude when me national income which gives unrealistic results.
11. **Difficulty in valuing work in progress and inventories.** The goods not yet sold to customers during the course of the year a in progress is difficult to value in monetary terms when co national income.
12. **Shortage of trained personnel/labour and inadequateequi** The process of computing national income requires ent staticians, economists, accountants and researchers who are sca in most LDCs. There is lack of enough facilities such as com computers/ calculators to analyze and store information for fur
13. **Problem of valuing unpaid for services.** This includes ser housewives which must be valued and included in national inc these are just estimated and this given unrealistic income figures.

PATTERNS OF INCOME DISTRIBUTION.

Income distribution. This refers to the spreading out of and services (resources) among various social groups of

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Income inequality. This refers to the economic gap/distance between the very rich and the very poor sections of the population.

Income inequality exists in form of individual inequality, regional inequality, sectoral inequality and intersectional inequality.

The pattern of income distribution in East Africa is unfair where income is concentrated in the hands of few individuals and therefore some people are worse off than others. This implied that there is a big gap between the rich and the poor.

UNEB 1998.

a) Account for income inequalities in your country (10 marks)
b) What policy measures have been adopted to reduce income inequalities in your country (10 marks)

CAUSES OF INCOME INEQUALITY/ DISPARITIES IN UGANDA.

NB. Two sided points beginning with the phrase differences should be presented and explained showing high income and low income.

1. **Differences in regional distribution of natural resources.** Some regions are endowed with abundant and high quality natural resources such as fertile lands, minerals, water resources are exploited which provide high income to people while areas with limited natural resources provide low income to the population.
2. **Differences in distribution of infrastructure.** Areas with well-developed infrastructure such as roads, schools, power supply and banking facilities facilitate more production hence high income to people while in areas with limited infrastructure, production and economic activities are limited hence low income to people.
3. **Differences in physical ability/strengthamong individuals.** Strong and energetic people are able to perform a variety of activities and get high income compared to weak individuals who are unable to perform several activities who get low income.
4. **Differences in employer's ability to pay.** Some employers have huge businesses and pay high wages to workers hence high income but some employers have small businesses and are unable to pay high wages to workers hence low income.
5. **Differences in individual's natural talents.** Talented individuals such as popular musicians footballers and athletes exploit their talents and get high income while less talented individuals get low income.
6. **Differences in political atmosphere between regions.** Politically stable regions attract infrastructural development and different forms of business which provide high income to people compared to politically

unstable regions which discourage investments because of insecurity for life and business hence low income to people.

7. **Differences in level of education and skills.** Usually highly educated and skilled people are employed in highly paying jobs and earn high income while less educated and unskilled people have low income.
8. **Differences in family/social background.** People are born in different families in relation to wealth possession. Some people get high income because of inheriting property form rich parents while those from poor family background remain with loess income.
9. **Discrimination in the labour market.** Discrimination by employers of some workers basing on age, religion, sex, family background, political parties, colour leads to high income inequality since a great majority of people unemployed. Therefore those who are favoured get high income while those who are not favoured get low income.
10. **Differences in nature of occupations/jobs.** Some occupations are highly paying and give high income to people such as risky jobs while other occupations are less paying hence low income to people such as less risky jobs.
11. **Differences in access to credit and vital contracts.** Individuals that are able to access credit and vital contracts are able to expand their investments and get more richer hence high income but individuals that are unable to access credit remain with low income.
12. **Differences in strength of trade unions.** Strong trade unions such as Uganda Law Society are able to bargain for high income and other better conditions of work for their members hence high income while weak trade unions are unable to bargain for high income for their members.
13. **Differences in working experience/seniority.** Highly experienced labour generally gets high income while less experienced and junior workers get low income.
14. **Differences in individual's ability to bargain for income.** Individuals with high ability to bargain for high income get high income while individuals with limited ability to bargain for high income get low income.
15. **Differences in elasticity of supply of labour.** Labour whose supply is inelastic gets high income while labour whose supply is elastic gets low income.
16. **Differences in number of hours worked.** Those who work for many hours get high income while those who work for less hours get low income basing on time rate method of wage payment.
17. **Political influence in allocation of resources in favour of certain regions/sectors.** Those are politically favoured get high income while those that are not politically favoured get low income.

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Income inequality. This refers to the economic gap/distance between the very rich and the very poor sections of the population.

Income inequality exists in form of individual inequality, regional inequality, sectoral inequality and intersectional inequality.

The pattern of income distribution in East Africa is unfair where income is concentrated in the hands of few individuals and therefore some people are worse off than others. This implied that there is a big gap between the rich and the poor.

UNEB 1998.

a) Account for income inequalities in your country. (10 marks)
b) What policy measures have been adopted to reduce income inequalities in your country. (10 marks)

CAUSES OF INCOME INEQUALITY/ DISPARITIES IN UGANDA.

NB. Two sided points beginning with the phrase differences should be presented and explained showing high income and low income.

1. **Differences in regional distribution of natural resources.** Some regions are endowed with abundant and high quality natural resources such as fertile lands, minerals, water resources are exploited which provide high income to people while areas with limited natural resources provide low income to the population.
2. **Differences in distribution of infrastructure.** Areas with well-developed infrastructure such as roads, schools, power supply and banking facilities facilitate more production hence high income to people while in areas with limited infrastructure, production and economic activities are limited hence low income to people.
3. **Differences in physical ability/strengthamong individuals.** Strong and energetic people are able to perform a variety of activities and get high income compared to weak individuals who are unable to perform several activities who get low income.
4. **Differences in employer's ability to pay.** Some employers have huge businesses and pay high wages to workers hence high income but some employers have small businesses and are unable to pay high wages to workers hence low income.
5. **Differences in individual's natural talents.** Talented individuals such as popular musicians footballers and athletes exploit their talents and get high income while less talented individuals get low income.
6. **Differences in political atmosphere between regions.** Politically stable regions attract infrastructural development and different forms of business which provide high income to people compared to politically unstable regions which discourage investments because of uncertainty for life and business hence low income to people.
7. **Differences in level of education and skills.** Usually highly educated and skilled people are employed in highly paying jobs and earn more income while less educated and unskilled people have low income.
8. **Differences in family/social background.** People are born in different families in relation to wealth possession. Some people get high income because of inheriting property form rich parents while those from poor family background remain with loess income.
9. **Discrimination in the labour market.** Discrimination in favour of some workers basing on age, religion, sex, family background, political parties, colour leads to high income inequality since it leaves out majority of people unemployed. Therefore those who are favoured get high income while those who are not favoured get low income.
10. **Differences in nature of occupations/jobs.** Some occupations are highly paying and give high income to people such as risky jobs while other occupations are less paying hence low income to people such as less risky jobs.
11. **Differences in access to credit and vital contracts.** Individuals that are able to access credit and vital contracts are able to expand their investments and get morericher hence high income but individuals that are unable to access credit remain with low income.
12. **Differences in strength of trade unions.** Strong trade unions such as Uganda Law Society are able to bargain for high income and other better conditions of work for their members hence high income while weak trade unions are unable to bargain for high income for their members.
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16. **Differences in number of hours worked.** Those who work for many hours get high income while those who work for less hours get low income basing on time rate method of wage payment.
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ADVANTAGES OF INCOME INEQUALITY IN AN ECONOMY

- **Creates harmony and respect between employees and employers.** This creates good employer-employee relationship. The poor workers respect their rich bosses.
- **Encourages labour mobility.** As the poor strive to get better paying jobs they move from one place or job to another.
- **Encourages innovativeness and creativity among the poor.** This leads to development of a large entrepreneur class as poor people try to copy the rich.
- **Forces the government to undertake income redistributive measures** such as progressive taxation, poverty alleviation, empowerment of the poor.
- **Presenceof cheap labour farm those occupations which are undertaken by the poor.** This increases labour supply to even unattractive jobs.
- **Results into an increase in investment among the rich.** This because rich people tend to have high marginal propensity to save and are able to invest more and take the advantage of the poor who are the majority.
- **Encourages hard work and effort among the poor.** This results into more out in the long run.
- **It is a source of government revenue through progressive taxation.** This helps to provides social services.

DISADVANTAGES OF INCOME INEQUALITY IN AN ECONOMY.

1. **Reduces government tax revenue.** This is especially where the majority are poor and unemployed which means that they have no capacity to pay taxes since they have no incomes to tax.
2. **Leads to misallocation of resources.** The rich tend to influence effective demand thus luxurious commodities demanded by the rich are produced leaving poor people with limited commodities.
3. **Reduces aggregate demand.** This is especially where the majority are poor and this discourages production since they have low purchasing power.
4. **Leads to brain drain.** This is brought about by unfair treatment of workers which limits development of manpower.
5. **Increases rural urban migration and its evils.** Poor people tend to move to urban areas expecting to get better paying jobs.
6. **Increases government expenditure** in providing social services and subsidizing the poor thus budgetary deficits.
7. **Leads to exploitation and domination of the poor by the rich.** Major political and economic decisions are made by rich people on behalf of poor people.

8. **Creates social tension and conflicts between** the rich and the poor. This leads to disharmony between individuals and even political instability.
9. **Increases capital outflow.** This is especially when the majority people are non-citizens of the country. Besides most developing countries prefer to invest their capital in foreign countries that are economically stable.
10. **Leads to overdependence of the poor on the rich.** This increases dependence burden thus limiting savings.
11. **Leads to low standard of living among the poor.** The poor tend to live below the minimum economic welfare.
12. **Leads to regional imbalances in development.** Some regions develop at the expense of others depending on differences in income.

MEASURES THAT SHOULD BE ADOPTED TO REDUCE/OVERCOME INCOME INEQUALITY IN LDCs.

1. **Improve and maintain political stability throughout the country.** The government should continuously campaign for political stability by holding peace talks with rebels and ensure good governance to encourage investment in all parts of the country which increases employment and income.
2. **Provision of affordable loans or credit to the poor/establishment of credit schemes for the poor.**
Poor people should be helped to have access to affordable loans through establishment of rural financial institutions such as village banks, micro-finance institutions and SACCOS. These will help the rural poor to engage in small-scale businesses and generate incomes.
3. **Adopt population control measures.** This should be encouraged through family planning measures, especially in rural areas where birth rates are high so as to reduce dependency burden and increase savings. This reduces dependence burden which increases savings and investment among people and increase their income.
4. **Adopt land tenure reforms.** The way in which land is owned should be changed so a s to enable majority of poor people acquire land from rich landlords and participate in production to increase their income.
5. **Emphasis on developing sound infrastructure.** The government should rehabilitate existing infrastructure and establish new ones such as roads, railway, power supply facilities, banking institutions to encourage increase investment and resource utilization to avail income to the poor.
6. **Use of progressive taxation.** High taxes should be imposed on individuals and high income earners. This income should be used to subsidize the poor and uplift their income.

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7. **Encourage education reforms.** There should be introduction of practical subjects to increase labour skills, employment opportunities and income.

8. **Promote diversification of the economy.** Agricultural diversification should be emphasized by introducing several crops and animal varieties and establishment of both small and large scale industries to reduce over reliance on agriculture whose prices are ever fluctuating leading to more employment and increase income.

9. **Use of decentralized governance.** This should be ensured and maintained to encourage participation of all nationals in affairsof development from the grass root level and increase projects, employment and incomes at local levels.

10. **Promote modernization of agriculture.** Agriculture is carried out by the majority of the population, therefore policies should be put in place to increase and stabilise prices of agricultural products to avail the rural people with enough income through strong commodity agreements, emphasizing the role of cooperatives to increase employment and income among farmers.

11. **Increase government expenditure to develop disadvantaged group and regions.** The government should increase expenditure to poor regions to enable such regions get access to income generating projects and increase income.

12. **Improvement in investment climate.** This should be done through fair taxes on producers, establishing mi9nstitutions to encourage investment so as to increase employment opportunities and income.

13. **Liberalization of the economy.** This attracts many economic activities which increases participation in production thus high employment opportunities and income.

14. **Raise wages of low income groups.** The government should raise wages of low income groups so as to reduce wage differentials between occupations and close the income gap.

15. **Encourage development of small scale enterprises.** The development of small scale industries and other enterprises should be adopted especially in rural areas so as to increase income generating activities.

UNEB 2007.

a) Account for uneven distribution of income in your country. (10 marks)

b) What measures have been adopted to minimize uneven distribution of income in your country? (10 marks)

MEASURES THAT HAVE BEEN ADOPTED TO MINIMIZE UNEVEN DISTRIBUTION OF INCOME IN UGANDA.

1. **Used progressive taxation.** The rich have been taxed highly than the poor which has reduced income gap.
2. **Adopted land tenure reforms.** This has been done to allow many people especially the poor to access land and participate in production to increase onthein income.
3. **Educational reforms.** This has been done through emphasizing science and practical subjects so as to increase labour skills necessary for increased employment and income generation.
4. **Improved political climate.** This has been done through encouraging political stability in all parts of the country so as to increase investment, employment and income.
5. **Provision of investment credit/affordable loans to poor people.** Credit facilities have been provided to the poor at low interest rates to as to set up income generating projects.
6. **Diversification of the economy.** This has been emphasized so as to reduce dependence on agriculture and this has created many economic activities leading to increased employment and income.
7. **Controlled population growth rates.** This has been done by employing family planning methods so as to reduce dependence burden, increase saving and investment to create more income.
8. **Agricultural modernization.** This has been done through increased mechanization, supply of subsidized inputs to farmers so as to increase production in rural areas and increase income.
9. **Decentralization of governance.** This has been done to encourage planning at local levels so as to absorb rural opportunities, increase investment and income.
10. **Liberalization of the economy.** Unnecessary government controls on economic activities have been removed which has increased establishment of projects to provide more income to the population.
11. **Improvement in infrastructure.** This has been done through constructing more roads, power supply systems so as to facilitate more income generating activities and spread employment opportunities.
12. **Improved investment climate.** This has been done through providing tax holidays, tax exemptions and subsidies to various investors so as to increase investment opportunities and income.
13. **Increased government expenditure to develop disadvantaged regions and groups.** This has been done through provision of free education to the poor for instance universal primary and secondary education, establishment of projects for disabled people.
14. **Encouraged development of small scale enterprises.** The development of small scale industries and other enterprises has been

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emphasized especially in rural areas so as to increase income generating activities.

STANDARD OF LIVING AND PERCAPITA INCOME.

Standard Of Living.

Standard of living refers to conditions of life in which people live or hope to live.

Or

It refers to socio-economic wellbeing/welfare of an individual or society as represented by the basket of goods and services consumed.

Or

It refers to the measure of the level of social and economic welfare of an individual or society as represented by the basket of goods consumed.

It is all about the conditions of living among the people as measured in terms of welfare and normally indicated by the quality and quantity of goods and services consumed.

Percapita Income.

Percapita income is the average income per individual of a country ina given year. **Or**

It refers to income perhead in a country usually a year.

Percapita income= GNP of the year

Total population of the same year.

It is used as a good indicator of standard of living in a country at specific period, over time and comparing standard of living between countries.

Given that the GNP of country X is $1200 million and total population is 20 million people for a given year. Calculate percapita income for such a country.

Percapita income=**GNP of the year.**

Total population.

$ 200m/20m people

Percapita income= $60.

UNEB 2006.

a) Distinguish between cost of living and standard of living. (04 marks)

b) Explain the factors that influence people's standard of living in an economy. (16 marks)

DETERMINANTS OF STANDARD OF LIVING IN AN ECONOMY/FACTORS THAT INFLUENCE/AFFECT PEOPLE'S STANDARD OF LIVING IN AN ECONOMY.

NB. *Neutral points are presented and explained in two ways namely standard of living and low standard of living.*

1. ***General price level/rate of inflation.*** *Low general price level/low cost of living which leads to high standard of living.*
2. ***Nature of income distribution.*** *Uneven distribution of national income is in the hands of few individuals implies low standard of living while fair income distribution among individuals leads to high standard of living.*
3. ***Level of education and skills.*** *High level of education and skills increases the standard of living while low level of education and skills leads to low standard of living.*
4. ***Degree of political freedom.*** *High degree of political freedom leads to high standard of living while limited political freedom leads to low standard of living.*
5. ***Degree of social costs/level of environmental pollution.*** *High degree of social costs inform of air, land and water pollution leads to low standard of living while limited social costs leads to high standard of living .*
6. **Nature of goods produced.** *Production of more capital goods may not improve welfare directly while production of more consumer goods improves standard of living directly.*
7. **Level of income.** High level of income among the population implies high standard of living.
8. **Quality and quantity of goods and services produced.** *High quantity of goods and services produced and of high quality lead to high standard of living .*
9. **Level of employment in the country.** High level of employment in the labourforce implies high standard of living while low level of employment leads to low standard of living.
10. **Level of development of social and economic infrastructure.** High level of infrastructure development inform of health facilities, transport facilities, power supply increases production hence high standard of living while low level of infrastructure development implies low standard of living.
11. **Availability of time for leisure.** presence of enough leisure time implies that people do not overwork hence high standard of

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limited time for leisure implies that people overwork to increase production hence low standard of living

12) **Political climate.** Favourable political climate increases production and security for life and property hence high standard of living while political instability discourages production, creates uncertainty for life and property which leads to low standard of living.

PERCAPITA INCOME AS A MEASURE OF STANDARD OF LIVING

Percapita income is used as a good indicator of [illegible] in a country at specific period, overtime and comp[illegible] of living between countries. However percapita income is [illegible] indicator of standard of living in an economy at a given period [illegible] and between countries.

UNEB 2002.

a) Distinguish between standard of living and cost of living (04 marks)
b) Why may percapita income not be a good indicator of standard of living? (10 marks)

1. **Reasons why percapita income may not be a good measure of standard of living in an economy/a country.**

Holding other factors constant, high percapita income in a country should be an indicator of high standard of living while low percapita income should be an indicator of low standard of living.

However, high percapita income does not necessarily imply high standard of living and low percapita income does not necessarily imply low standard of living in a country because percapita income ignores a variety of aspects that influence standard of living.

Percapita income may not be a good measure of standard of living in an country at a given time because of the following.

1) **It ignores the nature of income distribution.** Percapita income may be high where income is unevenly distributed, concentrated in the pockets of the rich sections/in the hands of few rich people while majority are actually suffering hence high degree of income inequality and this does not imply high standard of living.
2) **It does not consider the nature/type ofgoods produced.** Percapita income may be high in a country which produces capital goods such as machinery which do not improve welfare directly and percapita income may be low where there is production of consumer goods which improve welfare.
3) **Percapita income does not take into account the amount of leisure enjoyed and foregone.** Percapita income may be high where people over work and forgo leisure to increase output which reduces welfare and low

percapita income where people have enough time for leisure does not mean low standard of living.

4) **It ignores the size of subsistence output.** Percapita income may be low where there is a large subsistence sector and this will not imply low standard of living because many of goods produced are not counted in GNP and they contribute to standard of living.
5) **It does not consider the level of social costs.** Percapita income may be high where there are high social costs such as pollution which reduce standard of living and low percapita income where there are low social costs does not imply low standard of living.
6) **It does not consider level of accuracy of statistical data.** Percapita income may be high or low because of inaccurate population figures made during population census and this is likely to reflect a low or a high standard of living which may not be realistic.
7) **It does not consider the patterns of government expenditure/how income is spent.** Percapita income may be high when government is spending highly most of its income on non-productive activitiessuch as military hardware which do not contribute to welfare directly and this does not mean high standard of living.
8) **It ignores political climate of the country.** Percapita income may be high in a country where there are political instabilities and this will not mean high standard of living and low percapita income where there is political stability does not mean low standard of living.
9) **It ignores tastes and preferences of the population.** Percapita income may be high in a country where produced goods and services are not in line with tastes and preferences of people and this will not mean high standard of living.
10) **It ignores the level of employment in a country.** Percapita income may be high in a country where there is high rate of unemployment due to the use of capital intensive technology in production which affects the welfare of people and low percapita income where majority are employed doesnot mean low standard of living.
11) **It ignores price level/rate of inflation.** Percapita income may be high because of high national income figures as result of inflation and this will not mean high standard of living and low percapita income where there is no inflation does not imply low standard of living.
12) **Percapita income does not consider the nature and level of taxation on incomes.** High percapita income where people are subjected to unfair direct taxes reduce the standard of living.
13) **It ignores working conditions/occupational hazards.** Percapita income may be high and yet workers are subjected to high occupational hazards and this does not imply high standard of living.
14) **It does not consider the quality of goods produced.** Percapita income may be high when the quality of goods produced is poor and this

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will not imply high standard of living and low percapita income but with high quality goods produced does not imply low standard of living.

UNEB 2011.

a) *Differentiate between disposable income and percapita income (04 marks)*

b) *What are the limitations of using percapita income to compare standards of living between countries. (16 marks)*

2. Why may percapita income not be a good measure of standard of living between countries?

If country K has high percapita income than country M, does it mean that people in country K are enjoying a higher standard of living than those in country M?. percapita income ignores the fact that various factors that influence standard of living differ from country to country.

Percapita income may not be a good measure of comparing standard of living between countries because of the following g.

1. **Percapita income ignores differences in nature of income distribution between countries.**
   Percapita income may be high in a country where income is in the hands of few individuals which may not mean high standard of living and low percapita income in another country where income is evenly distributed does not mean low standard of living.
2. **It ignores differences in the nature/type of goods produced between countries.** A country with high percapita income may be producing capital goods which do not contribute directly to standard of living and another country with low percapita income may be producing consumer goods which enrich the standard of living.
3. **It ignores differences in price levels/structures (rate of inflation) between countries.** This is due to differences in currencies which have different purchasing power. One country may have high percapita income because of inflation and high price structure but this does not mean high standard of living than another country with a low price structure and free from inflation.
4. **It does not consider differences in level of subsistence sector/production between countries.** Percapita income may be low in one country than the other because of high subsistence production but this contributes to standard of living.
5. **It ignores differences in levels of accuracy of statistical data between countries.** Percapita incomemay be high or low in one country because of inaccurate population figures during population census and this doesnot mean that it enjoys low or high standard of living than another country.
6. **It does not consider differences in the amount of ... and foregone by people between countries.** High ... country where people forego leisure to increase output ... that such a country enjoys high standard of living than ... low percapita income but where people have enough time for ...
7. **It ignores differences in level of employment** between ... high percapita income in one country where machines ... labour to increase output is an indicator of low standard of ... country where majority are employed but with low percapita ...
8. **It ignores differences in political climate** between ... Percapita income may be high in one country where there ... instabilities and therefore uncertainty about life and proper... does not mean high standard of living but low percapita ... politically stable country does not mean low standard of living.
9. **It does not consider differences in level and nature of ... incomes between countries.** High percapita income in ... where people are subjected to heavy and unfair taxes will not ... standard of living compared to a country with fair direct taxes ... low percapita income.
10. **It does not consider differences in tastes and prefer... people between countries.** High percapita income in a country ... produced goods and services are not in line with tastes and pre... of people doesn't mean high standard of living and low percapita ... in another country where produced goods and services are ... tastes and preferences of people may not mean low standard of ...
11. **It does not take into account differences in requir... between countries due to climatic differences.** In European ... since it is not necessary to have such facilities.
12. **It does not consider differences in social costs ... countries.** Percapita income may high in a country where there ... social costs which does not mean high standard of living than ... with low percapita income and low social costs.
13. **It does not consider differences in quality of goods pr... between countries.** Percapita income may be high in one country ... the produced goods and services are of a poor quality which d... mean high standard of living than a country with low percapita ... but where the produced goods and services are of a high quality.
14. **It ignores differences in boundary of production and met... compiling national income between countries.** These give ... results which make percapita income differ which is not a true ... on standard of living.
15. **It ignores differences in patterns and nature of gov... expenditure between countries.** Percapita income may ... country when government is spending highly on ...

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activities such as military hardware which do not contribute to welfare directly and this does not mean high standard.

10. **It ignores differences in transport costs/costs of production between countries.**

UNEB 2005.

a) *Distinguish between real income percap... ...inal income percapita (04 marks)*

b) *What are the limitations of using percapa... ...elfare of people in a country overtime. (16 mark...*

3. Why may percapita income not be a good ... ... standard of living/welfare in a country overtime?

Low percapita income in one period and high percapita income in another period may not form a strong foundation to conclude on standard of living between those two periods because such a situation ignores the fact that there are changes that take place overtime in major variables that influences standards of living not necessarily only percapita income.

Percapita income may not be a good measure of standard of living in a country overtime because of the following.

- Percapita income ignores changes in distribution of income overtime.
- It ignores changes in composition/type of goods produced overtime.
- It does not take into account changes in working conditions over time.
- It doesnot consider changes in price levels/rate of inflation overtime.
- It ignores changes in level of subsistence production overtime.
- It ignores changes in accuracy of statistical data over time such as population figures.
- It does not consider changes in the amount of leisure enjoyed by people overtime.
- It doesnot take into account changes in the nature andpatterns of government expenditure over time.
- It does not consider changes in quality of goods produced overtime.
- It does not consider changes in level of employment overtime.
- It ignores changes in political climate overtime.
- It ignores changes in the level and nature of taxation on income overtime.
- It ignores changes in tastes and preferences of people overtime.
- It does not consider changes in social costs overtime.

PRICE INDEX.

Price index is a measure of relative changes in prices from one period to another/overtime.

It measures relatives changes in prices overtime/between two periods. It helps to determine whether there has been an increase or a decrease in

general price level and hence determines an increase or a decrease in standard of living and cost of living between two periods.

Consumer price index. This is a measure of relative changes in prices of selected consumer goods overtime.

Costs of living index. *This is a measure of relative changes in prices of basic needs of a group of people overtime.*

Or

It is a measure of relative changes in prices of basic needs of people from one period to another/overtime.

All prices in the base year are given an index of 100 as a point of economic stability.

Producer price index. *This is a measure of relative changes in prices of goods sold by manufacturers in a given period of time.*

Retail price index. *This is a measure of relative changes in consumer prices overtime.*

Price index of GDP. *This is a measure of relative changes in prices of both consumer and capital goods overtime.*

COST OF LIVING.

Cost of living refers to the amount of money required by an individual to sustain the life style he is accustomed to.

Or

Cost of living refers to amount of money required by an individual to maintain a given level of welfare/standard of living in terms of goods and services.

UNEB 2008.

Describe how price indices are computed in an economy (06 marks)

PROCEDURE FOR COMPUTING PRICE INDICES.

1. **Selecting a suitable base year.** The base year is any previous year when the prices of commodities were relatively stable/reflecting normal economic conditions. It should be a year of no production shortages, price stability and no trade malpractices. The index of the base year is always given as a standard index of 100 as an indicator of price stability.
2. **Selecting a basket of commodities/goods.** A number of commodities are selected and these must be a representative of the whole society which arte popularly bought. This can be done by interviewing households, personal visits to retail shops for instance beans, meat, Sugar, soap and rice.
3. **Collecting prices of commodities.** Prices of the selected commodities both in the base year and the current year are obtained.
4. **Calculating simple price index/price relatives for each commodity.** This relates the price of the current year to the price of the base year. This is also called current year index.

$$\text{Simple price index/price relatives} = \frac{\text{current year price}}{\text{Base year price}} \times 100$$

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5. **Calculating average simple price index for the year.** This is for all commodities in the basket.

ASPI=Summation of price relatives/simple price index
Number of commodities.

- When ASPI is above 100, it implies an increase in the general price level.
- When ASPI is equal to 100, it implies that the general price level remained constant.
- When ASPI is below 100, it implies a reduction in the general price level.

6. **Attaching weights to the selected commodities.** Weight of a commodity is the relative importance which a customer attaches to that particular commodity. Commodities are weighed according to their importance to the consumer, products which are very important to the consumer are assigned h9igher weights and those that are rarely bought have lower weights.
7. **Calculating weighted price index for each commodity.** This shows the relative importance the consumer attaches to each commodity considered.

Weighed index= price relative/simple price index for a given commodity x weight for that commodity.

8. **Calculating average weighted price index for the year.**

Average weighted index= **Total weighted index.**
Total sum of weights.

Worked examples.

Study the table below showing the country's price indices for selected commodities and answer the questions that follow.

Commodity (kg)	2000 average prices	2000 simple price index	2002 average prices	Weight
Beans	800	100	1000	3
Sugar	450	100	600	5
Maize	220	100	400	6
Rice	700	100	1200	2
Meat	550	100	950	4

Calculate;

1. Simple price index for 2002.
2. Average simple price index for 2002.
3. Weighted price index for 2002.
4. Average weighted price index for 2002.

a) **Simple price index = current year price**
Base year price x 100.

Beans = 1000/800x 100 = 125

Sugar = 600/450 x 100 =133.3
Maize = 400/220x100 =181.8
Rice = 1200/700 x 100 = 171.4
Meat = 950/550 x 100 = 172.7

Average simple price index= summation of price relatives
Number of commodities

= 125+133.3+181.8+171.4+172.7
5

Average simple price index= 784.2/5=156.8

b) Weighted index for 2002 = price relative x weight.
Beans = 125 x 3 = 375.
Sugar = 133.3 x 5 = 666.5
Maize = 181.8 x 6 = 1090.8
Rice = 171.4 x 2 = 342.8
Meat = 172.7 x 4 = 690.8

d) Average weighted index = Total weighted index
Total/ sum of weights.

375+666.5 + 1090.8 + 342.8+ 690.8
3+5+6+2+4

Average weighted index. 3165.9/20 = 158.2

i) It implies that the general price level increased by 58.2%
ii) Cost of living also increased by 58.2%
iii) Standard of living reduced by 58.2%
iv) The value of money reduced by 58.2%.

UNEB 2000

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

Commodity	Base year price (1990)	Base year index (1990)	Selected year price (1998)	Th
Beans	200	100	700	
Sugar	150	100	500	
Maize	500	100	1000	
Rice	100	100	300	
Meat	700	100	1200	

a)

Calculate,

1. Simple price index for each commodity in 1998

Simple price index= current year price
Base year price x 100

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Commodity : A = 700/200 X 100 =350

B= 500/150 X 100 = 333.3

C= 1000/500 X 100 = 200

D= 300/100 X 100 = 300

E = 1200/700 X 100 = 171.4

2. Weighted index for each commodity in 1998.
3. Weighted index = simple price index x weight

Commodity : A = 350 x 5 = 1750

B = 333.3 X 4 = 1333.2

C = 200 X 3 = 600

D = 300 X 2 = 600

E = 171.4 X 1 = 171.4

iii) Average weighted price index.

Average weighted index = total weighted index.

Total sum of weights.

1750 + 1333.2 + 600 + 600 + 171.4

5+4+3+2+1.

Average weighted index = 4454.6/15.

Average weighted index = 296.97

b) Explain the problems encountered when compiling price indices 14marks.

UNEB 2005.

a) Study the table below showing commodity prices for selected items in 2000 and 2004 and answer the questions that follow.

Commodity	*Average prices index 2000 (Ug. Shillings).*	*Simple index2000.*	*Average prices index . 2004 (Ug. Shillings)*	*Weight index 2004.*
A	*1000*	*100*	*1200*	*2*
B	*800*	*100*	*1000*	*4*
C	*400*	*100*	*650*	*3*
D	*750*	*100*	*900*	*5*
E	*1500*	*100*	*1800*	*1*

Calculate

(i) Simple index for 2004. (06marks)

(ii) Weighted index for 2004. (06marks)

b) Explain the problems which are encountered in the computation of price indices in your country. (08 marks)

i) simple index for 2004= Average price index 2004.
Average price index 20000 x 10

Commodity A= 1200/1000 x 100 = 120

B = 1000/800 X 100 = 125

C = 650/400 X 100 = 162.5

D = 900/750 X 100 =120

E = 1800/1500 X 100 = 120

(iii)Weighted index for 2004 = simple index for 2004 x weight for the commodity.

Commodity A = 120 X2 =240

B = 125 X 4 = 500

C = 162.5 X 3 = 487.5

D = 120 X 5 = 600

E = 120 X 1 = 120

UNEB 2006, 2000.

(i) Define the term retail price index. (01 marks)

(ii) Give any three uses of price indices. (03 marks)

USES OF PRICE INDICES.

- They measure changes in the value of money/rate of inflation overtime. This reveals the rate of inflation between the two time periods in the economy.
- Help in determining wages. Wages should go hand in hand with changes in general price level to avoid a decline in standard of living of workers. Wages should change according to changes in cost of living basing on sliding scale methods of wage payment.
- Help to determine tax levels/rates in different regions which should match with inflation. Direct and indirect taxes are adjusted basing on price indices for specific commodities to avoid causing an increase in cost of living.
- They are used to compare cost of living/standard of living in a country over time. Percentage changes in price help to tell changes in cost of living which has a direct impact on standard of living.
- They are used to deflate/adjust nominal national income to give real national income. This is to convert nominal GDP to real GDP.

Real GDP = Nominal GDP

GDP deflator/price index x 100.

GDP deflator is calculated the same way as price index and it covers all the sectors of the economy which are included in national income.

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Worked examples.

a) Given that a country has nominal GNP of 170 million dollars and price index of 112. Calculate real GNP for such a country.

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

170,000,000/112 x 100

Real GNP = 151,785,714.3 dollars.

B 2014

Commodity	Base year Prices 2010	Base year simple index	Current year prices 2013	Weight
Sugar (kg)	1500	100	3100	4
Beans (kg)	300	100	450	3
Rice (kg)	1200	100	1500	2
Bread (½ kg)	1200	100	1800	1

a) Calculate the:

i. Simple price index, (03 marks)
ii. Average price index, (03 marks)
iii. Weighted price index (03 marks)

For the year 2013.

b) Explain the uses of price indices in an economy. (14 marks)

UNEB 2011.

a) Why is it necessary to compute consumer price indices in your country? (08 marks)
b) Discuss the difficulties encountered when compiling consumer price indices in your country. (12 marks)

OBJECTIVES OF COMPILING CONSUMER PRICE INDEX IN A COUNTRY/WHY IS IT NECESSARY TO COMPUTE PRICE INDEX IN AN ECONOMY

- To measure changes in the value of money/rate of inflation overtime.
- To compare the cost of living/standard of living overtime.
- To determine wages.
- To measure terms of trade of a country.
- To determine tax levels.
- To determine real national income using nominal national income.

UNEB 2001

Why is computation of price indices difficult? (12 marks)

UNEB 1998

a) Explain how price indices are computed. Illustrate your [illegible] marks)
b) Why may price indices be unreliable indicators of cost of living marks)

PROBLEMS/DIFFICULTIES ENCOUNTERED WHEN COMPILING INDICES/COST OF LIVING INDEX.

(Limitations of using price indices in measuring the cost of [illegible] standard of living/why may price indices be unreliable indicators [illegible] living)

- **Difficulty in choosing a suitable base year.** A year which [illegible] relatively stable is difficult to get due to constant price changes.
- **Difficulty in attaching weights to commodities** in the [illegible] Different consumers value commodities differently and this makes [illegible] to get common weights for all consumers which gives unreal[illegible] on cost of living.
- **Changes in tastes and preferences of consumers overtime.** [illegible] place overtime and therefore a need to compile new price indices [illegible] to accommodate the changes.
- **Limited skilled personnel/labour.** The process of compiling [illegible] indices requires skilled statisticians and economists who may not [illegible] supply leading to inaccurate statistical data which may be misleading.
- **Quality improvement in products that usually affects [illegible] goods.** Changes in technology leads to quality improvement [illegible] products produced which affects price level and this is [illegible] misinterpreted to be inflation when in actual sense it is [illegible] improvement in quality of the products and ends up giving [illegible] results about standard of living.
- **Price changes within a year/existence of inflationary [illegible] deflationary tendencies.** Price changes within a year [illegible] different factors, so there are no fixed prices for the whole year [illegible] tend to alter expenditure patterns of consumers.
- **Inadequate data or information.** Most people do not keep records [illegible] some do not give the right information about actual prices of [illegible] commodities thus no standard records about prices and quantities [illegible] market.
- **Appearance and disappearance of commodities from the market/emergence of new goods and exit of old ones.** Some new goods [illegible] emerge into the market and old products disappear from the market [illegible] when the exercise has been accomplished. This gives inconsistency [illegible] about the general price level.

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- **Lack of standard measures and weighing systems for commodities.** Different commodities are sold in different units such as heaps, sacks, tins, baskets and kilograms making it difficult to determine prices.
- **Few areas are usually sampled.** Only a few areas are normally considered and the information obtained cannot be realistic to conclude for the whole country on cost of living.
- **Varying prices of goods in different regions/no uniform prices throughout the country.** Prices change from one region to another due to reasons of differences in demand, transport and bargaining power yet a uniform price is considered which makes price indices unreliable.
- **Problem of choosing representative commodities/basket of goods.** Very many products are produced and consumed and it becomes difficult to determine which commodities to consider and what commodities to leave out.

NATIONAL INCOME EQUILIBRIUM AND DETERMINATION

This is where there is no tendency of national income values to either increase or reduce.

Equilibrium is a state of balance where two aspects in question have no tendency to change.

(i) **In a closed economy and without government**

For national income to be in equilibrium in a [illegible] without government intervention, leakages of which savings [illegible] equal to injections of which investments are part.

Therefore, equilibrium under national income [illegible] point where savings are equal to investments. Therefore [illegible] savings constitute a loss out of the circular flow of income and what compensates this leakage is investment expenditure which is an injection. Therefore savings constitute leakages and investment constitutes injections.

(ii) **In a closed economy and with government intervention.**

This implies that there taxation and government expenditure on goods and services. Therefore, taxes are leakages and government expenditure constitutes injections.

Therefore, S+T=I+G.

(iii) **In an open economy and with government intervention.**

National income equilibrium is determined by leakages and injections. At equilibrium, injections and leakages should be equal that is, I+G+X=S+T+M, where X stands for exports and M stands for imports. So exports constitute injections and imports constitute leakages.

INJECTIONS

Injections are elements that add to the circular flow of income.

Or

These are additions/inflows into the circular of income. In an open economy, injections include:-

- Investments (I),
- Government expenditure (G),
- And exports (X).

Injections increase aggregate demand curve and the size of the multiplier.

LEAKAGES

Leakages are elements that reduce the circular flow of income.

Or

These are withdrawals/outflows for the circular flow of income.

In an open economy, leakages include:-

- Savings (S),
- Taxation (T),
- And imports (M).

Leakages reduce aggregate demand curve and the size of multiplier.

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UNEB 2007

i) *Distinguish between injections and leakages.* *(02 marks)*
ii) *State any two examples of leakages in your country.* *(02 marks)*

UNEB 2004,

With examples, distinguish between injections into and leakages from a circular flow of income. *(04 marks)*

NB. National income is in equilibrium when aggregate demand is equal to aggregate supply.

AGGREGATE DEMAND

Aggregate demand refers to total demand for goods and services by all sectors of an economy in a given period of time.

Or

It refers to the total amount of expenditure of goods and services by all sectors of an economy in a given period of time.

Aggregate demand is classified according to different sectors of the economy that spend.

Aggregate demand= C+I+G+(X-M), where C stands for household sector, I stands for business sector, G stands for government sector and (X-M) stands for foreign sector.

Each sector has a different demand curve, therefore summation of all these demand curves gives us aggregate demand curve.

DETERMINANTS OF AGGREGATE DEMNAD IN AN ECONOMY.

NB. These are presented as neutral points and each point is explained in two sides showing high aggregate demand curve and low aggregate demand.

1. **Level of income in an economy.** High level of income leads to high aggregate demand while low level of income leads to low aggregate demand.
2. **General price level.** High general price level for goods and services leads to low aggregate demand while low general price level leads to high aggregate demand.
3. **Population size and its growth rate.** Holding other factors constant, a large population size which grows at a high rate leads to high aggregate demand while a small population size which grows at a low rate leads to low aggregate demand.

4. **Nature of income distribution.** Even and fair distribution of income leads to high aggregate demand whereas uneven distribution of income in the hands of few individuals leads to low aggregate demand.
5. **Level of employment.** High level of employment leads to high aggregate demand while low level of employment leads to low aggregate demand.
6. **Political climate.** Favourable political climate leads to high aggregate demand whereas unfavourable political climate leads to low aggregate demand.
7. **Stock of available consumer goods and services.** A large stock of goods and services leads to high aggregate demand while a small stock of goods and services leads to low aggregate demand.
8. **Monetary policy existing in an economy.** Restrictive monetary policy reduces money supply leading to low aggregate demand whereas expansionary monetary policy reduces money supply leading to high aggregate demand.
9. **Level of capital inflow and capital outflow.** High level of foreign resources inflow and low capital outflow leads to high aggregate demand while low level of inflow of foreign resources and high capital outflow leads to low aggregate demand.
10. **Nature of taxation and subsidization.** High direct taxes and no subsidizing lead to low aggregate demand.
11. **Variety of tastes and preferences.** Tastes and preferences of the population have a special influence on aggregate demand in a country.
12. **Existing capital stock.** Large capital stock implies increased demand while a small capital stock leads to low aggregate demand.

UNEB 2011

i) *What is meant by aggregate demand.* *(01marks)*
ii) *State any three components of aggregate demand in an op* *(03 marks)*

COMPONENTS OF AGGREGATE DEMAND IN AN OPEN ECON

a) Consumption expenditure by household **C**.
b) Investment expenditure by firms (I).
c) Government expenditure (G) on goods and services.
d) Net foreign expenditure (X-M).

AGGREGATE SUPPLY

Aggregate supply. Refers to the total amount of output that and offered for sale by all sectors of the economy at a given time

Aggregate supply curve implies that all SECTORS of the econ their output as prices increase and reduce their output as prices it slopes upwards from left to right.

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Therefore, the overall macro equilibrium is determined by interaction of aggregate supply and aggregate demand curves.

Aggregate demand and aggregate supply

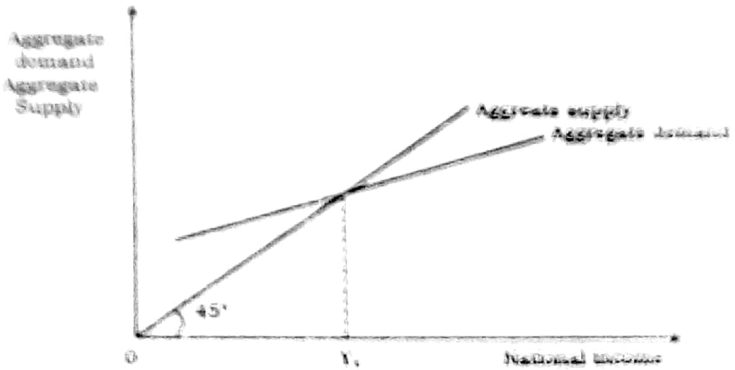

Figure 4.2: aggregate demand and aggregate supply

Y_e is equilibrium income.

UNEB 1998.

a) Distinguish between a deflationary gap and an inflationary gap (04 marks)

b) Examine the policies that a country should adopt to close

(i) A deflationary gap. (08 marks)

(ii) An inflationary gap (08marks)

NATIONAL INCOME DISEQUILIBRIUM.

Equilibrium is attained when aggregate demand equals aggregate supply and at this point. There is full employment and no need for government intervention. The planned expenditure is equal to planned output.

However, Lord Keynes disagrees that at equilibrium Ye, the economy is always at full employment. To him full employment level (YF) may be greater or less than equilibrium income. This is explained by an inflationary gap and a deflationary gap.

1. A DEFLATION GAP

A **deflationary gap** is a situation where aggregate demand at full employment level of national income

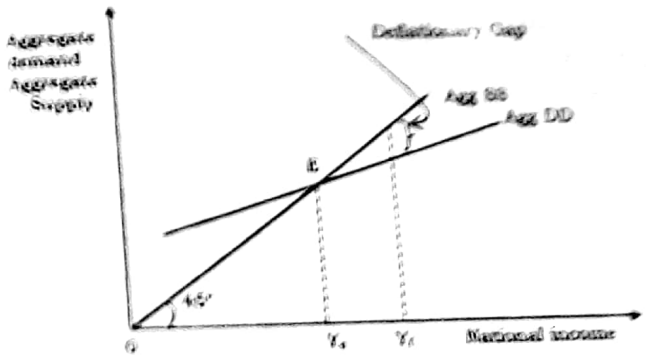

Figure 4.3: A deflationary gap

- Y_e shows equilibrium level of national income.
- Y_f shows a deflationary gap at full employment level of national income.

2. AN INFLATIONARY GAP

An inflationary gap is a situation where aggregate demand exceeds aggregate supply at full employment level of national income.

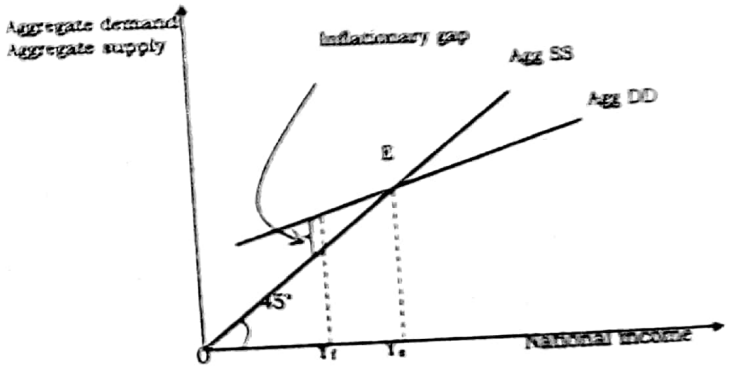

Figure 4.4: An inflationary gap

- Y_e shows equilibrium level of national income.
- Y_f shows an inflationary gap at full employment level of national income.

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POLICIES TO CLOSE A DEFLATIONARY GAP.

Closing a deflationary gap involves employing policies that help to increase aggregate demand.

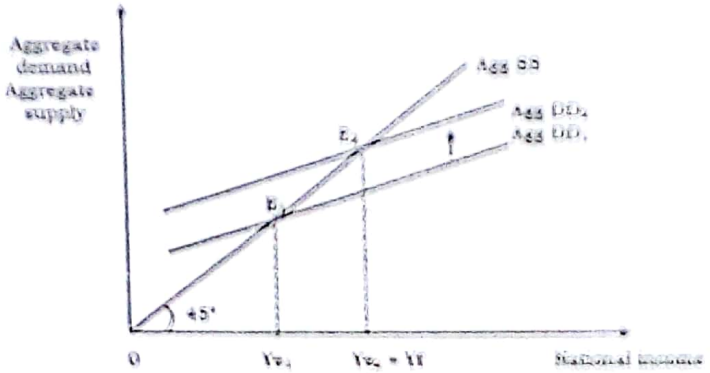

Figure 4.5: closing a deflationary gap.

Closing a deflationary gap involves increasing aggregate demand from Agg DD_1 to Agg DD_2.

Therefore at E_2 equilibrium is attained at full employment using the following policies.

- **Reducing direct taxes on people's income.** This helps to leave them with enough disable income.
- **Increasing government expenditure on employment and development projects.** This helps to increase people's income for spending and increase aggregate demand.
- **Use of expansionary monetary policy.** This is through reducing bank rate, reducing amargin requirement, buying securities from the public to increase money supply leading to increased aggregate demand.
- **Encouraging exports.** This is to increase net income from abroad for spending thus increasing aggregate demand.
- **Reducing imports of similar goods** produced to increase aggregate demand for locally produced goods.
- **Improvement in investment climate.** This is aimed at increasing employment opportunities and incomes. This is done by increasing investment expenditure and encouraging foreign investors in order to increase income and later increase aggregate demand.
- **Increasing wages of workers.** This helps to increase incomes among workers which increases consumption thus increasing aggregate demand.

- Provision of cheap loans to low income earners to increase demand for loans to undertake investments, increase consumer's purchasing power and increase aggregate demand.

UNEB 2007, 2003.

i) What is an inflationary gap. (01 marks)
ii) How can an inflationary gap be closed in an economy

POLICIES TO CLOSE AN INFLATIONARY GAP.

Closing an inflationary gap involves employing policies that lo aggregate demand.

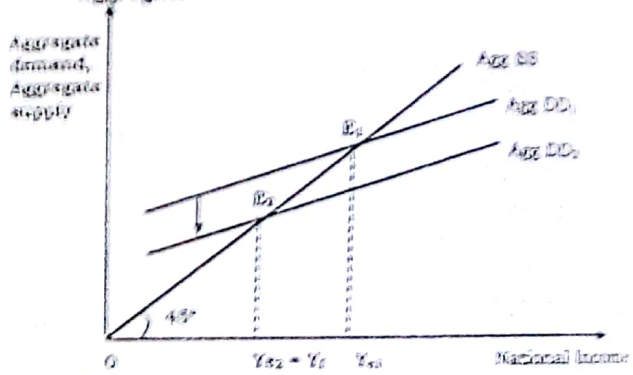

Figure 4.6: Closing an inflationary gap.

An inflationary gap is closed by reducing aggregate demand from AggDD2 using the following policies.

- **Use of restrictive monetary policy.** This is through increa rate, buying securities from the public, increasing margin re to reduce money supply and reduce aggregate demand.
- **Controlling wages/wage freeze.** This involves reducing workers which reduces incomes available for spending thu aggregate demand.
- **Reducing exports of scarce goods.** Reducing exportation especially for essential commodities to increase aggregate supp
- **Increasing imports of scarce goods.** This is through increasi especially essential/scarce commodities to increase aggregate
- **Increasing direct taxes** so as to reduce disposable inc reduces income available for spending thus reducing aggregate
- **Reducing government expenditure.** This helps to reduce inc people and reduces aggregate demand as well.
- **Providing a favourable investment climate.** This is done investment incentives to producers to attract more foreign increase aggregate supply.

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v. **Developing infrastructure** such as roads, power supply to increase production levels and match with the level of aggregate demand.

UNEB 2004.

i) *What is meant by an inflationary gap (01 marks)*
ii) *State any three effects of an inflationary gap in an economy (03 marks)*

EFFECTS OF AN INFLATIONARY GAP IN AN ECONOMY.

1. Increased resource utilisation.
2. Increased importation of goods.
3. Increased profit margins for firms.
4. Increased demand for factors of production.
5. Persistent increase in prices of commodities.

THE MULTIPLIER PROCESS.

Increase in expenditure/increase in aggregate demand increases income more than the original increase in expenditure. If a firm spends on investment it creates more income and people who receive that income also spend it and create more income and the trend continues.

Multiplier is defines as the number of times initial change in expenditure multiplies itself to give a final change in income.

It shows that expenditure creates more income and this income can be re-invested to create more income and the trend continues.

Multiplier= change in income (ΔY).
Initial change in expenditure (ΔE).

Multiplier = 1/MPS or 1/1-MPC.

NB. Multipliers do not have units.

TYPES OF MULTIPLIER.

a. **Government multiplier.** This is the number of times initial change in government expenditure multiplies itself to give a final change in income.
Government multiplier= change in income(ΔY)Change in government expenditure (ΔG).

b. **Tax multiplier.** This is the number of times initial change in taxation multiplies itself to give a final change in income.

Tax multiplier= change in income (ΔY) change in taxation (ΔT)

c. **Import multiplier**. This is the number of times initial change in import expenditure multiplies itself to give/generate a final change in income.

d. **Export multiplier.** this is the number of times initial change in export earnings multipliers itself to give/generate a final change in income.

e. **Consumption multiplier.** this is the number of times initial change in consumption expenditure multiplies itself to give/generate a final change in income.
Consumption expenditure - Change in income (ΔY)/Change in consumption (ΔC).

UNEB 2009.

a) *Differentiate between investment multiplier and government multiplier. (02 marks)*
b) *Given that marginal propensity to consume (MPC) in economy is 0.7 and there is a change in investment as shillings 50,000,000. Calculate the,*
   (i) *Investment multiplier (01 marks)*
   (ii) *Final change in income in the economy. (01 marks)*

f. **Investment multiplier.** This is the number of times initial change in investment expenditure multiplies itself to give a final change in income.

Investment multiplier = change in income(ΔY) change in investment expenditure(ΔI).

Other related concepts.

1) **MARGINAL PROPENSITY TO CONSUME (MPC).** This is a fraction/proportion of additional income that is spent on consumption. It increases with increase in income and reduces with a reduction in income.

MPC= Change in consumption (ΔC)/Change in income(ΔY).

2) **Marginal prosperity to export.** This is a proportion/percentage of additional income that is earned from MPE=change in exports (ΔX)/Change in income (ΔY). increases government tax revenue on imports.

3) **Marginal propensity to import (MPI).** This is a fraction/proportion/percentage of additional income that is spent on imports.

MPI=Change in imports (ΔM)/change in income(ΔY).

Example.

Given that GDP of a country increased form shillings 100million to shs 300million and the value of imports increased from shillings 25million to shillings 75million. Calculate the marginal propensity to import.

Marginal propensity to import (MPI)= Change in imports/change in income.

75,000,000-25,000,000
300,000,000-100,000,000.
50,000,000
200,000,000
MPI=0.25

UNEB 2013

i) *What is meant by the term" marginal propensity to import" (01 marks)*

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ii) Give any three effects of a high marginal propensity to import in an economy. (03 marks)

Effects of high marginal propensity to import.

- Leads to high outflow of foreign exchange.
- Leads to unfavourable balance of payment position.
- Limits growth of local industries/leads to decline in local industries.
- Causes unemployment problem.
- Increases dependence on other economies.
- Leads to limited inventions and innovations.
- Leads to imported inflation.
- Leads to underutilisation of local resources.
- Leads to erosion of social-cultural values.
- Leads to provision of a variety of goods
- Increases government tax revenue though taxing imports.

4) **Marginal propensity to save (MPS).** This is a proportion/fraction/percentage of additional income that is saved/not consumed. As income increases, MPS also increases. Rich people have high MPS than poor people.

MPS = change in savings (S)/change in income(Y).

UNEB 2001.

i) Distinguish between marginal propensity to save and marginal propensity to consume. (02 marks)

ii) Give any determinants of marginal propensity to save in your country. (02 marks)

DETERMINANTS OF MARGINAL PROPENSITY TO SAVE (MPS).

- Current level of income.
- General price level.
- Consumption habits.
- Degree of uncertainty.
- Level of liquidity preference
- Interest rate on deposits.

5) **Average propensity to consume (APC).** This is a fraction/proportion/percentage of total income that is consumed or spent on consumption.

APC=total consumption (C)/Total in income (Y).

Example.

Given that the country's total income is shillings 60,000billion and its total consumption is shillings 48,000billion. Calculate it's APC.

APC = TOTAL CONSUMPTION.
TOTAL INCOME.

48,000 billion/60,000billion

APC=0.8 or 80%.

6) **Average propensity to save (APS).** This is a proportion of total income that is saved. In most cases, it increases and reduces as income reduces.

APS =Savings(S)/income(Y).

7) **Marginal efficiency of capital (MEC).** This is anticipated/expected monetary returns on an additional invested.

Or

It refers to expected monetary returns from employing an additional capital.

UNEB 2010.

i) What is meant by marginal propensity to save(MPS). (02 marks)

ii) Given that the initial national income of a country is shs 100billion and MPS is 40%.

Calculate the final income in that country. (03 marks)

UNEB 2000.

i) Define then term marginal efficiency of capital. (01 mark)

ii) Mention any three determinants of marginal efficiency of capital. (03 marks)

DETERMINANTS OF MARGINAL EFFICIENCY OF CAPITAL (MEC).

NB. Neutral points are required showing high marginal efficiency and low marginal efficiency of capital in explanation.

1. **Level of expected output.** High level of expected output leads to high marginal efficiency of capital whereas low level of expected output leads to low marginal efficiency of capital.
2. **Level of taxation on investment.** High level of taxation on investment leads to low marginal efficiency of capital.
3. **Interest rate on capital invested.** High interest rate on capital invested leads to low marginal efficiency of capital while low interest rate on capital invested leads to high marginal efficiency of capital.
4. **Size of the market for output.** A large size of market for output leads to high marginal efficiency of capital while a small market for output leads to low marginal efficiency of capital.
5. **General price level in an economy.** High general price level leads to high marginal efficiency of capital while low general price level leads to low marginal efficiency of capital.
6. **Rate of depreciation of capital.** High rate of capital depreciation leads to low marginal efficiency of capital while low rate of depreciation of capital leads to high marginal efficiency of capital.
7. **Quality and quantity of other cooperant factors.** The quality and quantity of other co-operant factors of

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high marginal efficiency of capital whereas low quality and quantity of cooperant factors production leads to low marginal efficiency of capital

UNEB 2010.

i) *Differentiate between average propensity to consume and marginal propensity to consume (02 marks)*

ii) *Given that the country's total income is shillings 60,000 billion and its total consumption is shillings 48,000billion. Calculate its APC. (03 marks)*

Examinable questions.

1) Given that MPC in a two sector economy is 80%, initial investment is shillings 20,000,000. Initial equilibrium level of income is shillings 80,000,000 and if the investment increased by shillings 5,000,000,000. Calculate the,

i) Multiplier value.

ii) New equilibrium level of income.

Solution.

i) Multiplier = 1/1-MPC

1/1-80%=5

Multiplier value=5times

ii) New equilibrium level of income=

(Change in investment X multiplier) + Original equilibrium level of income.

(5,000,000,000 X5) + 80,000,000.

New equilibrium level of income = shillings 25,080,000,000

2) Given that the GDP of country's X is shillings 200million, its change in national investment expenditure is shillings 50million and its MPS is 0.5.

Calculate the,

i) Multiplier

ii) Final level of national income.

Solution.

i) Multiplier = 1/MPS.= 1/0.5 Multiplier =2times

ii) Final level of income =multiplier x change in national investment expenditure + GDP.

2X50,000,000 +200,000,000.

100,000,000+200,000,000.

Final level of income = shillings 300,000,000 or shs. 300million.

3) Given the MPC in an economy is 0.7 and there is a change in investment as shillings 50,000,000.

Calculate,

i) Investment multiplier.

ii) Final change in income in the economy.

Solution.

i) **Investment multiplier=1/1-MPC**

1/1-0.7=3.3

Multiplier = 3.3times.

ii) **Final change in income = investment multiplier x change in investment**

a. x 50,000,000.

Final change in income= shillings 165,000,000 or Shs. 165million.

4) Given that, the initial national income of a country is shillings 22 billion and that MPS is 40%.

Calculate the final change in income.

Multiplier=1/MPS 1/40% = 2.5times

Final change in income = multiplier x initial national income.

a. X 22 billion.

Final change in income=shillings 55billion or shs. 55,000,000,000

5) Given that the current level of GDP is shillings 300million, the increase in national investment expenditure is shillings 50million and MPS is 0.2, calculate the final level of national income.

Multiplier=1/MPS.

1/0.2=5times

Change in income 5x50 million = shillings 250 million.

Final level of income = **change in income + current level of GDP**

250 million + 300million.

Final level of income = shillings 550million.

6) Given that an individual's income increased from shillings 200,000 to shillings 350, 000 and this led to an increase in savings by shillings 50,000. Calculate the marginal propensity to save.

MPS=change in savings/change in income

50,000/350,000-200,000

50,000/150,000

MPS =0.3

7) Given that a country's GDP is shillings 5,800 billion and investment expenditure increased from shillings 1,000 billion to shillings 1,400billion. Calculate the final level of income of the country is MPS is 20%.

Multiplier = 1/MPS = 1/0.2

Multiplier = 5times

Change in income=multiplier X Change in investment.

5X(1,400-1,000)

Shillings 2,000 billion.

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Final level of income = initial income level (GDP) + change in income.

5,800 +2,000

Final level of income = shillings 7,800 billion.

INVESTMENT MULTIPLIER IN LDCs

Change in investment expenditure leads to change in income by multiple times, but in developing countries, there is limited income arising from investment expenditure because of unfavourable economic, social and political factors.

UNEB 2001.

a) *Distinguish between consumption multiplier and investment multiplier. (04 marks)*

b) *Explain the factors which limit operation of investment multiplier in your country. (16 marks)*

UNEB 1998.

a) *Distinguish between an investment multiplier and an export multiplier. (04 marks)*

b) *Examine the factors limiting the effective operation of investment multiplier in your country. (16 marks)*

LIMITATIONS OF INVESTMENT MULTIPLIER IN LDCS/FACTORS THAT LIMIT THE SIZE OF INVESTMENT MULTIPLIER IN LDCS(Uganda).

1. **High level of liquidity preference.** In LDCs, majority of people prefer to hold their accumulated wealth in cash or near cash form instead of re-investing it to accumulate more income which limits the size of multiplier.
2. **Low level of entrepreneurship ability.** Lack of organizational skills limit the level of local investments because entrepreneurs are in short supply in developing countries thus limited undertaking of risky but profitable ventures thus a small size of multiplier.
3. **Low income levels.** Income levels in LDCs are very low due to low savings and investment which limits the size of multiplier.
4. **High rate of capital outflow.** This is through high profit repatriation by owners of foreign capitalinvestments which limits re-investment and multiplier effect.
5. **High marginal propensity to import.** Majority of existing potential consumers prefer imported items, importing expensive capita goods takes a very big percentage of accumulated income instead of re-investing it to increase domestic production thus small size of multiplier.
6. **Small market size.** Domestic market is ... purchasing power and foreign markets are hig... limits the level of expanding business and the ... of
7. **Poor infrastructure.** The existing social and ... are in poor state and in some areas not existing ... limited power supply, limited railways, inadequ... systems which reduces profitability of business thu... multiplier.
8. **Poor political climate/atmosphere.** Persistent politic... many LDCS discourage both local and foreign invest... creates business and life uncertainty which limit... business and size of the multiplier.
9. **Poor/unfavourable investment climate.** This is ca... high and unfair taxes on producers, limited subsidies ... and limited institutions to encourage investments whi... cost of production, low investment and size of the mu...
10. **Low levels of technology.** Production still depend... especially in primary sectors and there is constant ... down in major industries. This reduces the ra... utilization and the size of multiplier.
11. **High population growth rate.** Population in most L... rate of more than 20% per annum. This limits saving ... individual and government expenditure because of t... burden thus limiting the size of multiplier.
12. **High levels of corruption and embezzlement of fun... allocation.** Most resources which are provided by th... for project implementation and supporting the pro... misused by appointed official of government instead ... productive projects. This leads to a decline in investme...
13. **Large subsistence sector.** This sector is managed by ... limits large scale production thus low investment and ... multiplier.

SAVING.

Saving is a proportion/part of income which is not spe... consumption but kept a side for future use.

Or

It refers to the proportion of income that is not spe... consumption in order to create funds for future use . Saving ... increased future investment in an economy.

FACTORS INFLUENCING/AFFECTING THE LEVEL OF S... ECONOMY.

1. **Level of consumption/spending habits.** High level ... habits leads to low level of saving which low consumption ... high level of saving.

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3. **Level of income**. High level of income leads to high level of saving while low level of income leads to low level of saving.
4. **Interest rate on deposits**. High interest rate on deposited capital leads to high level of saving whereas low interest rate on deposited capital leads to low level of savings.
5. **Level of development of financial institutions**. High level of development of financial institutions leads to high level of saving whereas low level of development of financial institutions leads to low level of saving.
6. **Political climate**. Favourable political climate leads to high level of saving whereas unfavourable political climate leads to low level of saving.
7. **Population growth rate**. High population growth rate increases dependence burden which leads to low level of saving while low population growth rate leads to high level of saving.
8. **Rate of inflation/general price level**. High rate of inflation leads to low level of saving while low rate of inflation leads to high level of saving.
9. **Level of taxation and subsidisation**. Low level of taxation and high subsidisation leads to high level of saving while high level of taxation and low subsidisation leads to low level of saving.
10. **Size of existing stock of wealth**. A large size of existing stock of wealth leads to high level of saving whereas a small size of existing stock of wealth leads to low level of saving.
11. **Government policy on saving**. Favourable government policy on saving through compulsory saving schemes such as NSSF leads to high level of saving while unfavourable government policy on saving leads to low level of saving.
12. **Degree of monetization/commercialization of an economy.** High degree of monetization of an economy leads to high level of saving whereas low degree of monetization of an economy leads to low level of savings.
13. **Degree of accountability in the financial sector.** Poor accountability in the financial sector limits savings whereas proper accountability in the banking sector promotes the level of saving.

UNEB 2007.

Give any four factors which influence the rate of savings in your country.
(04 marks)

UNEB 2007.

i) *Distinguish between multiplier and accelerator theories of investment.*
(02 marks)

ii) *Given that marginal propensity to consume is 0.75, calculate the size of multiplier.* *(02 marks)*

THE ACCELERATOR PRINCIPLE

The accelerator shows the number of times initial change in consumption expenditure multiplies itself to give a final change in investment.

The accelerator principle states that initial change in consumption expenditure multiplies itself to give a rise in investment.

Accelerator principle= change in investment (ΔI)/change in consumption (ΔC)

It shows how changes in consumer expenditure may lead to changes in the level of capital accumulation if there is an increase in consumer's expenditure, demand will increase leading to an increasein the level of production and investment.

INVESTMENT

Investment refers to the process of devoting a person's or nation's income to create capital goods/stock.

Or

It is the process of creating capital stock in an economy. It is the expenditure meant to increase and maintain capital stock.

For instancepurchase of machinery, stocking raw materials and constructing infrastructure.

Economic growth and development can never take place when there is no increased level of investment in different production sectors of the economy.

TYPES OF INVETSMENT

A. **Autonomous investment.**

Autonomous investment is a form of investment that does not depend on the level of income,

Or

This is a form of investment that is independent of the level of income but depends on other factors.

It is independently motivated investment which does not depend on any economic variables such as income but is propelling and can take place at any time.

It is influenced by factors outside the income stream such as level of technology, weather changes, political climate, research and population size/growth rate.

For instance investment undertaken by public sector such as setting up roads, hospitals for various national objectives.

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B. **Induced investment.**

Induced investment is a form of investment which depends on the level of income.

This is a type of investment that depends on economic variables such as changes in the level of income and it occurs in response to increase in consumer's demand for commodities.

It is influenced by factors within the income stream such as price of goods, level of demand, wage rate and interest rate on capital.

NB.

Gross investment is the total amount of investment in a given period of time without considering depreciation cost.

Net investment is defined as gross investment less capital depreciation cost.

UNEB 1997, 2002.

a) Define the term investment. (04 marks)

b) Examine the factors influencing the level of investment in your country (16 marks)

FACTORS DETERMINING/AFFECTING THE LEVEL OF INVETSMENT IN AN ECONOMY.

NB. These are presented as neutral points and explained in two sides showing high level of investment and low level of investment.

1. **Interest rate on borrowed capital.** Low interest rate on borrowed funds increases borrowing for investment which leads to high level of investment while high interest rate on borrowed capital discourages borrowing for investment which leads to low investment.
2. **Size of existing capital stock.** Large size of existing capital stock increases the utilization of other resources which increases production hence high investment levels whereas small size of capital stock limits utilization of resources which leads to low production leading to low level of investment.
3. **Level of income.** High income levels implies high savings for increased production hence high investment level while low income levels implies low savings hence low production leading to reduced level of investment.
4. **Political climate.** Favourable political climate attracts both local and foreign investments due to certainty for life and property hence increased production leading to high investment levels whereas unfavorable political climate scares away both local investors due to uncertainty for life and property hence low level of investment.
5. **Government policy on investment.** Favourable government policy towards investment through subsidies to producers, tax holidays, tax exemptions encourages production leading to high level of investment while unfavourable governmentpolicy towards investment through unfair taxes on producers, limited subsidies leads production leading to low level of investment.
6. **Market size/level of aggregate demand.** Presence of size both domestic and foreign implies profitability of encourages further production which leads to high inv whereas small domestic and foreign market for outp further production leading to low investment.
7. **Level of infrastructure development.** Presence of some infrastructure such as modern roads, railways, systems and banking institutions increase mobility production hence high investment level while infrastructure limit movement of factor inputs and hence low investment levels.
8. **Level of entrepreneurial ability.** High level of entrepre implies better organization of other factors of prod undertaking risky but highly profitable ventures leadi investment levels whereas low entrepreneurial ab organization of other factors of production hence lo levels.
9. **Population growth rate.** High population growth rate dependence burden which limits the level of savings hence investment whereas low population growth rate reduces burden which increases savings hence high level of invest
10. **Rate of inflation.** High rate of inflation increases cost which discourages investment while low rate of inflation level of investment.
11. **Level of technology in production.** High level of tec production increases resource utilizationleading to further hence high level of investment while low level of techno production leading to low level of investment.
12. **Level of savings.** High level of savings increases productio high level of investment while low level of savings lead investment.
13. **Marginal efficiency of capital.** High marginal efficien encourages further production which increases investmentwhile low marginal efficiency of capital discou production while leads to low level of investment.
14. **Profit level.** High profit level encourages further prod high level of investment whereas low profit level production leading to low level of investment.
15. **Level of inventions and innovations.** High level of innovations increases the level of investment while inventions and innovations reduces the level of invest

UNEB 2005.

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a) Distinguish between saving and investment. (04 marks)
b) Explain the factors that have influenced the level of investment in private sector in your country. (16 marks)

FACTORS THAT HAVE INFLUENCED/ AFFECTED THE LEVEL OF INVETSMENT IN PRIVATE SECTOR IN UGANDA.

NB. These must be presented as neutral factors and explained in two sides showing high level and low level of investment.

1. **Rate of inflation/economic climate.** High rate of inflation has increased cost of production which has discouraged investment while low rate of inflation has increased investment in private sector.
2. **Level of entrepreneur ability.** High level of entrepreneurial ability has increased proper organisation of other factors of production which has promoted investment while low level of entrepreneurial ability has limited investment in private sector due to poor organizational skills.
3. **Political climate.** Favourable political climate in some areas has created certainty for property hence increased investment while unfavourable political climate has created business uncertainty which has discouraged investment in the private sector.
4. **Interest rate on borrowed capital.** Low interest rate on borrowed capital has attracted many borrowers for increased investment while high interest rate has discouraged borrowing for investment which has discouraged increased investment in the private sector.
5. **Level of infrastructure development.** High level of infrastructure development in form of roads has increased mobility of factor inputs which has increased investment while low level of infrastructure development has limited transportation of factor inputs and output hence reduced level of investment.
6. **Level of income.** High level of income has increased investment level among some investors while low level of income level has discouraged increased investment in private sector.
7. **Business expectations.** During a boom, there is increased economic activity which has increases investment levels while during a period of low economic activity investment levels have been always discouraged in the private sectors.
8. **Marginal efficiency of capital.** High marginal efficiency of capital has increased investment levels while low marginal efficiency of capital has discouraged investment in the private sector.
9. **Government policy on investment.** Favourable government policy on investment through tax holidays, subsidies has increased investment levels while unfavourable government policy on investment such as high taxes, limited subsidies has limited the level of investment inj the private sector.

10. **Level of savings.** High level of savings has increased the level of investment while low level of savings has limited the level of investment in the private sector.
11. **Size of the market.** A large market size for output has promoted increased production hence high level of investment while a small market size has discouraged more production hence reduced level of investment in the private sector.
12. **Population growth rate.** Low population growth rate has reduced dependence burden which has increased the level of investment while high population growth rate has increased dependence burden which has limited the level of investment in the private sector.
13. **Level of technology.** High level of technology has increased resource utilization which has increased the level of investment while low level of technology has limited resource utilization which has increased the level of investment while low level of technology has limited resource utilization which has reduced the level of investment in the private sector.
14. **Profit levels.** High profit levels have increased the level of investment since such profits are ploughed back while low profit levels have discouraged ploughing back capital into businesses which has limited the level of investment in the private sector.
15. **Size of existing capital stock.** A large size of existing capital stock has increased the level of investment while a small size of capital has discouraged the level of investment in the private sector.

FACTORS RESPONSIBLE FOR A LOW LEVEL OF INVETSMENT IN UGANDA.

1. **Low level of income.** Levels of income among Ugandans are low implying limited capacity to expand production hence low investment.
2. **Poor infrastructure.** Poor road network, limited railways, limited banking institutions limit perfect mobility of factors of production thus low production and investment.
3. **Small market size.** The domestic market is insufficient due to low purchasing power while the foreign market is too competitive which discourages large scale production leading to low investment.
4. **Low entrepreneurial ability.** The level of ability to organise other factors of production is low among the existing investors which limits production hence low investment levels.
5. **Small size of existing capital stock.** The size of capital stock is limited implying limited production and investment initiatives.
6. **High rate of inflation.** Persistent inflation in Uganda leads to increased cost of production, leads to loss of money value which discourages increased level of production thus low investment levels.

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7. **High interest rate on borrowed capital.** Money lending institutions charge high interest rate on borrowed capital for investment which discourages borrowers for increased production and investment purposes.
8. **Poor political climate.** Unfavourable political climate creates uncertainty for life and property in some areas, increases government expenditure on military hardware instead of increasing expenditure in productive ventures thus low investment levels.
9. **Low level of technology.** Techniques of production in most production units are still poor which limits large scale production leading to low investment.
10. **Unfavorable government policy on investment.** The government policy at times is unfavourable towards investment inform of unfair taxes, limited subsidies to producers, high cost of trade licenses which discourages increased production hence low investment levels.
11. **Low level of savings.** The level of saving by the population is low due to high marginal propensity to consume implying limited resources for increased production hence low investment levels.
12. **High level of liquidity preference.** Many individuals prefer to keep their wealth in monetary form instead of investing it to create more wealth through increased investment. This limits production and investment levels.
13. **Low profit levels.** Profitability of business is still low which discourages further production leading to low level of investment.
14. **High population growth rate.** Population in Uganda grows at a high rate per annum which increases dependence burden, limits savings and in turn low investment levels.

MEASURES BEING TAKEN TO INCREASE THE LEVEL OF INVETSMENT IN UGANDA.

- **Controlling population growth rate.** The government is reducing population growth rate through family planning methods so as to reduce dependence burden and increase savings for investment.
- **Provision of investment incentives.** This is being done through providing tax holidays, tax exemptions and subsidies to producers to attract more investors.
- **Widening market for output.** Market for output is being expanded through joining economic integrations such as the EastAfrica community to encourage continuous production and attract more investors.
- **Improving and modernizing infrastructure.** The existing roads, power supply systems are being upgraded and new ones constructed so as to ease movement of factors of production and output leading to increased investment.
- **Conducting entrepreneurial** training. The ... acquisition of entrepreneurial skills through ... entrepreneur development thus increased ...
- **Maintaining economic stability.** The government ... through relevant fiscal and monetary policies ... of production and attract more investments.
- **Encouraging political stability throughout** the ... government is campaigning for continued political ... the country through good governance in order to ... life and property and increase investment levels.
- **Further privatization of public enterprises.** More ... are being transferred to private investors in order to ... investors and increase investment in the long run.
- **Providing information about investment opportunities** ... **place specialized institutions to encourage investment** ... information about investment opportunities is being ... through Uganda investment authority.
- **Encouraging savings through financial sector** ... Encouraging credit schemes such as SACCOs, micro ... to mobilize enough savings and avail credit to rural ... supported thus stimulating more investment.
- **Further liberalization of the economy.** More liberty ... private individuals to carry out economic activities ... government controls so as to attract more investment ... activities.
- **Intensifying war against corruption and embezzlement of investment funds.** Intensive war against corruption and embezzlement of investment funds is being done so as to restore confidence of investors through putting in place anti-corruption organs to encourage investment in both private and public sectors.
- **Providing cheap loans to investors.** Prospective investors and local investors are being availed with cheap loans at a low interest rate to undertake investment opportunities available in different sectors.
- **Improving on technology.** The existing technology is being improved through increased innovations and inventions, technology to produce high quality goods and increase the level of investment.

UNEB 2006.

a) Define the term investment.
b) Suggest measures that should be taken to encourage investment in your country.

Measures that should be taken to increase the level of investment in Uganda.

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- Provision of information about investment opportunities i.e. through UIA.
- Further liberalisation of the economy.
- Intensify war against corruption to reduce misuse of funds meant for investment.
- Control population growth rate.
- Further privatisation of public enterprises.
- Build strong and sound infrastructure.
- Provision of investment incentives such as tax holidays and subsidies.
- Maintain economic stability.
- Encourage political stability in all parts of the country.
- Widen market for output.
- Undertake entrepreneurial training.
- Encouraging savings.
- Provide cheap loans to local investors.
- Improve on the level of technology.

UNEB 2003.

a) Define the term investment. (04 marks)
b) Assess the impact of private foreign investment in your country. (16 marks)

PRIVATE FOREIGN INVESTMENTS IN LDCs (FOREIGN CAPITAL INVESTMENT)

Private foreign investments are investments in a country carried out by foreign companies, individuals and multi-national corporations as they transfer their productive resources and capital into the country. Many developing countries have endeavored to encourage foreign direct investments in a move to facilitate rapid economic growth and development.

In the recent years, developing countries have witnessed rapid growth of direct foreign investments by transnational corporations or multi-national corporations and other various forms of investment owned by foreign investors in areas of banking, insurance industry, industrial activities, education, telecommunication, hotel industry and other various forms of investment are owned by foreigners in most LDCs.

In Uganda, the government has offered incentives and created a favourable investment climate for foreign investors which has attracted numerous investments from abroad especially in banking, industrialization, telecommunication, mineral exploitation among others.

Foreign direct investment.

This refers to the transfer of productive resources and capital by foreign individuals, companies and multinational corporations into the domestic economy in form of business operations.

POSITIVE ROLE OF PRIVATE FOREIGN INVESTMENTS IN LDCs.

1. **They fill savings-investment gap.** Foreign investors come with their capital hence supplementing the insufficient domestic savings thus improvement in investment levels.
2. **They close foreign exchange gap/they increase inflow of foreign exchange.** Foreign investors come with additional supplies of foreign currency hence supplementing the available forex from exports.
3. **Fill skilled man power gap.** They come with skilled labour to supplement locally available man power by use of expatriates.
4. **Provision of employment opportunities.** Both skilled and semi-skilled labour gets employed in various projects set up by foreign investors thus increasing employment.
5. **Source of government tax revenue.** This is through corporatetaxation of investments carried out by foreign investors and incomes ofpeople employed in such investments thus increased government revenue.
6. **They promote development of local skills.** They usually provide on job training and undertake labour training programmes in technical, scientific and managerial aspects. This promotes development of local entrepreneurial skills for local people to start their own investments.
7. **Accelerate growth of industrial sector.** They set up and manage medium and large scale industrial firms such as steel and chemical plants which stimulates industrialization.
8. **Facilitate technological transfer and development/ they close technology gap.** Foreign investors come with efficient, new and advanced techniques of production in form of capital intensive technology thus improvement in technology.
9. **They encourage infrastructural development.** For instance transport routes, banking facilities, power projects, telecommunications and this is a sign of economic development thus leading to more investment.
10. **They promote efficiency of local firms due to increased competition.** Local firms compete with foreign firms in production and this leads to production of high quality output thus increased efficiency.
11. **Facilitate production of a wide variety of goods.** This is because they deal in diversified activities hence widening consumers' choice and improving standard of living.
12. **Promotion of international cooperation and understanding between countries.** This is important for increased foreign aid and increased international trade leading to increased production for export.
13. **They encourage innovations and inventions.** This is due to extensive research carried out by competing firms in production and use of better methods of production thus better quality output thus increasing market and profits.

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14. **Promote use of idle resources/increase resource utilisation**. This would be idle resources such as minerals, land are tapped which increases output and reduces resource underutilization.

15. **Promote economic growth due to increase in output**. They add to the productive capacity of the country due to the use of modern methods of production hence more goods and services are produced

NEGATIVE ROLE OF PRIVATE FOREIGN INVESTMENTS IN LDCs

- **They are accelerate capital outflow**. This is through profit repatriation by foreign investors which limits expanded investment in the domestic economy.
- **Worsen income inequality**. This is because, they employ few people who are highly paid and in most cases their own foreign manpower thus widened income gap.
- **They worsen unemployment problem**. This is due to preference of advanced capital intensive technology which replace human labour and use of foreign manpower thus limited employment creation.
- **Require excessive concessions/special fiscal incentives form the government** such as tax holidays, tax exemptions, subsidies which increases government expenditure and reduces benefits from such investments.
- **Lead to regional and sectoral imbalances in development**. They prefer to operate in urban areas with access to developed infrastructure and in few specific profitable sectors thus imbalances in development.
- **They out compete local firms** hence leading to closure of such firms and associated disadvantages. This is because they produce on a large scale and sell at low prices and out compete local firms which are still infant in nature.
- **Worsen economic dependence**. LDCs continue to rely on foreign investments from MDCs for resources, market, skilled labour and this discourages local initiatives.
- **Worsen rural urban migration and its disadvantages**. Most of the foreign businesses tend to locate in urban areas and attract people from rural areas leading to high crime rates in urban areas.
- **Worsen balance of payment problems**. This is because some resources are imported from other economies to facilitate production and they repatriate profits to their home countries thus high foreign exchange expenditure.
- **Lead to over/irrational exploitation of resources** leading to quick depletion of some key resources such as minerals, forests, water resources thus quick resource exhaustion.
- **They contribute to high social costs**. They establish large scale industries which pollute air, land and water thus environmental degradation.

UNEB 2000.

a) Assess the contribution of foreign capital investment ... of your country. (12 marks)

b) Examine the steps being taken to attract ... country. (08 marks)

UNEB 1998.

Assess the role of foreign capital investment in the ... country. (20 marks)

ASSESSING THE IMPACT OF FOREIGN CAPITAL IN UGANDA.

Positive impact of foreign capital investment (foreign capital ...

- It closes savings-investment gap.
- Means of technological transfer and development/... gap.
- Creates employment opportunities.
- Fills skilled man power gap.
- Leads to increased output hence economic growth.
- Promotes development of local skills.
- Accelerates growth of industrial sector.
- Promotes development of infrastructure.
- Leads to efficiency of local firms through competition.
- Promotes international cooperation and mutual under... Uganda and other countries.
- Provides government tax revenue.
- Fills foreign exchange gap/increased inflow of foreign ex...
- Increases production of a wide variety of goods and ... widens consumers choice.
- Increase utilization of domestic idle resources.
- Leads to production of better quality goods.

Negative impact of private foreign investment (for... Uganda.

1. Leads to regional and sectoral imbalances in develop...
2. Worsens unemployment problem.
3. Worsens income inequality.
4. Leads to over exploitation of resources hence ... resources.
5. Demands excessive concessions from government.
6. Worsens external dependence.
7. Increases capital outflow.
8. Local firms are out competed.

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g) Worsens balance of payment problems.
h) Leads to high social costs

UNNEB 2005.

i) What is meant by foreign direct investment. (01 marks)
ii) Mention any three merits of foreign direct investment to an economy (03 marks)

UNEB 2012

Mention any two

1. Factors that have influenced the level. (02 marks)
2. Benefits

Of foreign direct investment in your country. (02 marks)

FACTORS THAT INFLUENCE/AFFECT THE LEVEL OF FOREIGN DIRECT INVESTMENT IN AN ECONOMY (UGANDA).

- Level of external publicity of investment opportunities in the country.
- Economic climate/rate of inflation.
- Degree of liberalization of the economy.
- Market size.
- Degree of bureaucracy.
- Level of bureaucracy.
- Level of accountability/corruption and embezzlement.
- Land tenure system.
- Techniques of production available.
- Size of existing capital stock.
- Availability of raw materials/natural resources base.
- Political atmosphere.
- Level of infrastructure development.
- Availability of investment incentives/government policy on investment.
- Availability of skilled manpower/labour skills.
- Level of entrepreneurial ability.

UNEB 1999.

i) What is meant by an investment multiplier. (01 marks)
ii) Give any three ways of attracting foreign investment in your country. (03 marks)

STEPS BEING TAKEN TO ATTRACT PRIVATE FOREIGN INVETSMENTS IN UGANDA.

The government of Uganda has endeavored to put in place a conducive and favorable investment plat form to attract numerous foreign investments in form of foreign commercial banks, foreign insurance companies, foreign investors in various industries/industrial expansion, multi-national corporations, hotel management and tourism, super markets, telecommunication services, foreign investors in education and mineral exploitation.

Currently some of the leading investments and large tax bases are owned by foreigners in Uganda.

The government is attracting and has attracted all these investments through employing the following policy measures.

- **Offering investment incentives to various foreign investors.** Tax holidays, tax exemptions, subsidies are being provided to foreign investors so as to attract them in large numbers.
- **Building improving infrastructure.** The government is rehabilitating and setting up roads, power supply projects so as to ease coordination of production and reduce transport costs and attract many foreign investors.
- **Ensuring political stability.** This is being done especially in rebel affected areas by holding peace talks with rebel leaders to ensure political stability throughout the country so as to ensure certainty for life and property among foreign investors.
- **Further liberalization of the economy.** More liberty is being given to private individuals to participate in economic activities and this is meant to attract more foreign investors.
- **Ensuring economic stability.** The government is trying as much as possible to stabilize prices by controlling inflation through relevant fiscal and monetary policies to stabilize the value of the currency and attract foreigners in investment.
- **Establishing and continuous funding of specialized institutions to encourage investments.** The government is setting up institutions such as the UIA to provide necessary guidance to foreign investors.
- **Carrying out international publicity/campaigns.** This is being done through advertising in foreign media to strengthen bi-lateral ties and make foreign investors get informed about existing investment opportunities in Uganda which attracts such investors.
- **Creation of a wider market.** The government is doing this through joining economic integration such as EAC, COMESA which expands market and attracts more foreign investors since they get assured of potential market.

Scanned by CamScanner

- **Further privatization of public enterprises.** The government is encouraging privatization of public companies to attract foreign investments since most of these enterprises are bought by foreigners withenough capital.

CONSUMPTION

Consumption refers to use of part of income for the expenditure non final goods and services to satisfy human wants in a given time.

Consumption is therefore the use of available economic resources so as to satisfy an economic need.

Consumption function refers to the relationship between consumer's expenditure and the factors that influence these expenditures.

Consumption can either be autonomous consumption or induced consumption.

Autonomous consumption.

Autonomous consumption. Is consumption which does not depend on the level of income. Consumption is even at zero income where one consumes past savings or borrowed funds.

Induced consumption.

Induced consumption. Is consumption which depends on the level of income.

DETERMINANTS OF CONSUMPTION IN AN ECONOMY.

(Factors that influence/affect the level of consumption in an economy).

1. **Level of income among individuals.** High income level leads to high level of consumption while low income level leads to low level of consumption.
2. **Rate of interest on borrowed capital.** High interest rate on borrowed capital leads to low levels of consumption while low interest rate on borrowed capital increases the level of consumption.
3. **Level of taxation on income.** High direct taxes reduce consumption levels while low direct taxes lead to high level of consumption.
4. **Level of government expenditure.** High level of government expenditure leads to high level of consumption whereas low level of government expenditure leads to high level of consumption whereas low level of government expenditure leads to low level of consumption.
5. **Availability of credit facilitates such as hire purchase arrangement.** Presence of enough credit and hire purchase arrangements increase the level of consumption while limited credit and hire pu... lead to low level of consumption.
6. **Nature of income distribution.** Fair distribution o... individuals leads to high level of consumption while ... of income among individuals leads to low level of consump...
7. **Attitude towards savings/level of savings.** Negative ... towards savings leads to high level of consumption ... attitude of people towards savings reduces the level of ...
8. **Expectation of future changes in price.** When pri... increase in near future, consumption increases in the ... case price is expected to reduce in the near future, ... in the present.
9. **Size of the population and its structure.** Holding ... constant,a large population size increases the level of ... a small population size leads to low level of consumption.
10. **Level of advertising in an economy.** High level of ... persuasive advertisements in an economy leads t... consumption while limited and informative advertisem... level of consumption.
11. **Quantity of available consumer goods and services.** ... goods and services in an economy leads to high leve... while limited quantity of goods and services in an econo... level of consumption.
12. **General price level.** High general price level reduces ... power of individuals hence low level of consumption wh... price level increases the purchasing power of individuals ... of consumption.
13. **Political climate.** Favourable political climate leads ... consumption whereas unfavourable political climate lead... consumption.

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CHAPTER 5: STRUCTURE OF UGANDA'S ECONOMY

Structure of an economy refers to the basic features of a national economy in terms of pattern of production, output levels, ownership, control and organization of resources, the major sectors of the economy and their composition.

It seeks to describe the basic or outstanding characteristics of features of an economy.

UNEB 1998.

a) Describe the structure of the economy of your country. (10 marks)
b) Examine the factors responsible for underdevelopment in your country (10 marks)

UNEB 2003.

Mention any four features of your country's economy. (04 marks)

SALIENT FEATURES OF UGANDA'S ECONOMY.

NB. Qualifiers are necessary when giving your points and do not speculate.

- It is *predominantly* agricultural in nature in that the main economic activity carried out is agriculture which employs the largest percentage of labourforce either directly or indirectly and is a major foreign exchange earner.
- There is a *small but growing* industrial sector due to inadequate necessary industrial requirements. Most industries are smalls scale, medium and few large scale industries.
- It is a dual economy with examples of dualism such as rural and urban areas, subsistence production and monetary production, the rich and the poor, the elites and illiterates.
- It is *basically* a mixed economy with both public and private sector, although the current trend puts more emphasis on expansion of private sector because the government has adopted privatization and economic liberalization which has increased private participation in production.
- It is an open economy. Uganda participates in multi-lateral trade since it is involved in importation and exportation of different products involving various countries.
- It is *highly* a dependent economy. Uganda depends on other economies for trade, decisions and resources for her survival. This is reflected through direct economic dependence, trade dependence, sectoral dependence and external resource dependence.
- Labour force is *predominantly* unskilled and semi-skilled. This leads to limited entrepreneurial abilities which limits production levels.
- Most of the productive sectors *mainly* produce at excess capacity implying underutilization of resources. For instance the industrial sector and agricultural sector.
- It has high population growth rate relative to economic growth which reduces output and income percapita. This is attributed to various factors.
- There is a growing informal sector which brings together many traders on small scale basis such as shoe shiners, hair dressers, tailors, hawkers and carpenters, mechanics.
- There is generally low level of infrastructure development both economic and social due to inadequate resources. There are limited modern roads, banking institutions, recreational centres, power supply systems, health facilities and educational institutions are still poorly developed in most areas.
- There is generally wide spread unemployment and underemployment of labour. Many people are not employed and even those who are employed are not fully exploiting their potentials.

KEY SECTORS IN THE UGANDA'S ECONOMY.

A. THE AGRICULTURAL SECTOR.

Agriculture is a science which deals with the production of crops, rearing of animals and marketing their products. In Uganda, agriculture development involve the transformation of agricultural production from subsistence production to a highly commercialized production so as to increase agricultural production. Many people in Uganda derive their live hood directly and indirectly from this sector.

UNEB 2014

State any four features of the agricultural sector in your country. (04 marks)

UNEB 2009.

Mention any four features of the agricultural sector in your country. (04 marks)

STRUCTURE OF UGANDA'S AGRICULTURE SECTOR/FEATURES OF AGRICULTURAL SECTOR IN UGANDA.

NB. Qualifiers are necessary when giving your points and do not speculate.

- It is *predominantly* subsistence in nature since majority of producers grow crops for home consumption though the trend is changing to commercialized production.
- The sector *mainly* depends on nature and subject to diminishing returns. Output level is mainly determined by natural factors such as soil fertility, climate with limited control over such factors.

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- It is mainly done on small scale and most farms exist on small scale peasant holdings though there are few large scale farms owned by foreigners
- It is dominated by use of rudimentary tools such as pangas, hoes and this makes land and labour less productive. It uses basically labour intensive technology
- It mainly produces low quality output due to limited knowledge and use of scientic methods on farm activities
- It mainly employs semi skilled and unskilled labour which is considered to be relatively cheap.
- The sector is basically rural based because land and labour in rural areas are relatively cheaper.
- Mainly dependent on a few export crops since production is mainly for domestic market.
- Production is mainly composed of food stuffs and there is a narrow range of cash crops such as coffee, tea, cotton and tobacco.
- It dominated by use of family labour where women play a crucial role especially in food sub sector production and a few men in cash crop production and livestock. Most of the farm requirements are met by use of family labour.

ROLE/POSITIVE IMPLICATIONS OF SUCH AGRICULTURAL SECTOR.

- **Provision of food to the rapidly growing population.** This is because agriculture is dominated by food crops which ensures food security and this keeps the population healthy and productive.
- **Provides employment opportunities.** Agriculture employs the largest percentage of the population especially semi-skilled and unskilled labour either directly or indirectly which reduces unemployment especially in rural areas.
- **Generates foreign exchange to the country.** Agriculture is the major forex earner to the country since it dominates export trade through exportation of major cash crops such as coffee, cotton, and maize thus increased forex earnings. This is essential for importation of capital goods.
- **Supplies raw materials to agro based industries at relatively low prices/promotes industrial development.** Such as sugar production industries, teas processing, grain milling, textile mills, cotton ginning and coffee hulling thus industrial development.
- **Generates government tax revenue.** Majority of people are employed in agriculture directly and indirectly and are therefore taxed to finance government expenditure.
- **Ensures equitable income distribution/reduces income inequality.** ... absorbs majority of people who are not taken up by other ...
- **Reduces rural urban migration** and it does ... the fact that, it is being carried out mainly ... absorbs rural population.
- **Encourages rapid development of infrastructure.** ... carried out in rural areas, it facilitates establishment ... such as roads, power supply, railways, banking ... development and transformation.
- **Contributes greatly to gross domestic ...** ... contributes greatly to total GNP since it forms ... dominates production.
- **Provides market to industrial goods.** For ... machinery thus growth and expansion of the ... industry.
- **Promotes balanced regional development.** ... carried out almost in every region thus ... all regions.

PROBLEMS FACED BY AGRICULTURAL SECTOR IN ...

1. **Natural hazards/unfavourable natural ...** drought, floods, torrential rains, crop pests and ... agricultural output and because of such risks ... insurance companies are not willing to insure ...
2. **Price fluctuations for agricultural products.** ... output both on the international market and ... stable because of dependence on natural ... output and competition from artificial fibres ... farmers.
3. **Limited market for agricultural products.** The ... not enough and the foreign market is flooded due ... artificial fibres which discourages farmers.
4. **Limited agricultural research facilities.** Research ... inadequate and this limits improvement in ... expanding market and limits introduction of new ... varieties.
5. **Inadequate capital.** Agriculture is carried mainly ... not have necessary capital to purchase required ... improve production and a small percentage of the ... normally allocated to agriculture which limits ... production.
6. **Under developed infrastructure.** The road network ... especially in rural areas are limited and in poor ... difficult to connect agricultural productive areas ...
7. **Poor land tenure system.** Majority of ... squatters on land and in other areas land is ... reduces initiatives to increase agricultural ...

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8. **High level of conservation among some farmers**. High attachment to social cultural factors makes farmers resist changes meant to improve agriculture is in most cases left for women which limits agricultural modernisation.
9. **Low level of technology**. There is mainly use of rudimentary tools such as pangas, hoes which yield low quality output and of limited quantity.
10. **Limited skilled man power**. The sector mainly employs un-skilled and semi skilled labour who are less efficient and productive leading to low agricultural output.
11. **Political instability in some areas**. Political unrest in some areas limits farmers from settling down for serious agricultural production leading to low output.
12. **Rapid growing population**. Agricultural land is increasingly becoming scarce, land wrangles are rampant which has increased land fragmentation thus low agricultural output is realized.

UNEB 2011.

a) *Explain the role of agriculture in the development of an economy (10 marks)*

b) *What measures can be done to improve agricultural sector in an economy (10 marks)*

STEPS BEING TAKEN TO IMPROVE AGRICULTURAL SECTOR IN UGANDA.

The government is trying to improve the performance of agriculture through plan for modernization of agriculture aimed at eradicating poverty by transforming agriculture from subsistence production to commercial agriculture and is aiming at implementing several reforms in agriculture.

- **Establishing agro-based industries/industrialization within the agricultural sector.** This is being done in order to add value to agricultural products so as to fetch high prices especially on the international market.
- **Adopting land reform policies.** The government is putting more emphasis on redistributing land from absent landlords and rich owners of large expanses of land to people who need to use it for agriculture thus increasing agricultural output.
- **Diversifying markets for agricultural products/market expansion.** The government is increasing market for agricultural output through joining regional groupings such as the EAC, COMESA and discouraging importation of agricultural products similar to what is locally produced together with liberalization of agricultural export markets.
- **Developing and improving infrastructure.** Existing roads are being upgraded and feeder roads are being established in order to ease the transportation of agricultural products to market centres. Transportation of agricultural inputs and rural electrification is being promoted.
- **Providing credit facilities to low income farmers**. The government is encouraging the establishment of financial institutions in rural areas for instance SACCOS and micro finance institutions so as to avail credit to farmers for agricultural production.
- **Promoting mechanization of agriculture**. The government is implementing the plan for modernization of agriculture through setting up irrigation schemes, agricultural mechanization to increase output by availing farmers with tractors, ox-ploughs to increase agricultural production.
- **Diversifying agricultural sector.** The government is encouraging them production of variety of crops and rearing of animals through NAADS programme to reduce dependence on a few agricultural crops and problem of price fluctuations.
- Stabilizing political climate. The government is holding peace talks with rebel groups in affected areas to ensure certainty for life and property and enable people effectively carryout agriculture.
- **Carrying out research within their agricultural sector.** Research is being carried out to improve on quality of products in agriculture, introduce new crop and animal varieties. For instance introducing of new crop and animal varieties by NARO and ensuring participation of all stake holders, Entebbe research centre for animal veterinary, Kawanda research centre.
- **Training of labour reforming education system.** The government is promoting the teaching of agriculture in schools and tertiary institutions to empower students with farming skills and create practical agricultural practioners so as to change the negative attitude of people towards agriculture.
- **Improving extension services to farmers.** This is being operated at various levels through NAADS programme where extension officers normally conduct demonstration farms, education to farmers on better crop varieties, proper farming methods and the use of fertilizers. There are extension workers at any sub country aimed at bringing agricultural extension services near to farmers.
- **Encouraging development/revival of co-operatives**. For instance Uganda national farmers association and joining cooperatives through Uganda cooperative alliance and this ensures joint marketing and storage of agricultural products. This helps to stabilize prices hence high agricultural returns.

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- **Provision of inputs to farmers at subsidized rates.** This is being done in order to encourage production at a low cost and attract several agriculturalists
- **Improving pricing policies.** This is done through strengthening international commodity agreements which encourages increased production among farmers.

MECHANIZATION OF AGRICULTURE.

Mechanisation of agriculture refers to extensive introduction of machinery in agriculture (farm production activities) thus resulting into reduced labour input per given level of output. It involves mainly use of capital intensive techniques of production in agricultural activities such as tractors, combine harvesters and ox-ploughs.

It is mainly used in large scale farms.

Advantages of agricultural mechanization.

- Increases output since it makes farmers cultivate more land. It increases productivity of labour.
- Improves the quality of agricultural output through mechanized planting, harvesting and spraying.
- Simplifies farming activities by making it easier and less tiresome.
- Increases the size ofland under cultivation hence reducing excess capacity in agriculture.
- Increases acquisition of skills by farmers who are trained to use machines.
- Reduces costs in terms of supervision of labour.
- Appropriate to climate changes in agriculture. For example in dry areas, it can still be applicable.
- Encourages the development of rural infrastructure.
- Very helpful where labour is scarce.
- Promotes agricultural research hence inventions and innovations in agriculture.

UNEB 2008

Mention any four factors that limit agricultural mechanization in your country. (04 marks)

FACTORS THAT LIMIT AGRICULTURAL MECHANIZATION IN UGANDA.

- Inadequate capital among farmers.
- Limited technical man power to handle machines so as to maintain them in good state.
- Conservation among some farmers.
- Poor land tenure system.
- *Limited market for agricultural output.*
- *Unfavourable natural factors such as rugged terrain,*
- *Under developed infrastructure.*
- *Unstable and low agricultural price.*
- *Political instability in some areas.*
- *Corruption and embezzlement of funds hea mechanization.*
- *Limited entrepreneurial skills.*

Subsistence Agriculture.

Subsistence agriculture *refers to agricultural produc own consumption. It involves production of mainly fo requirements of the farmer.*

It is characterized by.

- *Family labour is mainly used.*
- *Production is mainly on a small scale.*
- *It uses mainly poor techniques of production.*
- *Quality of output is generally low.*
- *Limited specialization in production.*
- *Low productivity is generally realized.*

Why is it necessary to reduce dominance of subsis an economy.

- *To reduce income inequalities.*
- *To widen the tax base.*
- *To accelerate the process of rural transformation.*
- *To expand market for industrial output.*
- To encourage more innovations and creativity in pr
- To increase productivity and reduce production at
- To encourage monetization of the economy.
- To improve the quality of agricultural output.
- To create more employment opportunities.
- To increase supply of raw materials to agro based

Commercial Agriculture.

Commercial agriculture is agricultural production whic for market. It is carried out a large scale but in most dev is still generally on a small scale compared to developed

It refers to promotion of agricultural production main involves use of modern tools, use of modern tools, u improvement of land, use of improved crop and anima it is limited by-

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- Limited capital among farmers.
- Land fragmentation.
- Poor land tenure system.
- Poor political climate.
- High level of conservation among farmers.
- Underdeveloped infrastructure.
- Inappropriate education system in relation to agriculture.
- Limited use of mechanization practices.

AGRICULTURAL DIVERSIFICATION

Agricultural diversification is the creation of a wide range of economic activities in agricultural sector to avoid relying on few activities in order to produce variety of agricultural output.

Or

It refers to attendance of widening the scope of production activities within the agricultural sector. For instance producing a variety of crops and rearing many animals.

AGRICULTURAL MODERNIZATION

Agricultural modernization. Is the process of changing the agricultural sector from subsistence production to a commercialized high yielding sector.

Or

This refers to the process of changing agriculture from traditional subsistence production to modern commercial production aimed at increasing both quality and quantity of output.

It has been embarked on in Uganda as a macroeconomic agricultural plan known as plan for modernization of agriculture (PMA).

PMA is meant to eradicate poverty and improve people's livelihood through raising farm productivity on a sustainable level. It aims at introducing technological changes throughout the agricultural sector.

UNEB 2008.

i) *Define the term agricultural modernization. (01 marks)*
ii) *Mention any three methods of agricultural modernization. (03 marks)*

METHODS OF AGRICULTURAL MODERNIZATION.

- Rehabilitation and extension of necessary infrastructure in different places.
- Undertaking land reforms to increase productivity.
- Diversification of agriculture.

- Provision of favourable credit facilities to farmers.
- Carrying out agricultural research.
- Provision of inputs to farmers at a subsidized price.
- Providing extension services and setting up demonstration farms.
- Mechanization of agriculture.
- Industrialization in order to increase on quality of output.
- Ensuring better marketing systems.

UNEB 2010

a) *What is meant by the term "agricultural modernization. (04 marks)*
b) *Explain the factors limiting agricultural modernization in your country. (16 marks)*

LIMITATIONS OF AGRICULTURAL MODERNIZATION IN UGANDA.

1. **Limited market size for agricultural products.** The market for agricultural output is limited both internally and externally which discourages large scale agricultural production through the use of machinery.
2. **Limited supply of capital/low incomes.** Many farmers have low incomes and are unable to raise enough capital and purchase agricultural inputs to increase agricultural production.
3. **Inadequate skilled labour.** Agricultural engineers and extension workers are not enough and most farmers are unskilled thus low quality and quantity of agricultural output.
4. **Price fluctuations of agricultural products/low prices of the products.** prices of agricultural products are never stable both in the domestic market and foreign market which reduces monetary returns for reinvestment in the sector and discourages farmers.
5. **Conservatism of some farmers.** Certain tribes still maintain tieswith their traditional crops and animals and are reluctant to adopt new and high yielding animal and crop varieties which keeps production on a subsistence level.
6. **Unfavourable natural factors/ natural hazards.** These are in form of crop pests and diseases, unpredictable climatic conditions which reduce agricultural output.
7. **Poor land tenure system.** Large expenses of land belong to few individuals who are not willing to use it for agriculture which limits free use of land for increased agricultural output.
8. **Poor infrastructure.** Road network, railway network is not modernized especially in rural areas which limits transportation of agricultural output to market centres and agricultural inputs to areas of production which limits large scale agricultural production.

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9. **Political instability in some areas.** Poor political climate in some areas discourages large scale agricultural production because of increased uncertainty for life and property among farmers
10. **Poor techniques of production/low level of technology.** Agriculture is dominated by use of rudimentary tools such as hand hoes, axes, pangas, such low level of technology leads to small scale agricultural production
11. **Low levels of accountability.** Rampant corruption and embezzlement of funds meant for agricultural modernisation by policy makers and implementers limits the necessary changes in the sector for agricultural modernization.
12. **Unfavourable topography.** This is in form of rugged relief which limits use of machinery in production thus low output.
13. **Limited entrepreneurship skills.** This limits proper organization of other factors of production leading to limited output.

UNEB 2007.

Mention any four features of industrial sector in your country. (04 marks)

B. THE INDUSTRIAL SECTOR.

Industrialization is the process of transforming raw materials with the aid of human resources and capital goods into consumer goods and new capital goods. The industrial sector in Uganda is generally small but growing at a steady rate.

UNEB 2008.

a) *Describe the structure of industrial sector in your country. (06 marks)*
b) *Examine the factors that have influenced the development of the industrial sector in your country. (14 marks)*

UNEB 2011.

a) *Describe the features of the industrial sector in your country. (10 marks)*
b) *Explain the measures being taken to improve the industrial sector in your country. (10 marks)*

STRUCTURE OF INDUSTRIAL SECTOR IN UGANDA/...
INDUSTRIAL SECTOR IN UGANDA.

NB. Qualifiers are very important but do not specialize ambiguous and generalized responses.

1. It is *dominated* by small scale industries and a fe... industries thus employing very few people.
2. It *mainly* comprises of processing industries such as ... and tea processing, sugar and cement processing industr...
3. *Most* small scale industries are privately owned by ... and large scale industries are *mainly* owned by foreign ... industries, brewing industries and soft drinks industries.
4. *Many* industries are agro based such as dairy industr... sugar processing, tea processing and coffee processing.
5. The sector is *basically* urban based in towns such as ... Jinja, Mbale, Tororo, Hoima and Mbarara.
6. Production is *mainly* of low quality manufactured g... employing poor technology.
7. Industries *mainly* produce consumer goods such as ... dairy products, bread, soft drinks and beverages.
8. It is *dominated* by import substitution industries ... production is largely for local market such as beverage ... sugar processing industries, soft drinks industries.
9. It *basically* depends on imported raw materials and int... which are used in processing and manufacturing industr...
10. *Mainly* uses labour intensive techniques of production ... scale industries where capital intensive technology is em...
11. The sector has limited linkages with other sectors of th...
12. Industries *mainly* produce at excess capacity and the... contribution to GDP is low due to limited power ... entrepreneur skills and inadequate market.
13. Many industries *mainly* use unskilled and semi skilled...
14. Durable consumer goods industries are mostly assem... instance different parts of vehicles are imported and ... Uganda.

FACTORS THAT HAVE INFLUENCED THE DEVELOPM... INDUSTRIAL SECTOR IN YOUR COUNTRY.

NB. Have/has/is can be used in explanation for such a qu... speculate.

Neutral points must be presented and explained in two ... positive part which favours industrial development and a ne... limits industrial development.

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7. **Government policy on industrial development.** Favourable government policies on industries such as subsidization, fair taxes have encouraged development of industries while unfavourable government policies on some industries such as heavy taxes have limited industrial development.
8. **Availability of land for expansion.** Presence of enough land in in some areas has encouraged ion has limited the development of industries.
9. **Level of technology.** High level of technology through the use of capital intensive technology especially in urban foreign owned industries has increased industrial development whereas low level of technology through the use of poor and labour intensive technology has limited the growth of some industries.
10. **Level of accountability.** Proper accountability in some industrial firms has encouraged development of such industries whereas corruption and embezzlement in some industries has limited industrial development.
11. **Size and quality of labour force.** Presence of enough labourforce and of high quality skills for some industries has encouraged industrial development while limited labourforce for some industries has limited industrial development.
12. **Amount of capital.** Presence of enough capital has encouraged the growth of some industries while limited capital has limited the development of some industries.
13. **Level of economic stability.** High level of economic instability in form of persistent inflation has limited the development of industries whereas low level of economic instability has encouraged the development of industries.
14. **Political climate.** Politically stable areas have encouraged industrial development while industrial development has been discouraged in politically unstable areas.
15. **Level of infrastructure development.** High level of infrastructure in terms of roads, railways, power supply have increased the level of industrial development whereas underdeveloped infrastructure has discouraged industrial development.
16. **Size of market for output.** A big market size for industrial output ha encouraged the growth of some industries while a small market size ,for industrial output has discouraged the development of some industries.
17. **Supply level of raw materials.** High supply of raw materials for industries has encouraged zthe development of some industries while limited in some has discouraged their development.

UNEB 2005.

a) *Describe the features of the industrial sector in your country.* (10 marks)

b) *What are problems faced by the industrial sector in your country.* (10 marks)

CONSTRAINTS TO INDUSTRIAL DEVELOPMENT\PROBLEMS FACED BY INDUSTRIAL SECTOR IN YOUR .

1. **Weak entrepreneur skills.** Most investors in the sector have limited initiative and leadership skillsand are not able to organize other factors of production for increased production and this leads to collapse of already established industries
2. **High taxes imposed on industries.** These increase production costs and reduce profitability hence a distinctive to industrialists since it reduces profits.
3. **Poor land tenure system.** This leaves ownership of land to a few a few people who cannot effectively exploit it for industrial expansion for instances there is shortage of industrial land in Kampala and Mukono which limits industrial expansion
4. **Limited skilled man power.** There are few accountants and industrial managers available for employment and therefore dependence on expatriates who are very costly.
5. **Inadequate market size.** The domestic market faces stiff competition from high quality imported commodities and foreign marketsis highly competitive because L D Cs produce similar commodities.
6. **Poor infrastructure.** This is in form of limited telecommunications facilities, banking facilities and poor roads and railway net work which makes transportation of factor inputs and industrial products difficult.
7. **Limited capital stock.** There is inadequate supply of real and monetary capital and therefore firms are forced to produce at excess capacity because industries require heavy capital investment thus low capital accumulation.
8. **Low levels of technology.** There is heavy dependence on imported expensive technology which limits industrial expansion and this is worsened by constant industrial breakdown which limits industrial growth.
9. **Political instability in some areas.** Political unrest in some areas discourages producers from setting more industries and destroys the existing industries thus discouraging investors in the sector.
10. **Poor performance of agricultural sector.** Agriculture is the main source of raw materials for industries but because of uncontrollable natural factors, it continues to perform poorly thus unreliable supply of raw materials to industrial sector especially agro based industries.
11. **Stiff competition from foreign goods.** There is increased importation of high quality commodities because of high marginal propensity to import which discourages large scale industrial production.

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MEASURES BEING TAKEN TO IMPROVE ON THE PERFORMANCE OF INDUSTRIAL SECTOR IN UGANDA.

The government is campaigning for an internationally competitive, variable and strong industrial sector through the following ways;

- **Ensuring economic stability to stabilise prices.** This is being done through the use of relevant monetary policies so as to give confidence to industrialists about future prices. This is through fighting inflation and stabilizing interest rates to encourage production at a low cost.
- **Adopting land reform policies.** The government is redistributing idle land to potential industrialists to create more room for industrial activities hence leading to setting up of various industries.
- **Developing necessary infrastructure.** New roads are being constructed and the existing ones rehabilitated to ease the transportation of industrial inputs and final products, power supply projects thus increased industrial production.
- **Widening market for output.** The government is joining economic groupings to increase market for manufactured products through EAC, COMESA so as to reduce on trade barriers and expand market for industrial output to attract more industrialists.
- **Provision of investment incentives to industrialists.** The government is giving subsidies to both local and foreign industrialists, tax exemptions and holidays thus attracting more investors in the sector. For instance removal of sales tax to avoid double taxation.
- **Further liberalization of the economy.** The government is removing all unnecessary controls and barriers on trade to free trade so as to encourage people to set up industries. For instance liberalization of foreign exchange markets to enable industrialists acquire foreign currencies easily.
- **Further privatization of public enterprises.** This is being done so as to enhance effective performance of the industrial sector by attracting more private investors into the industrial sector.
- **Vocationalising education to equip labour with skills.** Educational policy aimed at equipping labour with industrial skills is being promoted through skills oriented educational programmes through, practical subjects and providing on job training to local labour to enhance effective performance of industrial sector.
- **Setting up specialized institutions to encourage investors.** Institutions such as UIA are being established so as to give direction and information to both local and foreign industrialists thus promoting industrial growth.
- **Stabilizing political climate.** The government is continuously putting more emphasis on political stability by equipping security agencies, holding peace talks with rebel groups to ensure security throughout the country and this is a pre-requisites for industrial development.
- **Modernization of agriculture (developing cheaper supply of raw materials).** The government is putting more agricultural development through plan for modernization in order to ensure constant supply of raw materials to agro and production at low costs thus expansion of the industrial
- **Improving technology/techniques of production.** through technology transfer, development and stimulate industrial growth by improving the quality and
- **Improving entrepreneurial skills.** Investors are being organizational skills through training in various workshops growth. Promoting entrepreneurship education that investors in the sector.
- **Fighting corruption and embezzlement allocation.** Misuse of resources by policy makers and plan being fought using relevant organs such as police and so as to attract more industrialists.
- **International publicity campaigns to attract industr** The government is extensively advertising in foreign mass me the various industrial investment opportunities available i attract more foreigners in the sector.
- **Provision of affordable credit/capital for industrialist** being done so as to attract many investors in the sector du accessibility to credit.

ECONOMIC DUALISM IN UGANDA'S ECONOMY.

Economic dualism is where there is co-existence of two econ economic situations/conditions with one being superior and another being inferior and undesirable.

A dual economy is the one where there is co-existence of t sectors one being desirable and another one undesirable.

It means that one sector is advanced, modern, desirable, supe other is traditional, backward, inferior, or undesirable.

UNEB 2014

(i) What is adual economy? (01 mar

(ii) State any three advantages of a dual economy. (03 m

UNEB 2007.

i) What is meant by the term dual economy. (01 mark)

ii) Mention any three features of a dual economy. (03 mar

UNEB 2005, 2003, 2001.

State any four features of dualism in your country. (04 mar

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UNEB 2013.

Mention any four features of dualism in your country. (04 marks)

EXAMPLES OF ECONOMIC DUALISM.

- Mordern technology versus rudimentary technology.
- Extremly rich versus very poor people.
- Commercial production versus subsistence production.
- Rural areas versus urban areas Developed regions versus underdeveloped regions.
- Formal sector versus informal sector.
- Bater trade versus monetary trade fillites versus illiterates.
- More developed countries versus less developed countries.
- Small scale production versus large scale production.

CAUSES OF DUALISM IN UGANDA.

- Concentration foreign investments in specific areas and sectors of interest especially in major urbarn centers.
- Un even distribution of social economic infrastructure.
- Importation of social economic infrastructure.
- Uneven natural resource endowement.
- Demonstration effect on consumption in developing countries.
- Comperative advantage theory which ties L D Cs to primary products.
- Unfavourable policies of taxation.
- Rapid population growth rate.
- Emergency of monopoly and oligopolistic firms in production.

PROBLEMS/DEMERITS OF ECONOMIC DUALISM IN DEVELOPING COUNTRIES.

- Leads to rural urbarn migration.
- Creates imbalance in development.
- Results in to un even distribution of income.
- Leads to under utelisation of resouses in the traditional sectors.
- Results in unemproyment such as technological unemployement.
- Reduces government tax revenue due to reduced taxable capacity.
- Reduces aggregate demand for goods and services.
- Creates social conflicts\un rest between the poor and the rich.
- Makes government economic planning difficult because of divergent sectors.
- Leads to mis allocation of resources to cater for then inferior sectos.
- Leads to domination and exploitation LDCs by MDCs.
- Retards the rate of economic growth especially by the inferior sectors.

THE INFORMAL SECTOR.

An informal sector refers to an immediate sector that exists between the modern sector and the traditional sector or back ward sector.

This is a sector which is midway between the traditional subsistance sector and modern monetary sector.

Its is a sub urban sector made up of small scale individually operated business with Limited formal book keeping and out side direct government control. For instance shoe shiners petty retail trade,tax drivers,tailors,local distillers, caperiters and hawkers.

UNEB 2009, 2006.

i) Define the term informal sector. (01 marks)
ii) State any three features of informal sector. (03 marks)

UNEB 2011.

Mention any three features of an informal sector. (04 marks)

UNEB 2015

State four characteristics of the formal sector in your country. (04 marks)

CHARACTERISTICS OR FEATURES OF AN INFORMAL SECTOR.

NB. Qualifies are necessary when giving your points.

- Its *dorminated* by small scale firms which are individually owned.
- Production is *mainly* for domestic market.
- It uses *mainly* simple production techniceques which are labour intensive.
- It produces *mainly* consumer goods.
- It *mainly* uses locally available inputs or raw materials.
- Limmited accounting procedures such as formal book keeping and record management.
- Its *mainly* sub urbarn and urbarn based.
- Limmited government control over the activities carried out in the sector.
- *Mainly* low quantiy of out put is produced by firms ie .there is genellary low productivity.
- *Dominated* by sole prpprietorships.
- Its *mainly* dominated by unskilled and semi skilled labour.
- *Mainly* produces low quality goods.

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UNEB 2000.

a) *What are the features of an informal sector* (04 marks)
b) *Assess the contribution of the informal sector to your country* (16 marks)

UNEB 2000.

a) *What are the features of an informal sector.* (04 marks)
b) *Asses the contribution of the informal sector to your country* (16 marks)

UNEB 2003, 2001.

What is the role of the informal sector to your country (04 marks)

ROLE OF INFORMAL SECTOR IN AN ECONOMY.

Positive role of the informal sector in an economy.

1. **Creation of employment opportunities.** This is because it mainly uses labour intensive technology where both semi skilled an un skilled labour is absorbed thus reducing unemployment.
2. **Widens consumers choice.** There is awide range of activities carried out in the sector hence increased diversification. It reduces awide variety of commodities from where the consumers chooses.
3. **Promotes technological development or increases innovation and invention.** The sector is dormited by small scale firms and thi creates comperative production which are innervative.
4. **Promotes fair distribution of income.** Since it mainly uses semi skilled and un skilled labour and majority participate in production, it fairy distributes income
5. **Promotes commercialization of the economy.** It produces mainly for market which helps to reduce the subisistance sector.
6. **Contributes tax revenue to the government to some extent.** The diverse economic activities carried out in the sector are taxed by the government thus increasing government tax revenue.
7. **Promotes acquisition of entrepreneur skills.** Individual sole proprietors are able to organize factors of production to ensure that their business performs successfully thus acts as training ground for managers in acquisition of entre prenuer skills.
8. **Facilitates exploitation of local resources.** It largely depends on locally inputs and this increases output and exploitation of domestic resources such as minerals, forests, water.
9. **Provides cheap training ground for local labour.** Since the sector employs mainly semi skilled and un skilled labour there is on job training which enhances skill acquisition.

10. **Reduces capital out flow.** The sector uses less on imported raw materials and it is thus reduced profit repatriation.
11. **Facilitates production of locally affordable goods.** uses local inputs and production costs are lower, priced output leading to increased consumer welfare.
12. **Increases the level of GDP.** The sector contribute level of output thus increase in the Gross Domestic

Negative role of the informal sector in an economy.

1) **Leads to congestion in sub urban areas.** It attracts lar sub urban areas since its activities are normally concentrate
2) **Causes high social costs in sub urban areas.** This lead its negative effects on the environment thus hig expenditure. The small scale industries pollute air, wa through their activities.
3) **Creates wasteful competition and duplication of** through excessive advertisement by individual firms leadi wastage.
4) **Promotes production of poor quality output.** The use and un skilled labour and low technology are associated low quality.
5) **Leads to high administrative costs.** The government to maintain effective performance of the sector in monitoring its activities. For instance setting up infrastructure and providing security.
6) **Less government revenue or fluctuation in the governm** This is due to the limited record keeping, un registered bus rate of tax evasion and avoidance in the sector.
7) **Produces at excess capacity leading to under utili available resources.** This implies low level of output.
8) **Leads to under employment and disguised unemploy** because most activities are on asmall scale with the sector

PROBLEMS FACED BY THE INFORMAL SECTOR IN UGAN

1. **Inadequate capital.** Owners of businesses in the secto access to finance due to lack of collateral security and this expansion.
2. **Interruption from the government.** Town inspectors and activities. For instance chasing town vendors from streets
3. **Limited market size.** This is due to the stiff compe producers of similar products which limits expansion of th

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6. **Poor management of the business.** Majority of the operators in the sector are not well versed with modern business management skills thus frequent closure of the business.
7. **Low level of technology.** Industries mainly use simple technology leading to low quality output which can compete favourably with imported similar products in the domestic market.
8. **Limited entrepreneurial skills.** Most owners of the business in the sector do not have skills to organize other factors of production beyond their first year of operation thus limited business expansion.
9. **Under developed infrastructure.** The productive infrastructure required to support the growth and expansion is limited for instance under developed roads and power supply.
10. **Shortage of basic raw materials.** Since they are competed for by several firms. This limits the ability of business to expand.
11. **Un stable prices or inflation.** Persistent increase in the general price leads to loss of money value and this reduces profitability of the business and business expansion as well.
12. **High costs of doing the business.** This is inform high rent,cost of trade license in sub urban areas thus discouraging business operators.

UNEB 2009.

i) Distinguish between economic dependence and interdependence. (02 marks)

ii) State two forms of economic dependence in your country. (02 marks)

ECONOMIC DEPENDENCE

Economic dependence is the reliance of an economy on another or specific economic sectors for resources and economic decisions for her development or survival.

There is no any economy in the world that is self sufficient but the degree of dependence differs from country to country depending on the level of economic development.

UNEB 2007.

a) In what ways is your country economically independent (10 marks)

b) What are the implicationsn of economic dependence in your country (10 marks)

UNEB 2011.

i. Differentiate between economic dependence and economic interdependence. (02 marks)

ii. Give any two of economic dependence in your country. (02 marks)

UNEB 2016

(i) What is meant by the term economic dependence? (01 marks)

(ii) Mention any three forms of economic dependence in your country. (03 marks)

WAYS IN WHICH UGANDA IS ECONOMICALLY DEPENDENT.

- **External resource dependence.** This is where an economy depends on external resources such as foreign capital foreign skills foreign entrepreneurs and foreign technology for her survival.
- **Direct economic dependence.** This is where decision making power on the direction of economic management are are undertaken by foreign governments and multinational corporations and international organizations ie dependence on foreign decisions such as world bank IMF play avery big role here.For instance policies such as privatization trade liberalization, rentrenchmentin are initiated here byIMF and the wold bank.
- **Sectoral dependence.** This where the country relies on a particular sector for most of its developmentactivities. For instance on agriculture as amajor source of foreign exchange.
- **Trade dependence.** This is where acountry relies on importation and exportation of apaticular commodities from or to other countries. It is involves awide range of imports and exports for both consumer and capital goods to meet the market demand.

Trade dependence may be in form of export dependence on afew exports and in this case, Uganda depends on a few primary export crops such as coffee cotton tea tobacco as amajor source of foreign exchange. It is also in inform of import dependence where acountry relies on imports of both consumer and capital goods. Uganda imports awide range of veriety of commodities such as marchinary ,drugs, veichles clothes auto mobile and computers.

UNEB 2009.

i) Define the term economic dependence. (01 marks)

ii) Give three effects of economic dependence in an economy (03 marks)

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NEGATIVE EFFECTS OR PROBLEMS OF ECONOMIC DEPENDENCE IN YOUR COUNTRY.

- **Worsens the balance of payement problem.** Since LDCs export primary products and import mainly expensive capital goods, theren is ahigh foreign expenditure.
- **Leads to under utilisation of domestic resources.** A country relies on other countries for particular resources instead of utelising her domestic resources.
- **Discourages local initiatives and efforts or encourages laziness.** High foreign given to LDCs discourage or makes people in the recipient coutry. This suppresses the development of locall skills and entrepreneurs.
- **Leads to heavy debt burden.** External debt crisis facing LDCs results directly from high external resource dependence.
- **Leads to erosion of social culture values.** The natives adopt undesirable fporiegn values and beliefs leadin to culture erosion.
- **Subjects an economy to dumping for manufactured goods from donors.** This suffocates the domestic maket leading to collapse of infant industries.
- **Encourages capital out flow.** It leads to continuous loss of acountrys capital through debt servicing, importationn of foreign goods and profit repatriation by foreign investors .
- **Leads to economic dormination by foreigners.** Since the economy depends on economic decisions made by donor agencies, it is unstable to carry uout independent decisions with out seeking approval from foreign donors.
- **Leads to political dormination by foreigners/loss of political independence.** Over reliance on other contries for decisions and resources erodes acountry of her politicalsoveriengnity and foreigners take politics of the country.
- **Leads to imported inflation.** Heavy importation increases chances of importing from infration hit economies because of un restricted inflow of imports.
- **Leads to unemployement of local man power.** This results from heavy importation of marchinary thus replacing human labour and excessive use of expertriats.
- **Leads to stagnant development of the local technology.** This limits technological development.
- **Discourages domestic savings and investment.** This is due to increased reliance on external resources.

UNEB 2004.

(i) What is meant by the term economic dependence. *(01 marks)*

(ii) Suggest any three measures to reduce economic [illegible] country. (03 marks)

MEASURES TO REDUCE ECONOMIC DEPENDENCE [illegible] OR IN LDCs.

1. **Diversification of the economy.** Various economic [illegible] encouraged so as to increase the the volume [illegible] exports.
2. **Trainig of local labour force.** Local labour should be [illegible] job training so as reduce dependence upo expatriates [illegible]
3. **Diversification of markets.** Local labour should be [illegible] joining economic integration to reduce [illegible] concentration of trade.
4. **Encourage local savings and investments.** Domestic [illegible] increased through financial istitutions developme[illegible] financial base of the country and reduce on foreign [illegible]
5. **Promote development of local technology.** There [illegible] appropriate technology so as to minimize depen[illegible] technology which is expensive.
6. **Ensure suitable patial and macro economic** pla[illegible] planning should be done so as to increase resource [illegible] ensure consistent use of available resources so as t[illegible] and minimize over reliance on imports.
7. **Improvement in political climate.** There is a need [illegible] stability to minimize capital out flow on importation [illegible] military hard ware and encourage large scale producti[illegible]
8. **Promotion of local entrepreneure skills.** Thism shoul[illegible] relevant educational training to increase investment a[illegible] reliance on foreign investors.
9. **Promote import industrial substitution strategy.** In[illegible] established in the domestic economicsm to reduce [illegible] commodities which reduce on the rate of importation.

UNEB 2006.

Give four demerits of economic dependence in your country

Demerits of economic dependence in Uganda.

- ✓ Increased capital flow.
- ✓ Stagnants development of local technology.
- ✓ Discourages domestic savings and investment.
- ✓ Increased persisitet balance of payement problems.
- ✓ Heavy external debt burden.
- ✓ Kills local initiative or encourages lazmess.
- ✓ Increaseed economic dormination by foreigners.

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- ✓ Increased political domination by foreigners or loss of political independence

ECONOMIC INTERDEPENDENCE.

Economic interdependence is the situation in which two or more economies rely on each other for mutual benefits of all.

Or

It's the mutual co existence between two or more economies where economies

Benefit equally from trade and other activities. This is only possible where trading countries are at the same level of development.

UNEB 2009.

a) Describe the structure of exports in your country. *(06 marks)*
b) Suggest measures that should be taken to increase export earnings in your country
(14 marks)

STRUCTURE OF UGANDA'S TRADE.

A. EXPORT SECTOR IN UGANDA.

The export sector is dominated by agricultural products and other semi finished products which make export volume and foreign exchange earning unpredictable.

Uganda's exports are destined to COMESA region, European Union, Asia and east African countries.

Major exports of Uganda include- coffee, cotton, tea, cattle hides, flowers, fish and fish products, fruits, vanilla, textile fibres, live animals, timber dairy products, maize and electricity.

UNEB 2004.

Give any four features of Uganda's export trade. (04 marks)

FEATURES OF EXPORT TRADE IN UGANDA/STRUCTURE OF UGANDA'S EXPORT TRADE.

NB. Qualifiers are necessary when giving your points.

- ✓ Exports are *mainly* agricultural products dominated by traditional crops such as coffee, cotton, tea and tobacco.
- ✓ Limited variety of exports/commodity concentration of trade.

- ✓ Exports are basically semi processed/low value added implying low value added on exports.
- ✓ Limited range of markets for export/geographical concentration of trade.
- ✓ Mainly poor quality goods are exported.
- ✓ Mainly fetch low prices which are ever fluctuating on the international markets.
- ✓ Few manufactured consumer goods are exported.
- ✓ Few services are exported.
- ✓ Mainly low volume of exports.

MEASURES THAT SHOULD BE UNDERTAKEN TO INCREASE EXPORT EARNINGS IN UGANDA.

1. **Diversification of export products.** Measures need to be put in place to have a variety of commodities for export and reduce commodity concentration of trade.
2. **Extensive advertising of commodities for export in the foreign markets.** This can be done by increased advertising in foreign media to increase demand for exports.
3. **Processing primary products to add value.** Value addition especially on agricultural products should be done through agro-based industries so as to increase prices for exports on the world market.
4. **Campaign for removal of trade barriers in exports market.** This increases the volume of exports thus increasing export earnings.
5. **Lowering costs of production.** This helps to increase competitiveness of exports on the world market thus increasing export earnings.
6. **Strengthening commodity agreements.** This stabilizes price on the world market thus increasing earnings from exports.
7. **Allowing the local currency to depreciate.** This increases demand for exports thus increasing foreign exchange earnings.
8. **Increasing the volume of exports by setting up export promotion industries.** Producing more for export market helps to increase export earnings.
9. **Diversification of export markets/joining economic integration.** This can be done through economic integration so as to increase export volume and reduce geographical concentration of trade.
10. **Establishment of export promotion institutions** such as Uganda export promotion board which is intended to encourage exports.
    Uganda export promotion board was created in 1996 by the act of parliament to promote and manage export industries.

B. IMPORT TRADE/SECTOR IN UGANDA.

Uganda is a net importerof commodities such as machinery, petroleum andits products, chemical materials,iron and steel. Office machines and

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automatic data processing machines, telecommunication and sound producing equipment, road vehicles , electronically machinery and appliances, paper and pulp, military hardware, human drugs, iron and steel, rubber manufacturers, essential oils, clothes and shoes.

FEATURES OF IMPORT TRADE IN UGANDA/STRUCTURE OF UGANDA'S IMPORT TRADE.

NB. Qualifiers are necessary when giving your points.

- ✓ Uganda *mainly* imports finished products such as petroleum products, pharmaceutical products and military hardware, machinery.
- ✓ Goods imported are *mainly* consumer goods and capital goods such as machinery.
- ✓ Importation of *basically* few services such as tourism, banking, insurance and telecommunication services.
- ✓ *Majority* of imports are highly priced.
- ✓ Imports are *mainly* of high quality.
- ✓ Importation of petroleum products *mainly* take the highest import share.
- ✓ Uganda *mainly* imports second hand commodities such as used vehicles, second hand clothes and bags.

MULTI-NATIONAL CORPORATIONS.

Multi-national corporations are international/transnational companies which have their headquarters in one country but with a variety of branches and areas of operation in a number of countries across the world *both developing and developed countries).

Examples are Philips, Shell, Coca-cola, Pepsi Cola, Barclays bank.

These multi- national corporations are playing a great role in spearheading economic growth and development in developing countries Uganda inclusive.

UNEB 2007.

Assess the impact of Multi-national Corporation in your country. (20 marks)

UNEB 2001.

a) What are multi-national corporations? (04 marks)
b) Assess the contributions of multi-national corporations to the development of your country. (16 marks)

POSITIVE CONTRIBUTIONS/IMPACT/ROLE OF MULTI-NATIONAL CORPORATIONS.

1. **Filling savings investment gap.** Multi-national corporations come with their capital hence supplementing the insufficient domestic savings.

2. **Closing the skilled man power gap.** They supplement what is locally available.
3. **Filling the skilled man power gap.** They supplement what is locally available.
4. **Create employment opportunities.** Labour projects set up by such corporations thus reducing
5. **Source of government tax revenue.** Thus a of investments carried out by such corporations employed in such investments thus increasing
6. **They promote development of local skills.** training and undertake labour training scientific and managerial aspects. This promotes local people to start their own investments.
7. **Accelerate industrial growth.** They set up and chemical plants, processing plants which and capital accumulation.
8. **Promote technological transfer and** corporations come with advanced techniques capital intensive technology thus technological
9. **Encourage infrastructural development.** They of transport routes, bankingfacilities, power services and this is a sign of economic development.
10. **Increase competition in production between foreign firms.** This leads to efficiency of local high quality output. They encourage innovations due to extensive research carried out by corporations and local enterprises in production.
11. **Facilitate production of a wide variety of** diversified activities hence a variety is produced choice.
12. **Promotion of international cooperation between countries.** This is important for international trade.
13. **Increase local resource utilization.** The would tapped which increases output since such corporations to exploit the resources which reduces resource
14. **Facilitate economic growth due to increased** an increase in GDP. They add to the productive hence more goods and services are produced scale.

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NEGATIVE CONTRIBUTIONS/IMPACT/ROLE OF MULTINATIONAL CORPORATIONS IN DEVELOPING COUNTRIES.

1. **Accelerate capital outflow**. This is through profit repatriation thus limiting further investment. This worsens balance of payment problems due to increased foreign exchange expenditure.
2. **Worsen income inequality**. This is because multi-national corporations employ few people who are highly paid and get high income at the expense of others thus widened income inequality.
3. **They worsen unemployment problem**. This is due to preference of advanced capital intensive technology and limited local labour is employed.
4. **Require excessive concessions/special fiscal incentives from the government**. These are inform of tax holidays, tax exemptions which are very costly for the government.
5. **Lead to regional and sectoral imbalances in development**. They prefer to operate in urban areas and in few specific sectors thus imbalances in development.
6. **They out compete local firms**. This leads to their closure and associated disadvantages because the produce on a large scale.
7. **Worsen external dependence which discourages local initiatives**. Most developing countries rely heavily on such corporations and limited initiatives for development are undertaken at home.
8. **Contribute to political and economic domination by foreigners**. Large scale multi national corporations interfere with the political decisions and economic decisions of the country thus limited national sovereignty.
9. **Contribute to over exploitation/irrational exploitation of resources.** This leads to quick depletion some key resources.
10. **Contribute to high social costs.** Negative externalities such as pollution increase due to large scale operations carried out by such corporations.
11. **Worsen rural urban migration and its disadvantages.** Most of these corporations tend to locate urban areas and attract people from rural areas thus high crime rates, congestion in urban areas.
12. **Contribute to erosion of cultural and moral values.** Developing countries copy undesirable culture beliefs such as modes of dressing which are socially undesirable.

PUBLIC SECTOR.

Public sector is that section of the economy where resources are publically owned and major economic activities are undertaken by the state

UNEB 2004

a) What is a parastatal organization? *(01 marks)*

b) Give any three reasons for the poor performance of parastatal organizations in developing countries.
(03 marks)

PARASTATAL ORGANIZATIONS.

Parastatal organizations are statutory bodies set up by the act of parliament to carry out certain functions that may not necessarily be profit motivated.

Or

These are business organizations established by the act of government to carry out specific activities on behalf of the state. They qualify to do so if at least 51% of the shares are owned by the state.

They are managed by people appointed by the government unlike public corporations. For example Uganda Coffee Development Authority, National Social Security Fund,National Insurance Corporation, Uganda Revenue Authority, National Agricultural Research Organization, Uganda National Bureau of Standards, National Drug Authority, Uganda Wildlife Authority.

A Public Corporation.

A public corporation refers to a business enterprise/organization in which the government holds either all the shares or majority of its share capital.

It is established by an act of parliament which clearly defines its aims and objectives to run specific activities within the state.

For instance Uganda national waters and Sewerage Corporation, National Housing and Construction Corporation.

A Public Enterprise.

A public enterprise is a business organization/enterprise which is set up, controlled and owned by the government or the state.

UNEB 2014

a) What is a parastatal organisation? *(02 marks)*
b) Describe the role of parastatal organisation in an economy. (18 marks)

UNEB 2008.

i) Distinguish between a private and a public enterprise. (02 marks)
ii) Give any two reasons for the establishement of public enterprises in your country. *(02 marks)*

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NEED FOR PARASTATAL ORGANIZATIONS /REASONS FOR ESTABLISHMENT OF PARASTATAL ORGANIZATIONS/PUBLIC ENTERPRISES IN UGANDA.

- To promote economic development.
- To avoid duplication in production and resource wastage.
- To provide essentials of life at fair prices such as water ,electricity and medical facilities.
- To ensure regional balance in development and reduce income inequality.
- To complement the private sector and reduce monopoly powers from the private sector.
- To protect consumers from exploitation and consumption of dangerous commodities by providing the services.
- To create sustainable employment opportunities.
- To promote investment.
- To raise public revenue for national expenditure and development.
- To produce goods of strategic importance i.e undertake very sensitive and risky strategic ventures such as national security and mining.
- To ensure social security.
- To undertake large scale enterprises which cannot be managed by private investors.
- To provide goods and services which have low commercial profitability but having high socio/economic benefit.
- To mobilize savings.

UNEB 2010.

a) What is a public corporation *(04 marks)*

b) Assess the role of public corporations in an economy *(16 marks)*

UNEB 2013.

a) Explain the contribution of public enterprises to the development of your country. *(10 marks)*

b) What are the problems faced by public enterprises in your country.(10 marks)

POSITIVE ROLE OF PUBLIC ENTERPRISES/CORPORATIONS IN AN ECONOMY.

- **Provide essential services to the population at affordable prices** such as education, health, water, supply. This improves standard of living since such enterprises normally charge low prices for output.
- **Help in avoiding foreign domination of the economy/promote economic independence.** Presence of large public enterprises reduces

the strength of private sector thus reducing ... domestic economy thus reduced balance of ...

- **They undertake strategic and risky ... strategic importance/investments of national ...** in strategic projects is effectively managed by ...
- **Provide non profitable but essential goods ... garbage collection.** The private sector is not ... such goods to benefit the entire population.
- **Source of revenue to the government.** This is ... prices for services rendered by public corporations.
- **Create sustainable employment opportunities** ... reduce on employment and ensure job security.
- **They complement private sector hence controlling ... and its evils.** Their activities helps to supplement ... private thus reducing the dangers of private monopoly.
- **They ensure social security.** This reduces on ... property especially insurance companies.
- **Raise large capital and undertake large scale ...** which private firms cannot easily manage.
- **Promote the level of investment thus economic ...** because are development oriented.
- **Ensure consumer protection against exploitation ... goods.** For instance Uganda National Bureau of ...
- **Promote fair distribution of income and wealth.**
- **Avoid duplication in production and resource ...**
- **They promote infrastructure development.**
- **They promote balanced regional development.**
- **They help to mobilize savings.**

NEGATIVE ROLE OF PUBLIC CORPORATIONS/ENTE... ECONOMY.

- **They are normally interfered with by politicians.** ... officials in these enterprises is normally influenced by p...
- **Result into poor accountability by public offici...** rampant in public corporations which limits production.
- **Limited flexibility in their activities.** There is ... necessary changes.
- **They discourage private investments/discourage ... private sector.**
- **They lead to high bureaucracy in decisio... implementation of plans.** This negatively affects their ...
- **They strain the government budget through subsid...** high government expenditure.
- **They produce poor quality products and services ... competition.**

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- **The public is taxed highly to cover the losses made by these public corporations.**
- **They limit consumer sovereignty.** This is because what is produced by such corporations does not correspond to consumers desires.
- **Shortages occur in times of breakdown.**

UNEB 2002.

State any four causes of poor performance of public enterprises in your country. *(04 marks)*

UNEB 1999.

Mention any four problems faced by public enterprises in your country. *(04 marks)*

PROBLEMS FACED BY PARASTATAL ORGANISATIONS/PUBLIC SECTOR/PUBLIC ENTERPRISES IN UGANDA OR CAUSES OF POOR PERFORMANCE/INEFFICIENCY OF PUBLIC ENTERPRISES IN UGANDA.

- Low levels of accountability/rampal corruption and embezzlement of funds.
- High bureaucracy andred tape.
- Foreign interference and influence. This discourages expansion of such enterprise.
- Poor management in most government departments/lack of enough skilled manpower.
- Poor infrastructure especially in rural areas.
- Political interference and sabotage in running of the enterprises.
- Limited commitment and interest on part of employees and management.
- Political instability and change of government. This limits expansion of such enterprise in such areas.
- Limited capital to run the enterprises due to low tax base.
- High level of competition from the private sector.
- Limited market size.
- Poor techniques of production.
- Price instabilities.
- Limited supply of raw materials.

PRIVATE SECTOR.

Private sector refers to that section of the economy consisting of productive activities directed and controlled by private individuals and companies.

In uganda it consists of a number of invetsments carried out by both foreign and local invetsors or individuals. With government privatization and economic liberalization, the private sector has greatly expanded in Uganda in the last 20years.

Several private investors both local and foreign have been attracted on board to participate in a diversity of economic activities.

Uganda has affected some reforms in providing a conducive investment platform for the growth of private sector which has led to the emergence of various private enterprises owned by both local and foreign investors.

A private enterprise is a business unit owned and controlled by private individual(s).

Characteristics/structure of private sector in Uganda.

- The main aim in production is basically profit maximization.
- It is dominated by small scale enterprises.
- Firms are mainly sole proprietorship.
- There is mainly production of low quality goods .
- Firms mainly employ local resources.
- Most firms mainly produce for local markets.
- Firms mainly employ unskilled and semi skilled labour.
- Most firms are characterised by poor or no record keeping.
- It tends to be dominant in urban areas.
- Large firms in the private sector are basically foreign owned.
- The private sector mainly produces consumer goods.

UNEB 2004.

a) Explain the role of the private sector in development of your country. *(10 marks)*

b) What are the problems faced by the private sector in your country *(10 marks)*

POSITIVE ROLE OF PRIVATE SECTOR IN DEVELOPMENT OF UGANDA.

1. **Provides employment opportunities.** Both semi skilled and unskilled labor is employed in various investments set up by individuals thus reducing unemployment.
2. **Accelerates economic growth.** This is because various industries and investments set up to increase output hence economic growth.
3. **Provision of government tax revenue.** The government taxesvarious activities in this sector and incomes of workers in such investments hence increasing government revenue.
4. **Promotes inventions, innovations and technological development.**This is as a result of stiff competition between various private firms especially where substitutes are produced.

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5. **Provision of a variety of goods and services.** Various products produced and supplied to the market hence widening consumers' choice. Private individuals engage in a variety of businesses so as to cater for different tastes and preferences.

6. **Facilitates the increased use of local resources.** Local resources such as land, water and forest resources are greatly utilised by various businesses established by various private individuals thus reducing resource under utilization.

7. **Promotes efficiency in production thus high quality products areproduced.** This is due to the stiff competition between producers and supervisors which increases consumer's welfare.

8. **Brings about infrastructural development.** It forces the government to establish supporting infrastructure in form of roads, power supply systems and infrastructure set by private individuals such as buildings hence smooth running of the economic activities.

9. **Helps in training local labor / development of skills of labor.** Thisleads to development of local skills through job training especially those employed in private industrial sector.

10. **Promotes commercialisation in production/reduces subsistence production.** Private individuals produce basically for market hence increased use of money as a medium of exchange.

11. **Increases foreign earnings which improves balance of payment position.** Some private enterprises produce for foreign markets and foreign entrepreneurs bring in foreign exchange for increased investment.

12. **Promotes industrial growth.** Private sector encourages the establishment of private industries hence industrial growth leading to increased production level.

13. **Promotes development of entrepreneurial skills.** Itenables people to engage in business activity leading to development of entrepreneur skills.

14. **Promotes economic diversification.** this reduces economic dependence because of increased involvement in various economic activities.

NEGATIVE ROLE OF PRIVATE SECTOR IN DEVELOPMENT OF UGANDA.

1) **Results into inequality.** Income tends to concentrate in the hands of few individuals with access to factors of production thus increased income gap.

2) **Creates unnecessary competition and duplication of goods and services.** This leads to resource wastage in production especially where substitutes are produced.

3) **Results into production of undesirable goods.** private individuals are driven by profit maximization goal and they

engage in production of harmful commodities consumer welfare

4) **Leads to irrational exploitation of** resources are over utilized to maximize profit resource depletion.

5) **Leads to foreign dependence and domination** scale private enterprises in private sector foreigners especially in the industrial sector

6) **Increases regional imbalances in development migration.** Most private individuals especially invest in urban areas with necessary neglecting rural areas. This implies that many are urban based.

7) **Worsens capital outflow.** Several private have to repatriate profits to their home countries investment in the domestic economy.

8) **Neglects production and provision of public** roads, water supply, security since private inv profit oriented thus reducing the strength of the

9) **Makes it very difficult for government planning** of the private sector are not directly controlled and it becomes difficult to be incorporated in the thus limiting effective economic planning.

10) **Causes constant price fluctuations** individuals aim at profit maximization through hoarding and speculation thus causing scarcity leading to high prices for commodities.

11) **Leads to emergence of private monopoly.** between private firms pushes weak firms to leading to monopoly powers thus unemployment of consumers by few existing firms.

12) **Increases social costs.** This is in form of production is controlled by profit motives thus le of the environment.

UNEB 2009.

a) Explain the challenges being faced by the private sec countries.
marks)

b) What measures should be taken to promote the developing
(10 marks)

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PROBLEMS FACED BY PRIVATE SECTOR IN UGANDA/DEVELOPING COUNTRIES.

- **Inadequate capital.** Most private investors have low incomes to pay workers, buy and maintain machinery hence limited scale of production in the sector.
- **Limited skilled manpower.** There is use of unskilled and semi skilled labour due to poor educational facilities and high illiteracy leading to low productivity and poor quality output.
- **Small domestic and foreign markets.** Domestic consumers have low purchasing power due to low incomes and foreign markets are highly competitive and this limits expansion of businesses.
- **Low level of technology.** Labour intensive technology dominates production hence leading to low output and production of poor quality and low quantity of output.
- **Limited entrepreneural skills.** This leads to limited willingness to take on risks and inability to organise other factors of production which affects management and organization of firms leading to low production levels.
- **Poor infrastructure.** This is in form of poor road network, limited banking institutions and power shortage which limits easy movement of output and inputs and this limits the level of production.
- **Poor political climate in some areas.** Unstable political climate in some areas disrupts production and creates uncertainty among investors which discourages more investment in the private sector.
- **Poor investment climate.** This is inform of unfair and high taxes, limited subsidies, high cost of trade licenses which reduce profit margins of firms thus discouraging further production.
- **Poor land tenure system.** Land belongs to few individuals, in some areas it is communally owned and fragmented. This limits large scale production in private sector.
- **Unfavourable natural factors/poor performance of the agricultural sector.** These include drought, floods, landslides which mainly affect agricultural sector such as changes in climate, which leads to poor performance of agricultural sector which reduces the quantity of raw materials available for agro-based industries.
- **Shortage of basic sources of raw materials to use in industries and other projects.** Raw materials are competed for by many private firms especially in industries thus high cost of inputs.
- **Unstable prices/inflation.** This makes money to lose value which scares away most investors and reduces profitability of business since it increases the cost of operating businesses.
- **High corruption and embezzlement of funds.** Funds meant to promote and develop the private sector are misused by government officials on board, investors are denied investment opportunities in the process thus limiting investment opportunities and reduces the level of profits.
- **Ineffective enforcement of patent/copy rights.** There is a lot of forgery and duplication of activities because patent rights are not properly emphasized thus creating duplication.
- **Bureaucratic delays.** This is in most cases experienced in the process of acquiring contracts, exportation of output and importation of inputs.

POLICIES BEING TAKEN TO PROMOTE THE PERFORMANCE/DEVELOPMENT OF THE PRIVATE SECTOR IN UGANDA/DEVELOPING COUNTRIES.

- ✓ **Offering investment incentives/provision of a conducive investment climate.** These include tax holidays, tax exemptions, subsidies to attract many private investors.
- ✓ **Further privatization of public enterprises.** This is mainly intended to enable more private individuals own enterprises.
- ✓ **Further liberalization of the economy.** More liberty given to private individuals to carry out economic activities encourages more private individuals to set up investments.
- ✓ **Improvement in political climate.** This helps to enable investors develop confidence in the economy and this reduces uncertainty for life and property which attracts more private investors.
- ✓ **Stabilizing economic climate/controlling inflation.** This is through relevant monetary policies and this stimulates production among private investors due to reduced cost of production.
- ✓ **Carrying out international publicity/campaigns.** This is through extensive advertisements made in international media showing foreign investors various investment opportunities available in Uganda thus attracting more investments.
- ✓ **Improving infrastructure.** With modernized roads, railways and power supply, investment activities in private sector are encouraged through increased factor mobility.
- ✓ **Expansion of market through economic integration.** For instance EAC, COMESA to attract more local and foreign investors in production.
- ✓ **Establishment of more specialized institutions** to encourage investments such as Uganda investment authority to handle needs of investors and provide information on investment opportunities available thus attracting more investors.
  - ✓ **Providing affordable credit or loans to private sector.** This is through encouraging the development ofmicro finance institutions, SACCOs and commercial banks which increases access to credit for investment.
  - ✓ **Fighting corruption and embezzlement of funds meant for private sector/ encouraging proper accountability.** This is done through anti corruption legislations so as to strengthen private sector initiatives.

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- ✓ **Promoting development of entrepreneurial skills.** This is done through increased training on enterprise growth which helps to equip people with investment skills thus increasing private investors.
- ✓ **Undertaking land reforms/changing land tenure system.** This enables private investors to access land and participate in various economic activities.
- ✓ **Training labour to acquire necessary skills.** This increases efficiency in production thus increased investment in private sector.
- ✓ **Encouraging technological development.** This is being done by encouraging increased technological transfer thus increased technological development and increasing investment in the private sector.

UNEB 2013.

a) Explain the role of the private sector in the development of your country (10 marks)

b) What measures have been taken to promote the development of the private sector in your country? (10 marks)

MEASURES THAT HAVE BEEN TAKEN TO PROMOTE THE DEVELOPMENT OF THE PRIVATE SECTOR IN UGANDA.

1. Developed infrastructure.
2. Provided affordable loans/credit to investors.
3. Improved political climate/ensured political stability.
4. Widened markets both local and foreign.
5. Ensured price stability/fought inflation.
6. Undertaken privatization policy
7. There has been liberalization of the economy.
8. Trained labour to acquire relevant skills.
9. Offered investment incentives.
10. Encouraged technological development.
11. Changed land tenure system.
12. Improved entrepreneurial skills.
13. Encouraged proper accountability/fought corruption and embezzlement.
14. Enacted copy rights and patent right laws.
15. Undertaken international publicity and campaigns.
16. Establishment of specialized institutions to promote investment.

FOREIGN AID.

Foreign aid refers to the transfer/inflow of subsidized resources from one country to another either directly or through international agencies. It can be multi-lateral aid or bi-lateral aid.

Or

It refers to the international transfer of resources in form of technical assistance among others either directly from one country to another (bi-lateral aid) or indirectly through multi-national agencies (multi-lateral aid).

Developing countries depend heavily on various forms of foreign aid to finance their budgets and other development endeavors.

Multi-Lateral Aid.

Multi-lateral aid *refers to assistance given to a country by various international aid agencies or multi-national agencies such as the World Bank, IMF, UNESCO, WHO and UNICEF.*

Bi-Lateral Aid.

Bi-lateral aid *refers to direct assistance given by one country to another for instance Germany giving aid to Uganda.*

UNEB 2010.

i) What is meant by the term 'tied trade' marks)

ii) Give any three problems of relying on foreign trade marks)

Foreign trade can be tied or untied trade.

Tied Aid.

Tied aid is the aid which requires the recipient country to conditions set up by the donor. For instance the recipient country to purchase goods from the donor country using the grant recipient country is required to implement socio-economic conditions dictated by the donor before the aid can be given specific project named by the donor.
For instance project tied aid. It is therefore tied to projects dictated by the donor.

Project tied aid. This aid is where the donor countries direct that should be done with the provided aid.

Untied Aid.

Untied aid is aform of foreign aid where donor countries do how the aid given should be used by the recipient country. It the total needs and development plans of the recipient country.

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Forms of foreign aid.

- ✓ Loans in form of foreign currency which has to be paid back which is used to finance development expenditures such as roads, railways
- ✓ Projects in form of specific projects initiated by the donor country to the recipient countries.
- ✓ Technological aid in form of the machines, equipment and new scientific methods of production
- ✓ Educational aid in form of facilities such as scholastic materials such as laboratory equipment, text books and computers an buildings, scholarships to bright students.
- ✓ Humanitarian assistance/relief aid from the friendly countries. With UNICEF, FAO
- ✓ Military assistance in form of fire arms and ammunitions, uniforms, military assistance and training and hard ware
- ✓ Technical assistance in form of expatriates, to run the key sectors as engineers, managing directors.
- ✓ Grants and donations from friendly countries.

UNEB 2002.

a) What is the role of foreign aid in the economic development of your country? (10 marks)

b) Explain the problems associated with over reliance on foreign aid. (10 marks)

UNEB 2011.

a) Differentiate between bi-lateral and multilateral aid. (04 marks)

b) Assess the impact of foreign aid on the development of an economy. (16 marks.

UNEB 2013)

a) What is meant by foreign aid? (04 marks)

b) Assess the impact of foreign aid to the development of an economy. (16 marks)

POSITIVE ROLE OF FOREIGN AID IN DEVELOPMENT OF LDCs.

1. **Closes savings-investment gap.**The level of savings in developing countries is still low compared to planned expenditure and this is covered through foreign aid leading to high investment levels
2. **Fills/foreign exchange gap.** In LDCs foreign exchange earned from exports is less than what is required to buy the necessary imports because of the small forex pocket which is closed by the foreign aid. **Closes skilled man power gap.** There is limited skilled man power in l.d.cs is lower than their development requirements and this is solved through transfer of such technology from donor countries to the l.d.cs.
3. **Closes technology gap/increases technological transfer.** Level of technological transfer. Level of technology in l.d.cs is lower than their development requirements and this is solved throughfor transfer of such technology from donOor countries to l.d.cs.
4. **Closes government revenue-expenditure gap/budgetary deficits.** Planned revenue is normally less than planned expenditure of fiscal year and foreign aid from grants, loans is used for covering this gap and supplement the available revenue for the government expenditure
5. **Alleviates/reduces effects or catastrophes/natural calamities** i.e alleviating the effects of natural disasters such as floods, earth quakes and land machinery loan cooperates foreign expatriates in systems this large scale.Slide by giving the relief aid in form of drugs, food stuffs, clothes, medicine to cope up with humanitarian crisis.
6. **Facilitates the infrastructure development.**Foreignaid in form of machinery,loans,foreign experts,is used to facilitate the of roads,railways,power supply projects thus encouraging large scale production.
7. **Expands employment opportunities.** Many jobs are created by projects production and investment in mining, industry and agriculture funded by donor funds and employs more labor thusreducingencouraging unemployment.
8. **Strengsthens international corporations among countries.** This enhancesinternational trade and ensures political and economic ties betweendonor and recipient countries.
9. **Increases utilization of resources which increases productivity.** Necessaryforeign aid in form of technology, funds, and expatriates is used to increase exploitation of recourses minerals forests,land and water resources.
10. **Facilitates industrial development.** Foreign aid in form of capital investments, expert rites and loans accelerate industrial development in the recipient country.
11. **Promotes development of local skills.** Foreign aid in form of manpower training through scholarshipsincreases skills of local people in the recipient country.

PROBLEMS/ NEGATIVE ROLE OF FOREIGN AID IN LDCs.

1. **Worsens balance of payment problems.** This is through high capital outflow in paying foreign expatriates and repaying external loans thus high foreign exchange expenditure.
2. **Leads to unemployment of local man power.** Sometimes the foreign aid is inappropriate through expatriates and transfer of capital intensive technology which replaces the human labor.
3. **Discouragesthe local initiatives and effort/promotes laziness.** Creativityat home reduces becauserecipient countries are ever expecting aid from the donors incase o any problem.

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4. **Erodes cultural/social values of the recipient country**. People in the recipient country keep adopting the values of the donor countries for instance dressing's styles,eating habits which are undesirable for a country to demonstration effect created by the foreign aid
5. **May be withdrawn before the completion of some projects/**Its not **sustainable**. Foreign aid can be withdrawn before the completion of some projects being undertaken duet o to some reasons like political misunderstandings which leads to failure of such projects
6. **Politicalstrings attached to the aid undermines a country's political sovereignty**.It leads to political domination by the donor countries It is because of the tired aid to political conditions
7. **It is at times tied to UN productive projects/non priority sectors/areas of the economy which hinderedevelopment**. In most case said is tied to even part of the economy which many not be a priority to development.
8. **Creates external debt servicing problems which denies the nationals essential goods and services**. A large percentage of the nationalbudget is required in the long run to clear huge external debts especially when the aid is tied hence denying their nationals various essential goods
9. **Distorts economic planning** .This is because in most case s the foreign aid is inconsistence which limits implementation of plans, leading to plan failure.
10. **Worsens economic domination of donors over the recipient countries.** Donors dominate the economic policies of the recipient countries which erodes away economic independence of the recipient country.
11. **Leads to brain drain.** Foreign aid in form of training through the scholarships to bright students to study from abroad leads to brain drain because after acquisition of the skills, suchlabor doesn't come back.
12. **Promotes under utilization of the localresources.** There is reduced domestic production due to heavy reliance on foreign aid leading to under development.
13. **Sometimes the pre-conditions set by the donors are disastrous.** For instance SAPS.

FACTORS WHICH INFLUENCE/DETERMINE THE EFFECTIVE UTILISATION OF FOREIGN AID IN THE DEVELOPED COUNTRIES.

1. Availability of skilled labor.
2. Population growth rate.
3. Political climate.
4. Level of infrastructure development.
5. Rate of inflation.
6. Size of domestic market.
7. Level of corruption and embezzlement.
8. Level of technology.

7. Foreign aid conditionality

NB. Absorptive capacity is the ability of an economy efficiently the foreign aid given.

REASONS FOR THE LOW ABSORPTIVE CAPACITY IN

1. Limited skills among labor.
2. Political instabilities.
3. Poor infrastructure.
4. Persistent economic instabilities.
5. Corruption and embezzlement of funds.
6. Limited market.
7. High levels of conservatism.
8. Poor technique of production.

PRIVATISATION OF PUBLICENTERPRISES.

Privatization of public enterprises refers ownership of public/state enterprises to private sector in **Or**

It refers to the transfer of ownership of enterprises from the private sector.

Privatization runs a very broad range of activities with p develop the private sector and reduce the disadvantage public sector. It's one of the policy packages by IM developing countries.

In 1970s,the government participated greatly in the owned large public enterprises and many enterprises we expulsion of

In 1970s the government participated greatly in trading large enterprises and many enterprises were nationalize of

In 1986 the N R M government found at least 146 p place excluding banks and he government had the ma but by 2002, many of these enterprises ha This has attracted a large number of foreign inves enterprises.

Examples of divestures that have been made in Ug Kakira sugar works,Ugandan telecoms limited, U Uganda commercial bank Uganda grain milling pharmaceuticals limited ,Nytil Public Motors,Mbara cement works lake Victoria hotel Uganda air lines company Mt Elgon hotel White Rhino hotel Uganda horse in Nile hotel International conference cent limited Uganda electricity board among others.

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UNEB 2011.

State any four ways in which public enterprises are privatized (04 marks)

FORMS OR WAYS OF PRIVATIZATION OF PUBLIC ENTERPRISES.

1) **Partial privatization**. It is where the government and private individuals own shares in the enterprises. Agiven number of shares in the company is retained by the government and some are sold to the private sector for instance New Vision.
2) **Leasing out/mortageging.** The government rent out public enterprises to private enterprises for agiven period of time For instance public taxi and bus parks and markets.
3) **Privatization of management.** The government retains ownership of the enterprises but privatizes the management. For instance Sheraton hotel managed by Sheraton hotel international in USA air ports, water plants.
4) **Divestiture/complete sell off.** This is where the government transfers all its shares and assets of the public to the private sector . for instance Nile breweries shell Uganda Kakira sugar works Lake Victoria bottling company, NYTIL, Hima cement works.
5) **Denationalisation/repossession.** This refers to the return of the nationalised to their formal or original private owners for instance return of those enterprises formally owned byAsians who were expelled in1972. For instance Aghakan School
6) **Contracting**. The government retains ownership of the enterprise but provision of the goods and services is transferred to the private sector for instance maintaining by private individuals.
7) **Joint ventures/recapitalization.** The government runs businesses jointly with private entrepreneurs.

UNEB 2008.

"Developing counties should privatize public enterprises if they are to attain economic growth and development" discuss. (20 marks)

UNEB 2007.

a) *Distinguish between privatization and nationalization of public enterprises. (04 marks)*
b) *Assess the impact of privatization of public enterprises in your country. (16 marks)*

ADVANTAGES/POSITIVE IMPACT OF PRIVATIZATION OF PUBLIC ENTERPRISES IN UGANDA AND OTHER DEVELOPING COUNTRIES.

✓ **Reduced dependence on imports.** This is because of increased local production thus saving scarce foreign exchange leading to improvement in balance of payment position.
✓ **Reduced corruption and embezzlement in enterprises.** This results from high rate of supervision and accountability by private owners. Private individuals do not tolerate corruption to undermine their objectives thus leading to proper accountability.
✓ **Reduced unnecessary bureaucracy in business management.** There are limited delays in decision making under private owned enterprises compared to state owned businesses thus quick decision making.
✓ **Increased investment by foreigners/increased direct foreign investments.** More foreign investors are attracted to buy the enterprises available for sale thus advantages thus increased inflow of foreign capital.
✓ **Reduced government expenditure in form of subsidies on inefficient public enterprises.**
Government spends heavily on such enterprise but privatization reduces such expenditure hence limited budgetary deficits.
✓ **Improved quality of output produced.** This is because of stiff competition created among private enterprises leads to high quality output on the market.
✓ **Increased innovations and inventions/technological development and transfer.** This is because it encourages private initiatives so as to maximize profits. Private investors are able to carry out research so as to be very creative thus technological development and transfer.
✓ **Improved international relationships between Uganda and other countries.** This is because most of the public enterprises are bought by foreign investor's thus increased international trade.
✓ **Increased employment opportunities in the long run.** Privatized enterprises expand and employ more people in the long run thus reducing unemployment.
✓ **Controlled structural inflation due to increased domestic output.** This is because of increased domestic output on the market in the long run due to increased efficiency which keeps prices at a low level.
✓ **Improved efficiency in resource allocation/enables firms to operate more efficiently.** This is because of the e close super vision and profit motive and better management of firms by private sector and because of the competition hence better resource utilization.
✓ **Increased tax revenue for the government.** Privatized enterprises are expanded in the long run and this increases the tax base hence high government revenue for spending.
✓ **Widening the consumer's choice due to production of a wide range of variety of goods and services.** This is because privatized enterprises diversify their activities.
✓ **Increases output hence economic growth.** This is due to expanded production where more output is realized by privatized enterprises hence benefits of economic growth.
✓ **Improved skills of workers.** This is due to increase on job training of the labor employed in the privatized enterprises hence increasing the skilled labor.

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UNEB 2015

a) Why have public enterprises been privatised in your country? (10 marks)

b) Explain the contribution of the private sector to the economic development of your country. (10 marks)

UNEB 2009, 2001, 2000.

a) Account for the privatization of the public enterprise in your country (10 marks)

b) What problems have been encountered in the privatization of public enterprises in your country? (10 marks)

UNEB 2003.

a) Account for divestiture of the public enterprises in your country. (10 marks)

b) What are the problems encountered in the divestiture of the public enterprises in your country. (10 marks)

UNEB 2011.

a) Distinguish between the privatization and nationalization of the public enterprises. (04 marks)

b) Account for the privatization of the public enterprises in your country (16 marks)

REASONS/NEED FOR THE PRIVATIZATION OF THE PUBLIC ENTERPRISES. OR WHY IS IT NECESSARY TO PRIVATIZE PUBLIC ENTERPRISES AN ECONOMY.

NB. These are given as reasons not as effects or advantages.

- ✓ To fulfill the conditionality of I.M.F of creating a private sector led economy.
- ✓ To control structural inflation.
- ✓ To create more employment opportunities in the long rub.
- ✓ To increase tax revenue of the government /expand the tax base.
- ✓ To reduce over dependence on the on imports because of increased local production.
- ✓ To reduce corruption and embezzlement of the funds in the state enterprise s.
- ✓ To reduce UN necessary beauracracy in the /red tape in then business management.
- ✓ To attract direct foreign investments and hence increased capital Inflow.
- ✓ To reduce the government expenditure in form of subsidies on inefficient public enterprises.
- ✓ To enable firms operatemore efficiently hence better delivery of services.
- ✓ To encourage competition in production and improve quality of goods and services.
- ✓ To encourage private initiatives and creativity for inventions.
- ✓ To increase the level of resource utilization.
- ✓ To allow government concentrate on the provision of
- ✓ To increase the domestic output/economic growth.

DISADVANTAGES/NEGATIVE IMPACT OF PRIVATIZ AND OTHER DEVELOPING COUNTRIES.

- ✓ **Increased consumer exploitation.** private commodity prices in orderto earn more profits
- ✓ **Increased foreign control of the economy.** are bought the foreigners who to some extent economically and politically.
- ✓ **Increased unemployment in the short run.** restructuring and retrenchment of workers in labour and preferences to use capital intensive
- ✓ **Increased irrational exploitation of the resources** utilized leading to quick resource depletion degradation.
- ✓ **Increased profit repatriation/capital outflow.** are bought by the foreign investorswho repatriate countries hence limiting more investment.
- ✓ **Increased income inequality.** High profits are investors at the expense of other individuals hence
- ✓ **Losses are incurred by the government in** because of the under development of the enterpr costs of the whole process of privatization. E.g. ad and foreign media, asset evaluation which is very
- ✓ **Reduced provision of certain/vital services population.** Private individuals do not normal services such as security and water to the public
- ✓ **Increased resentment of the government by** public in most cases opposes the process sabotages development hence loss of political supp
- ✓ **Increased exploitation of labor.** It increases which tend to offer low wages to labor and poo condition so work.
- ✓ **Makes planning by the government difficult** increased non responsive growing private sector
- ✓ **Increased wasteful competition and duplicatio** leads to resource wastage in production.
- ✓ **Increases the price fluctuations.** This is due profits leading to inflation and its negative effects

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PROBLEMS ENCOUNTERED IN THE PRIVATIZATION PROCESS IN UGANDA

1. **Corruption within the privatized enterprises /limited transparency and accountability in the privatization unit.** There is corruption in the privatized unit where some officials on board take bribes from the intending buyers which scares away some investors and at time s such enterprises are sold cheaply.
2. **High opposition from the public.** The public normally decampaignthe process mainly due to general ignorance of the people about the benefits of privatization thus delaying the sale of some enterprises.
3. **Poor valuation of public enterprises that are on sale.** There is overvaluation or undervaluation which scares away buyers of enterprises and makes government lose respectively.
4. **Poor state ofsome public enterprises.** Many enterprises are old andin bad shape which discourages buyers of enterprises.
5. **Under developed capital markets.** There are limited stock exchange markets where shares can be bought. This limits smooth sale ofshares in the public ventures in case ofjoint venture privatization.
6. **Political sabotage.** Parliamentarians especially on opposition side normally block bills concerning the sale of public ventures to foreigners which delays the sale of enterprises.
7. **Poverty among nationals.** Most Ugandans have low incomes n and this forces the government to sell such enterprises to foreign investors since local investors lack enough capital to purchase these enterprises.
8. **High cost of the privatization process.** Privatization involves renovating enterprises meant for sale, advertising in local and foreign media, scrutinizing bidders and such a process is very costly which reducesthe benefits of privatization.
9. **Unscrupulous buyers/dishonest buyers.** Some people pretend to be buyers when they do not have adequate capital for purchasing the public enterprises meant for sale thus delaying the sale of some enterprises.
10. **Small market for output from the enterprises.** Local and foreign markets are still inadequate; this discourages buyers of such enterprises who aim majorly at profit maximization in fear of incurring losses.
11. **Political instability in some areas where the enterprises are located.** The prospective investors fear to risk their capital and life in such areas thus making such enterprises not attractive to buyers.

UNEB 2012.

1. *a) Define the term nationalization of enterprises. (04 marks)*
   b) Examine the merits and demerits of nationalization of enterprises in an economy. (16 marks)

NATIONALIZATION OF ENTERPRISES.

Nationalization of enterprises *is the taking over by the state the ownership, control and management of enterprises formerly owned by private individuals to be run in public interest. This can be done with or without compensation.*

Or

This is where the government/state takes over the ownership and control of enterprises formerly privately owned to be run in public interest. This can be done with or without compensation.

The government can take over the ownership and control of privately owned enterprises in case itintends to achieve given objectives and goals o development such as;

- *Reducing foreign domination of the economy.*
- *Providing sustainable employment.*
- *Discouraging emergence ofprivate monopolies.*
- *Controlling structural inflation and*
- *Achieving sustainable use of resources.*

In Uganda, nationalization oIenterprises was so pronounced in 1970's under Nkivubo pronouncements by president Milton Obote where the government was to take over 60% of over 80 corporations in the country including banks, oil companies, manufacturing industries, plantations, insurance companies but this was not fully realized.

It was also at high gears under President Idi Amin in 1972 when he presided over the expulsion of Asians from Uganda.

UNEB 2006

i) *Distinguish between privatization and nationalization of enterprises (02 marks)*
ii) *Give any two merits nationalization of enterprises in an economy (02 marks)*

MERITS OF NATIONALIZATION OF ENTERPRISES.

- **Reduces consumer exploitation by charging affordable prices /helps to provide essential goods and services to the population.** This is because the nationalized enterprises normally charge goods at fair prices for their services provided.

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PROBLEMS ENCOUNTERED IN THE PRIVATIZATION PROCESS IN UGANDA.

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UNEB 2012.

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NATIONALIZATION OF ENTERPRISES.

Nationalization of enterprises is the *taking over ownership, control and management of enterprises by private individuals to be run in public interest. This is without compensation.*

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UNEB 2006

i) *Distinguish between privatization and nationalization (02 marks)*
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MERITS OF NATIONALIZATION OF ENTERPRISES.

- **Reduces consumer exploitation by charging affordable to provide essential goods and services to the p** because the nationalized enterprises normally charge for their services provided.

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- **Reduces foreign domination of the economy with its evils /promotes indigenization of the economy.** This is especially where foreign owned firms are nationalized which reduces the participation of foreigners in the economy.
- **Reduces social costs such as pollution.** Nationalized enterprises are run in theirinterest of the publichence social costs are controlled by the government.
- **Ensures government control of strategic sectors/enterprises/vital investtiments in an economy.** Strategic areas of the economy such as security are easily controlled where enterprises are controlled by the government.
- **Provides sustainable employment.** This increases the employment opportunities due to the large production.
- **Makes it easy to respond to the rapid structural changes when need arises or quickens adjustments to the changing marketing conditions.** Thisis because such structural changes e.g occurrence of the natural disasters require quick attention from the government which is difficult with the private investors.
- **It helps to reduce the on production of the un desirable goods and services.** This is because what is normally produced by the enterprises is run by the government is of desired standards.
- **It helps to reduce on the actions of the private monopolies and its negative effects.** The actions of monopoly are reduced through government control of the productionprocesses through nationalization.
- **Reduces wasteful competition/avoids the duplication of goods and services and resource wastage in production.** This is due to limited competition in enterprises run by the government since they are not normally profit minded.
- **Helps to generate public revenue.** Natrionaliosed enterprises generate revenue for public expenditure.
- **Encourages large scale production.** It makes it easy to mobilize large amounts of capital for the large scale investment hence increased output.
- **Leads to equitable distribution of resources/wealth and income.** The government is able to reduce income inequality since nationalization reduces the possibility of accumulating excessive resources by the private investors whose businesses are taken over by the government.
- **Minimizes the profit and income repatriation by foreign investors.** This is because nationalization helps to limit the number of foreigners in comestic production.
- Promotes economic stability. Controls structural inflation because of controlle supply of commodities and use of price control.

DEMERITS OF NATIONALIZATION OF ENTERPRISES.

- **Leads to political interference and direction in running nationalized enterprises.** This is concerned with appointment of workers especially at managerial levels.
- **Limits the growth of a strong private sector/ private investment.** This limits enjoyment of advantages of high level of private investment.
- **Makes it difficult to check on corruption and misuse of funds in resource allocation.** This leads to misuse of public funds which limits expansion of enterprises.
- **Increases government expenditure on subsidizing nationalized firms.** This is especially if they do not make profits which leads to high taxation on nationals.
- **Leads to bureaucracy hence delays in decision making.** There are unnecessary procedures followed and this sows down the level of production.
- **Leads to inefficiency in firms.** This is due to poor supervision within public enterprises.
- **Low quality products are produced due to limited competition.** Limits innovations and research since firms are sheltered from completion.
- Limits consumer choices. This is due to limited variety of goods and services produced.
- **Leads to low tax revenue.** This is because most of these nationalized enterprises are exempted from taxation which limits government tax revenue.
- **Leads to resource misallocation.** This is because it interferes with the functioning of price mechanism and what is produced may not be in line with consumers demands.

ECONOMIC LIBERALIZATION.

Economic liberalization is the removal of unnecessary controls on economic activities hence giving people liberty to carry out economic activities without undue government controls. Many economies have embarked on economic liberalization because it opens the economy to trade and investment opportunities.

In Uganda, the economic recovery programme of May 1987 put more emphasis on economic liberalization and this has been affected on the following.

a) Trade liberalization. –foreign exchange liberalization. –financial sector liberalization.
b) Capital account liberalization policies in Uganda were implemented in late 1980s.

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UNEB 2003.

a) *Distinguish between trade creation and trade liberalization (04 marks)*
b) *Examine the implications of trade liberalization on economies of developing countries. (16 marks)*

UNEB 2013

a) *What is meant by the term "trade liberalization" (04 marks)*
b) *Examine the merits and demerits of trade liberalization to your country. (16 marks)*

UNEB 2015

a) *What is meant by the term trade liberalisation? (04 marks)*
b) *Examine the implications of trade liberalisation on an economy (16 marks)*

TRADE LIBERALIZATION.

Trade liberalization refers to the removal of unnecessary controls on trade hence giving people liberty to trade without undue government controls

Or

It refers to the removal of unnecessary restrictions on trade (by relaxing the use of instruments such as quotas, total ban, tariffs and administrative control) in order to give people opportunity for increased participation in trade (to increase value, volume and benefits of trade).

In Uganda, the government liberalized trade as one of the package policies of IMF and this has attracted many entrepreneurs, investors both local and foreigners to engage in diversified business activity.

UNEB 2009.

i) Define the term trade liberalization. (01 marks)
ii) Give any three advantages of trade liberalization in your country. (03 marks)

ADVANTAGES OF TRADE LIBERALIZATION IN AN ECONOMY.

1. **Increases employment opportunities.** This is due to increased investment because many private investors are free to join business thus employing more labor.
2. **Increases output levels hence economic growth.** More output is realized because of many firms attracted in production and expanded trade activities.
3. **Increases utilization of resources.** Free participation ... increased emergence of many private firms to utilize ... resources thus reducing underdevelopment.
4. **Encourages innovations and inventions/technological ...** Investors are forced to become more creative and this is ... which helps to compete and make more profits ... technological development.
5. **Increases efficiency among the different firms in ... processes.** Stiff competition is created which forces firms ... which leads to better quality products.
6. **Leads to production of variety of commodities.** Various ... are produced and this widens the consumers choice ... production of goods and services.
7. **Leads to improvement of the balance of payment ...** because of the reduction in the volume of imports and ... production of the exports which reduces the expenditure ... increases the foreign exchange earnings.
8. **Upholds the consumer sovereignty.** This is because the forces of demand and supply are left to determine what should be ... Production is based on the consumer's desire and the consumer ... best output to consume.
9. **Helps to control structural inflation.** Increasein production ... supply of commodities on market which controls ... general prices low.
10. **Increases government tax revenue.** Various taxes ... on various productive activities that emerge thus more revenue ... spending.
11. **Makes it easy to fight corruption and ... resource allocation.** Since production activities are in the hands of ... private individuals, corruption tendencies are minimized.
12. **Attracts more foreign capital investments ... into the country and their associated advantages.** Many ... investors are attracted to engage in the production ... inflow.
13. **Educes income and wealth inequalities.** People engaged in ... various economic activities and this reduces income gap between the rich ... and the poor.
14. **Leads to improved quality of goods.** This is because of ... competition among many producers to join production and ...
15. **Increased infrastructural development.** This is because of ... increased involvement in trade which necessitates construction of ... roads improving power supply hence development.

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DISADVANTAGES OF TRADE LIBERALIZATION IN AN ECONOMY.

- **It leads to income inequality.** Because of the abnormal profits earned by some investors and resource owners, income gap widens.
- **Results into consumer exploitation.** Because of the consumers' ignorance in the market, consumers end up being exploited through charging them high prices.
- **It leads to increased capital outflow.** This is through profit repatriation by various foreign investors who attract in business due to liberalized trade and increased expenditure on imports.
- **Creates danger of over utilization and quick depletion of resources.** Private individuals aim at maximizing profits and over utilize the available resources to produce more commodities with high prices.
- **Gives rise to monopoly powers and its evils.** Some inefficient and weak firms are out competed in the production processes by the large firms and these large firms establish as monopolies. This is duetto the lack of lack of protection and subsidization of infant industries.
- **Creates a danger of misallocation of resources.** Resources are mainly directed to the production of highly priced goods and services demanded by the rich and cheap necessary goods demanded by the poor are ignored.
- **Leads to then duplication of commodities.** This is because of many producers in similar production, ther is stiff competition which is resource wastage.
- **It creates flooding of the market which reduces the prices to uneconomic levels.** Because of many firms that are free to join production, output increases and forces prices to reduce sharply. This causes great losses on the part of the producers.
- **Distorts consumers choice.** Due to the various products on market and intensive advertising, sales, promotional activities, the consumer is confused on which commodities to consume.
- **Leads to unemployment** due to the stiff competition which pushes the weak firms out of production, workers are laid off.
- **Subjects the economy to economic instabilities such as inflation.** It creates large large private sector whose prices are never stable depending on changes in demand and supply.
- **Exposes the population to consumption of the harmful /undesirable products.** There are possibilities of private investors to engage in production of demerit goods such as expired drugs due to limited government controls which reduceconsumer'swelfare.
- **Leads to the collapse of local firms.** This is due to increased inflow of foreign of foreign owned firms, increased importation leading to stiff competition and closure of the local firms.

STRUCTURAL ADJUSTMENT PROGRAMS (SAPs) IN UGANDA.

SAPs refer to the package of policy instruments aiming at stabilizing and transforming the economy. Supported by the World Bank and I.M.F Structural information and micro economic stabilization for sustainable economic growth.

Through this initiative, various projects and programmers have financed by I.M.F and WORLD BANK in Uganda and other developing countries.

Objectives of saps in Uganda.

- *To increase GDP by stimulating production.*
- *To expand the private sector.*
- *To reduce the role played by the government budgetary deficits.*
- *To reduce on the burden of the public debt.*
- *To reduce on the problem of BOP deficit.*
- *To strengthen the value of the shilling internally by checking inflation and externally by stabilizing exchange rates.*

UNEB 2011, 2003.

Mention any four structural adjustment programs of the I.M.F that your country has implemented. (04 marks)

Examples Of The Saps That Uganda Has Implemented.

- **Restructuring of public service/retrenchment of workers or demobilization of soldiers.**
- **Liberalization of the economy/trade.**
- **Privatization of the public enterprises/expanding the role of private sector.**
- **Devaluation.**
- **Restructuring tax administration/improvement in the tax collection.**
- **Reduction in government expenditure on non essential services.**
- **Tightening monetary and credit policies.**
- **Cost sharing.**

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CHAPTER 6: UNEMPLOYMENT PROBLEM

This definition is given in relation to labor as a factor of production
Unemployment is a situation where some members of labor forcecare idle due to failure of getting jobs at a ruling wage rate despite once willingness to work.
It is one of the biggest macro economic problems that most economies face today. Unemployment rate in Uganda most especially among the youth is commonly is rising due to increased number of graduates alongside limited job creation opportunities.

Unemployment rate =number of unemployed labourforce 100
Total number of labourforce

NATURE OF UNEMPLOYMENT

It is divided into two categories:

- Voluntary unemployment.
- Involuntary unemployment.

A. VOLUNTARY UNEMPLOYMENT

Voluntary unemployment refers to the situation where the jobs areavailable but labor force is unwilling to take con the available jobs at ailing wage rate. **Or**

This is a situation where labor is not willing to work at the ongoing wage rate yet there are jobs.
Labor force is not interested in the work however much the jobs are available due to either undesirable /desirable existing circumstances.

UNEB 1998.

a) Examine the causes of voluntary unemployment. (06 marks)
b) Examine the policies being under taken to solve unemployment problem in your country. (14 marks)

UNEB 2012.

a) Explain the causes of voluntary unemployment. (08 marks)
b) Suggest measures that should be taken to reduce the level of unemployment. (12 marks)

CAUSES OF VOLUNTARY UNEMPLOYMENT IN AN ECONOMY.

✓ **Laziness among some individuals.** Some individuals especially women are naturally lazy and unwilling to take on the available jobs hence remain unemployed.

✓ **Socially unacceptable jobs to be undertaken.** Socially meant for specific sexes and age groupsfor instance a driver.

✓ **Desire by the unemployed to live on past saving** may decide to live on past savings so long as it can time.

✓ **Very low wages aid/poor remuneration on the** does not induce workers to take on the available jobs remain unemployed.

✓ **Good economic background.** Where someone comes family and inherits property.It becomesdifficult for the jobs existing since one is able to provide all the

✓ **Expectation of getting a better paying job in the the available ones.** Therefore one does not take on the the available ones which may be considered to be of a to get a better job.

✓ **The unemployed being too qualified for the present job may be considered inferior to the** graduate being asked to become a nursery teacher cannot take up such jobs.

✓ **Unfavorable geographical location of the job.** If the far from the ones home area and if the area has conditions, very inaccessible and one prefers to remain

✓ **Poor working conditions on the available jobs.** jobs are created for long hours, absence of limited medical allowances force labor to remain

✓ **High risks involved in doing the available job.** risky and can cause loss of one's life for instance industrialization and people prefer to remain risking their lives.

✓ **Preference of leisure to work.** Some individuals to work and therefore remain unemployment available.

B. INVOLUNTARY UNEMPLOYMENT.

Involuntary unemployment is a situation in which labor actively looking for jobs but cannot find jobs at the

Or

It refers to a situation in which people who are able and the current wage rate are unable to find jobs.

Or

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It is a situation in which labor force is able and willing to work but cannot find jobs at the ongoing wage rate. This implies that jobs are not available this is the unemployment which most economies are facing today.

UNEB 1999.

i) *Differentiate between voluntary unemployment and involuntary unemployment. (02 marks)*

ii) *State any two causes of involuntary unemployment in your country. (02 marks)*

CAUSES OF INVOLUNTARY UNEMPLOYMENT IN AN ECONOMY.

- Rapid population growth rate.
- Inappropriate education system.
- Discrimination in the labor market.
- Political instability in some areas.
- High rate of rural urban migration.
- Unfavorable structural adjustment programmers of IMF.
- Technological advancement thus replacing human labor.
- Ignorance of labor about the existingjob opportunities.
- Physical and mental disabilities among labor.
- Seasonal changes especially in agriculture.
- Shortage of co operant factors of production especially capital.
- Decline in demand for products which labor produces.

TYPES OF UNEMPLOYMENT.

1) Transitional/Frictional/Search Unemployment.

Frictional unemployment refers to short-term unemployment faced by labor force while in the process of changing/switching from one job to another.

Or

This is a type of unemployment which occurs when labor is switching off from one job to another in the short run.

Or

It is unemployment due to a miss match between demand for labor and supply of labor in the short run.

It arises in the short run when people leave their jobs and take time to get other jobs.

Causes of frictional/search unemployment.

- Ignorance of labor about existing jobs elsewhere.
- Immobility of labor both geographically and occupationally.
- Technological advancement leading to technological unemployment in the short run.
- High degree of specialization leading to limited skills in other jobs.
- Political instability which forces workers to leave insecure areas.
- High level of bureaucracy in getting a new job.

- *Temporary breakdown of machinery in production.*
- *Temporally shortage of raw materials.*

Solutions to transitional/frictional unemployment.

- *Extensive adverting of available job vacancies.*
- *Training of labor in a variety of skills.*
- *Emphasizing political stability.*
- *Increasing mobility of labor to areas where jobs are available.*
- *Developing necessary infrastructure.*
- *Encourage increased diversification of economic activities.*

2) Structural Unemployment.

Structural unemployment refers to unemployment resulting from structural changes in conditions/patterns of demand and supply in an economy.

It arises from structural changes in an economy. It is experienced when an economy is undergoing structural economic transformation or adjustments. Such structural changes don't match with supply of labor leading to limited jobs.

UNEB 1998.

a) Examine the causes of structural unemployment in an economy. (06 marks)

b) What measures should be taken to curb unemployment in an economy. (14 marks)

Causes of structural unemployment.

- **Change in demand patterns and fashion/fall in demand.** For instance when clay cups replace plastic cups, workers in the plastic cup industry would be unemployed, when laptop computers replace desk top computers, workers in industries producing desktop computers would be unemployed.
- **Political instabilities.** These lead to closure of existing business enterprises and scare away potential investors.
- **Infrastructural break down.** This is especially transport and communication lines.
- **Technological advancement.** i.e. more use of capital intensive technology than labor intensive technology.
- **Exhaustion of supply of major raw materials** such as minerals which limits further production as that concerned industries close down.
- **Structural breakdown of industries/production process** thus laying off some workers.

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UNEB 2008.

i) Distinguish between structural unemployment and seasonal unemployment. (02 marks)

ii) Suggest any two measures that should be taken to reduce structural unemployment in an economy. (02 marks)

Solutions to structural unemployment.

- Diversification in production to enable workers shift to other occupations.
- Development of necessary infrastructure to encourage labor mobility.
- Provision of more training facilities to labor in more than one job/diversification of skills of workers.
- Flexibility in production which enables industries/production units to change with changes in tastes and fashions of consumers.
- Use of appropriate technology so that workers are not replaced by machines.
- Ensuring political stability.
- Widening markets through economic integration.
- Ensure proper man power planning.

3) Seasonal Unemployment.

Seasonal unemployment is unemployment as a result of variations in seasons especially due to climatic changes. For instance in agriculture. This leads to limited economic activities in given seasons thus fluctuations in demand for labor. Farmers after planting and harvesting crops become idle.

UNEB 2003.

i) Distinguish between frictional unemployment and seasonal unemployment. (02 marks)

ii) Give any tow causes of seasonal unemployment in an economy. (02 marks)

Causes of seasonal unemployment.

- Climatic changes especially in agriculture.
- Failure to tame the nature.
- Periodical changes in demand for goods and services.

UNEB 1999.

i) Differentiate between seasonal unemployment and casual unemployment. (02 marks)

ii) Give any two remedies for seasonal unemployment. (02 marks)

Solutions to Seasonal Unemployment.

➢ Diversification of agricultural activities. Planting many crops including drought resistant crops to employ laborthroughout the year.

- *Training of labor to do a variety of jobs.*
- *Modernization of agriculture to reduce dependence use of irrigation.*

UNEB 2013.

i) Differentiate between casual and residual unemploy

ii) State any two effects of unemployment to an econom

4) Casual/Erratic Unemployment.

***Casual unemployment** is a type of unemployment employed when there is demand for it but becomes un time after the job is accomplished.*

Or

It refers to the type of unemployment where worke temporary basis and as soon as their contracts/wor unemployed.

This is a type of unemployment experienced in occupa needed for specific tasks which are not continuous or pe

For instance car washers, shoe shiners, contract brick repair workers and private doctors.

Causes of casual unemployment.

- ✓ Limited skills in other job s.
- ✓ Undiversified economy.
- ✓ Immobility of labor both geographically and occu

Solutions to casual unemployment.

- ✓ Training labor in multiple skills.
- ✓ Diversifying the economy.
- ✓ Improve on the production methods and techniq

5) Technological Unemployment.

Technological unemploymentis the type of unemployme technological advancement and discovery of new mac labor.

Or

This is the type of unemployment which results in advancement where some workers are replaced by instance use of computers in production, tractors in ag workers are replaced.

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6) Residual Unemployment.

This is the type of unemployment which occurs as a result of physical andmental disabilities /handicaps of labor making one to fail to get a job /work. Therefore, potential labor force is physically incapacitated to work.

Causes of residual unemployment.

- ✓ Accidents and hence physical disabilities.
- ✓ Long period of the illness of a person.
- ✓ Psychological complicationsi.e complications.

Solutions to residual unemployment.

- ✓ Development of the craft industry.
- ✓ Encouraging special needs education in higher institution of learning such as colleges and the universities.
- ✓ Development of the informal sector such as tailoring, welding, shoe making and shining.

UNEB 2009

a) Distinguish between disguised unemployment and frictional unemployment. (02 marks)

b) Mention any two solutions to the problem of disguised unemployment. (04 marks)

7) Disguised Unemployment/Hidden Unemployment.

This is the type of unemployment where the workers or labor appears to be fully involved in the production yet its marginal product is zero or negative or negligible. The additional worker can be removed from employment without a reduction in the level of output.

UNEB 2004, 2008

i) Distinguish between disguised and cyclic unemployment. (02 marks)

ii) Give any two causes of disguised unemployment in your country. (02 marks)

Causes of disguised unemployment in an economy.

- ➢ Limited information about the existing jobs/ignorance about the existing jobs.
- ➢ Nepotism and corruption in some sectors which results into over recruitment.
- ➢ Inadequate skills among the laborto engage in the other activities.
- ➢ Desire to retain labor for future use.
- ➢ High population growth especially In the rural areas.

- ➢ Poor manpower planning. High supply of the labor in given occupations than others.
- ➢ Poor land tenure system which leads to land shortage.
- ➢ Limited supply of capital.

Solutions to the disguised unemployment.

- ➢ Adopt population control measures to reduce the pressure on land.
- ➢ Encouraging economicdiversification.
- ➢ Advertising existing jobs/providing information about vacant jobs.
- ➢ Adopt land tenure system to avail land to the landless.
- ➢ Educational reforms to bring about the diversity of skills.
- ➢ Improve entrepreneurial ability.
- ➢ Promote development infrastructure.
- ➢ Availing firms with affordable capital for increased investment.

8) Open Urban Unemployment.

This refers to the unemployment that result from the rural urban migrationwhere people are openly doing nothing in the urban areas. It can be explained as a theory of the rural urban migration. This is either due to push factors or pulls factors.

Push factors are thosethat operate in rural areas and force people to migrate to urban areas. For instancepolitical instability, poor health services, over population, poor education services and unfavorable cultural values, epidemics, land pressure.

The pull factors are those which tat operate in urban areas and attract people to move to towns. For instance better social amenities such as schools, hospitals, goodhouses,security,peace and high opportunities for employment.

Causes of open urban unemployment.

- ➢ Rural urban migration due to economic gap between the rural and urban areas.
- ➢ Inappropriate education system which trains job seekers who prefer urban areas.
- ➢ Rapid population growth rate not matching with the rate of job creation in urban areas.
- ➢ Poormanpower planning by the government hence limited balance between demand for labor and supply for labor. This leads to excessive supply of labor. This leads to excessive supply of labor in certain fields.
- ➢ Increased use of inappropriate technology which is capital intensive.

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- Increased employment of foreign personnel/expatriation urban firms
- High rate of discrimination in the labor market/labor market imperfections.
- Slow growth of industrial sector/limited industrial development in urban areas hence excessive production in the urban areas
- Retrenchment of the civil servants as a structural adjustment programmes.
- Limited information about the available jobs opportunities

Solutions to the open urban un employment.

- ✓ Ensure proper manpower planning such as that laborts trained in relation to the available jobs in urban areas
- ✓ Promote rapid industrial development so as to absorb redundant labor l the urban areas.
- ✓ Encourage the use of appropriate technology especially labor intensive techniques so as to reduce the rapid growth and migration.
- ✓ Changing the education system to equip labor with relevant skills in urban areas.
- ✓ To promote population control measures such as the use of modern family planning so as to reduce rapid rural migration.
- ✓ Encourage development of rural areas through improved infrastructure so as to reduce rural urban migration.
- ✓ Promote political stability throughout the country so as to minimize the migration of people from the rural to urban areas.
- ✓ Encourage urban rural migrationby providing incentives to people who are willing to migrate and establish projects.
- ✓ Restrict he employment of foreign manpower in the urban centre so as to create jobs for the existing local labor.
- ✓ Changing the land tenure system so as to enable people access land for carrying out the economic activities in rural areas.
- ✓ Advertising the existing jobs so that the unemployed get informed with the available existing jobs inurban areas.

UNEB 2015

(i) Define the term cyclical unemployment. (01 marks)
(ii) Suggest any three measures that should be adopted to minimise cyclic unemployment in an economy. (03 marks)

9) Keynesian/Cyccllcal/Mass/Demanddefeclet Unemployment.

Cyclical unemployment is a type of unemployment which arise due to deficiency in aggregate/effective demand for final goods and services especially in the times of economic depression/recession.

Causes of Keynesian /Cyclical Unemployment.

- *A fall in the investment.*
- *A fall in the prices.*
- *A fall in the savings.*
- *A fall in the government expenditure.*
- *A fall in incomes.*

UNEB 2009.

i) State the Keynesian theory of unemployment.
ii) Give any three solutions to the Keynesian the problem.

UNEB 2006,2000, 1997, 1999

a) State the Keynesian theory of unemployment.
b) To what extent is the Keynesian theory re countries?

THE KEYNESIAN THEORY OF UNEMPLOYMENT (2

The theory of unemployment states that unemploym deficiency in the aggregate/effective demand for fina especially in the times of economic depression/recessi

According to him, due to low/limited/inadequate pu services, employers reduce their output, income levels a generally discouraged hence less labour and capital are

The major remedy to unemployment according to K aggregate demand through ,

- Reducing the taxation levels.
- Increasing wages.
- Subsidization of consumers.
- Improving investment climate by providing the in
- Increasing the government expenditure.
- Increasing money supply through expansionary mo

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The Keynesian theory of unemployment is illustrated as follows.

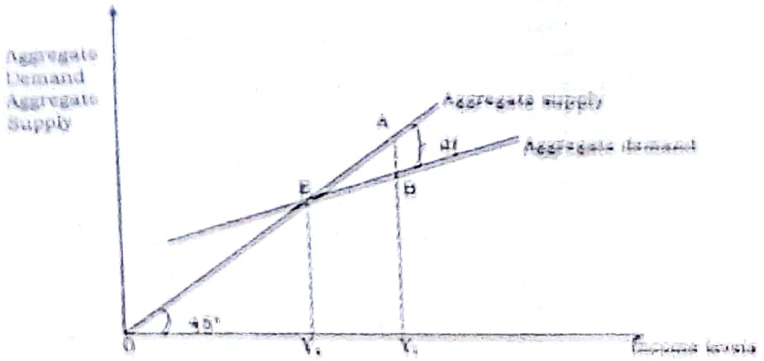

Figure 6.1: Keynesian unemployment

The level of unemployment YeYF is due to deficiency in aggregate demand shown by dI i.e. AB

IRRELEVANCIES/CRITICISMS/ LIMITATIONS OF KEYNESIAN THEORY OF UNEMPLOYMENT TO UGANDA/LDCS.

To a larger extent, the Keynesian theory of unemployment is irrelevant to Uganda / LDCs.

(direct your explanation to where the question is meant to apply i.e. either to your country or developing countries).

1. The Keynesian theory is mainly concerned with deficiency aggregate demand and yet unemployment in LDCs/Uganda is basically from the supply side.
   There is shortage of co operant factors of production, supply rigidities to expand agriculture, industry to create more employment opportunities.
2. The theory is mainly applicable in industrialized economies and yet LDCs are mainly and largely agro based economies.
3. The theoryis based on an assumption of ahighly monetized industrial economy and yet most of the economies of LDCs are basically subsistence.
4. As a solution to unemployment, Keynes prescribes poliices to increase money supply which increases aggregate demand but these policies tend to be inflationary in LDCs/Uganda.
5. The theory emphasizes investment multipler as the major contributor to emlployment yet in most LDCs (Uganda inclusive), it is the export multiplier in existence.
6. The theory is based on a closed economy and yet economies of LDCs are open which makes the theory irrelevant.
7. The theory assumes a well functional factor, product and money markets and yet they are not as functional as in more developed countries.

8. The theory is applicable under conditions of full employment yet such conditions are not found in LDCs/Uganda since many resources are still underutilized/unemployed.
9. The theory is based on the existence of a big and a strong private sector and yet the private sector is very small and weak in LDCs/Uganda. It cannot easily respond to create more job opportunities.
10. Firms in LDCs/Uganda tend not to respond quickly and effectively to changes in aggregate demand because of structural difficulties such as industrial breakdown, limited supply of raw materials hence rendering the theory irrelevant to LDCs.
    Therefore even if there is increased aggregate demand, it may not necessary be accompanies by increased production to increase employment since firms cannot respond quickly and effectively to changes in demand.

RELEVANCY/APPLICABILITY OF KEYNESIAN THEORY OF UNEMPLOYMENT TO LDCS/UGANDA.

To a smaller extent, the keynsian theory of unemployment is relevant to Uganda/LDCs

(i) The use of expansionary monetary policy to increase purchasing power in LDCs/Uganda has tended to increase aggregate demand which stimulates more production and employment levels and prescribed by Keynes.

(ii) Investment climate affects employment levels as suggested by the theory and therefore increased investment incentives in LDCs/Uganda helps to expand employment opportunities as stated by Keynes.

(iii) In Uganda/LDCs there is an element of industrialization and hence the theory applies in the industrialsector.

(iv) At times unemployment in LDCs/Uganda results from afall in aggregate demand for final goods either in the domestic or in foreign market. This discourages production leading to unemployment.
For instance in reeent years there has been a fall in employment in the coffee sub sector due to a fall in the prices of coffee hence making the theory applicable.

(v) In the long run, as supply of cooperant factors for labour increase such as capital, the theory becomes relevant to Uganda/LDCs. This is because increased acquisition of capital in the long run increases production and job creation.

Assumption of Keynesian theory of unemployment.

1. Assumes a closed economy.
2. Existence of full employment
3. A highly monetized economy.
4. A highly industrialized economy.

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5. A strong and large private sector.

Causes of unemployment according to J.M Lord Keynes.

1. A fall in the level f exports especiallyfor a particular commodity thus low foreigneachange earnings
2. A fall in prices of goods which forces employers to lay off some workers
3. A fall in government expenditure leading to low employment thus low aggregate demand .
4. A fall in the rate of savings which later affects the level of investment
5. A fall in incomes which reduces consumption and aggregate demand as well.

UNEB 2002

a) What according to J.M Keynes are the solutions to unemployment problem? (08 marks)

b) Explain the limitations of the Keynesian theory of unemployment in developing countries. (14 marks)

Remedies/Solutions To Unemployment According To J.M Lord Keynes.

The remedies/solutions to Keynesian unemployment are aimed at increasing aggregate demand to absorb more units oflabour that are originally unemployed thus increasing employment levels by.

1. Reducing direct taxes in order to increase disposable income and aggregate demand for goods and services which encourages more investment and creates more jobs.
2. Increased government expenditure to enhance investment, employment which increases earnings and later aggregate demand and creates more investment and employment.
3. Expansionary monetary policy. Increasing money supply by printing more money increases aggregate demand and creates more investment and employment.
4. Subsidization of consumers to increase their effective demand which increases investment and employment opportunities.
5. Improving on investment climate by givingincentives to investors to encourage private investments and increase aggregate demand which stimulates more production and employment and employment creation.
6. Increasing wages for workers so as to increase their incomes and later increase aggregate demand which stimulates more investment and employment creation.

UNEB 2001

a) Account for unemployment problem in your country. (08 marks)

b) Explain the measures being taken to tackle the unemployment problem in your country. (12 marks)

UNEB 2011

a) What are the causes of unemployment in an economy

b) Explain the effects of unemployment in an economy.

UNEB 2014

a) Explain the causes of unemployment in your country

b) Suggest measures that should be taken by the ... unemployment in your country. (10 marks)

GENERAL CAUSES OF UNEMPLOYMENT IN UGANDA

1) **Technological progress and increased use of techniques.** Many workers are replaced by machines in production, machinery in agriculture where human replaced by machines thus causing technological ...

2) **Rapid population growth rate compared to emp...** Population grows at high rate of 3.4% per annum ... join the labour market and the rate at which jobs ... due to problems associated with large population ... unemployment.

3) **Inappropriate education system/limited skills.** The ... is not practical since it is dominated by theoretical subjects leading to limited skills. It trains job ... makers hence limited entrepreneurship ability thus ... creation.

4) **Structural adjustment programmes of IMF of re... expenditure.** The government policy of restructuring ... workers in order to reducing the size of civil servant ... expenditure hence causing unemployment.

   Forinstance retrenchment of civil servants in Ugan... jobs.

5) **Limited cooperant factors of production especially** ... limited capital to expand investment and create jobs ... establishments thus limited employment creation. To ... difficult to mobilize the required funds by most investors.

6) **Discrimination in the labour market.** High rate ... imperfections rampant in Uganda is based on politics, religion, color, family background and some people ... such grounds. This leaves many qualified people with ...

7) **Poor political climate in some areas.** This discourages economic activity which limits investment by both ... investors and retards employment creation. Unstable ... some parts of Uganda scares away investors and redirects economic activities to destructive war efforts thus limiting

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9) **Physical andmental incapacitations leading to immobility of labour.** Disabled individuals are immobile both occupationally and geographically and in most cases remain unemployed since most companies cannot absorb such labour leading to residual unemployment.

10) **Changes/variation in seasons especially in agriculture.** There are fluctuations in the level of employment especially in the agricultural sector dueto limited diversification and over reliance on nature thus creating differences in demand for labour leading to seasonal unemployment

10) **High rate of rural urban migration.** Overwhelming majority of people move to urban areas especially the youth mainly due to social services gap and wage gap between rural and urban area As result, they fail to get jobs leading to open urban unemployment.

11) **Poor land tenure system.** Land belongs to a few landlords who own large pieces of land who in most cases don't use for serious production and majority of people do not have access to land toenable them participate in production and create self employment leading to disguised unemployment.

12) **Ignorance of labour about existing job opportunities.** Lack of enough information about availability of job opportunities in certain areas causes frictional unemployment. This is mainly due to limited access to information on existing jobs since there are no job centres thus increasing frictional unemployment.

13) **Unfavourable changes indemand and fashions/loss ofmarket/fall in demand.** This is due to low incomes and changes in tastes and fashions which discourages expanded production in specific sectors, laying off workers leading to structural unemployment.

14) **Poor manpower planning.** Manpower development programmes in Uganda are inappropriate and this leads to excessive supply of manpower in some sectors than demandfor labour and limited supply of labour in some sectors leading to unemployment.

15) **Changing of jobs causing frictional unemployment.** Labour is normally moving from one job to another especially after the expiry of contracts and in this process of looking for alternative jobs, such labour is unemployed.

UNEB 2003

a) What are the causes of disguised unemployment iun your country (04 marks)

b) Explain the measures that should be taken to increase the level of employment in your country. (16 marks)

UNEB 2010

a) Differentiate between voluntary unemployment and involuntary unemployment. (04 marks)

b) Suggest possible measures of reducing unemployment problem in your country. (16 marks)

MEASURES THAT SHOULD BE TAKEN TO REDUCE UNEMPLOYMENT IN DEVELOPING COUNTRIES.

1. ***Encourage use of appropriate technology.*** This should be done by establishing cottage industries/small scale industries which use mainlylaborintensive technology thus increasing employment of human labor both in rural and urban areas.
2. ***Population control measures.*** There is a need to control the growing population so as to match with the rate of investment through family planning methods, female education. This reduces adverseeffects o high population growth on labor supply in relation to available jobs.
3. ***Promote and maintain political stability.*** This helps to attract various investors and create more jobs through the multiplier process thus increasing production and employment creation. Good governance and peace talks with rebels to reduce a draw back on expansion of productive employment should be ensured.
4. **Further liberalization of the economy.** This is the removal of the unnecessary controls over trade thereby giving liberty to trade without undue government controls. Such a favorable trade policy helps to expand a job creation through expansion of the informal sector andcreation of more projects hence creating more jobopportunities.
5. **Expand market for goods and services.** This should be done by joining economic integrationssuch as COMESA,EAC to encourage labor mobility and increase investment to create more job opportunities.
6. **Setup and improve infrastructure.** The existing infrastructure inform of roads, railways, telecommunication services should be modernized to establish new ones where it is necessary to encourage production especially in rural areas, increase labor mobility and employment creation .
7. **Undertake educational reforms/serious manpower planning.** Educationalprogrammers' need to be vocationalisedso as to create graduates who are practical and job creators by equippinglaborwithrelevantskills that can easily be absorbed in the current labor market.
8. **Further privatization of public enterprises.** More transfer of the public enterprises to private sector thelong run due to improved efficiency because these investimentsare sized up on the by the private entrepreneurs and acquire capacity to employ more labor in the long run.

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9. **Promote diversioficuation of the economy**. This can be done by establishing small scale industries and diversifying the agricultural sector, introducing many economic activities which reduce seasonal unemployment.

10. **Set up more specialized institutions to encourage investment and job creation**. For instance institutions such as the Uganda investment authority are necessary to provide information to investors on various investment opportunities available and easy licensing to increase production and hence high investment and job creation.

11. **Increase advertisement of existing jobs**. Extensive advertising on available jobs in newspapers, radios, and televisions which helps to reduce ignorance among workers on the availability both public and private sectors which increases access to jobs.

12. **Adopt land reforms/facilitate access to land**. The ownership of land should be changed to enable the majority of people to have access to land and participate in serious production through land act to create their own businesses especially in rural area and expansion production hence reducing disguised unemployment.

13. **Attraction of more foreign investors or improve investment climate**. More foreign investors with huge businesses should be attracted through investment incentives such as tax holidays, tax exemptions, subsidies and extensive advertising in foreign media which helps to establish more investments that create more jobs in the long run.

14. **Provision of affordable credit or loans to local investors.** This enables the youth, women to acquire loans at low interest rates hence creating more jobs forinstance prosperity for all programes through whigh people start and expand self-help projects and create own jobs should be empasized hence increasing employment.

15. **Promote modernization and commercialization of agriculture.** This should be done with increased emphasis on such to improve the quality okf seed and animal varietie, irrigation practices to reduce overdependence on nature. This increases agricultural productivity and reduces seasonal unemployment.

16. **Provides special programes for persons with disabilities.** This helps to reduce residual unemployment.

INDUSTRIALIZATION AS A SOLUTION TO UNEMPLOYMENT IN UGANDA

industrialization is taking place in ugandna but it has failed to reduce rampat unemployment because of :-

- **Many industries are located in unrban areas.** This causes rural urban migration leading to open urban unemploying and worsens the situation.

- **Most industries use capital intensive ... scale industries**. This leads to technological ... employment for labour.
- **Most large scale industries are owned by ... employ their own man power**. This denies ... power.
- **Limited domestic market**. Market for ... that industries can not be expanded to absorb ... areas.
- **Limited enterpreneur skills to be employed**. Enterpreneurs are limited hence power ... production which leades to increased ... enterpreneurs hence living local man power ...
- **Rapid population growth compared to the ... created through industrialization**. Population ... high rate which increases the growth of labour ... is not rapidly growth.
- **Many industries operate on small scale ... employed.** Many industries lack ... redundant labour force in urban areas.
- **Limited skilled labour to work in industries.** ... are semi skilled and unskilled and cannot work ...
- **Excess capacity in most industries.** Most ... than optimum and this leads to less demand ... industries.

UNDER EMPLOYMENT

Under employment refers to as state of ... economic resources especially labor.

It's a state of underutilization of labor in terms of ... the desired or laborengaging in the jobs far below ...

This is a situation where labor is underutilized ... labor is not realized and a worker engages in a job ...

Under employment exists in the following ways

- Being employed but with negative attitude towards ...
- Fewer hours worked than expected.
- Working full hours on socially undesirable jobs.
- Taking up the jobs not in line with some ...
- When workers are overcrowded on a fixed ... disguised unemployment.

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PROBLEMS OF UNDER EMPLOYMENT IN AN ECONOMY.

- ✓ Low tax revenue from peoples income.
- ✓ Increases income inequality.
- ✓ Increases dependence syndrome.
- ✓ Leads to loss of productivity because scarce labour is not fully utilized
- ✓ Low GDP is realised because of low labour productivity.
- ✓ High crime rates among the under employed.
- ✓ Low aggregate demand for goods and services due to low income.
- ✓ Leades to emergency of social dualism i.e a class of the rich and the poor

UNEB 2010

Mention any four causes of underemployment in an economy. (04 marks)

CAUSES OF UNDEREMPLOYMENT IN AN ECONOMY.

- ❖ Inadequate supply of co operant factors of production.
- ❖ High rate of rural urban migration.
- ❖ Poor land tenure system.
- ❖ Poor man power planning.
- ❖ Political instability
- ❖ Negative attitude of people towards work.
- ❖ Desire to retain labouar force by employers.
- ❖ Discrimination in the labour market.
- ❖ High population growth rates.
- ❖ Poor attitude of people towards work.
- ❖ Limited market for output.
- ❖ Limited skills for employment .
- ❖ Seasonal changes especially in agriculture.
- ❖ Ignorance of the people about availability of the jobs.

UNEB 2001

a) What is meant by the term full employment. (04 marks)
b) Why is it difficult to attain full employment in an economy. (16 marks)

FULL EMPLOYMENT.

This is the situation where everybody who is capable and willing to work can get a job or it is a situation where the rate of an employment in an economy is 3% or less.

Or

It is a situation in which the number of people looking for jobs (job seekers) is equal to the number of available or unfilled job vacancies.

Or

It refers to a situation where there are more jobs than job seekers. It is a situation where all labour or factors willing to work can get work. The unemployment rate in an economy is 3% or less.

WHY IS IT DIFFICULT TO ATTAIN FULL EMPLOYMENT IN UGANDA AND OTHER LDCs.

In most developing economies, it is impossible to attain full employment because of the following:-

1. **Continued use of capital intensive technology.** Increases use of machines replaces human labour which leads to increase in technological unemployment hence making it difficult to attain full employment.
2. **High rate of rural urban migration.** This leads to open urban unemployment since the number of job seekers exceed job vacancies in urban areas which makes it difficult to attain full employment.
3. **Poor political climate which discourages investment.** This results into reduces job creation and involvement in work in affected areas making it difficult to attain full employment.
4. **High population growth rate.** This increases the size of labour force compared to the rate at which jobs are created making it difficult to achieve full employment.
5. **Seasonal changes due to heavy dependence on natural factors.** This causes seasonal unemployment especially in agriculture due to reduced demand of labour in some seasons making it difficult to attain full employment.
6. **Persistence of a large subsistence sector.** This discourages large scale production and limits job creation hence making it difficult to attain full employment.
7. **Limited domestic and foreign market.** This discourages expanded production and exployment creation hence making it difficult to attain full employment.
8. **Ignorance of labor about the existing jobs** thus frictional unemployment cannot be avoided in an economy. This makes it difficult to attain full employment.
9. **Shortage of co operant factors of production especially capital.** This limits creation of the investment opportunities making it difficult to attain full employment.
10. **Discrimination in the labor market.** This is based on age, sex, religion, family background, and political parties. High rate of social barriers in the labor market. These forces workers to remain unemployed make it difficult to attain full employment.

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11. **Structural changes in an economy** such as the exhaustion of raw materials, frequent break down of production firms which lead to temporary unemployment making it difficult to attain full employment.

12. **Trade union restrictions which restrict entry of new employees in various occupations.** They limit employment of new employees so as to keep their wages high hence making it difficult to attain full employment.

13. **Poor education system.** This is basically theoretical education which trains the job seekers instead of job creators hence making it difficult to attain full employment.

14. **High levels of capital outflow.** Increased capital outflow by foreign investorslimits the level of investment as well as job creation hence making it difficult to attain full employment.

UNEB 2008

a) Explain the causes of unemployment according to J M Keynes (06 marks)

b) What are the effects of unemployment in your country? (14 marks)

EFFECTS OF UNEMPLOYMENT /REASONS WHY UNEMPLOYMENT IS UNDESIRABLE IN ECONOMY/COSTS OF UNEMPLOYMENT

Costs of unemployment refer to the adverse effects unemployment has on an economy, the unemployed, their families and the society as awhole

1) **Increases the dependence burden of the unemployed on the employed.** The unemployed can depend on the few employed individuals which reduces investments and saving.

2) **Leads to the decline in the standards of living and causes misery.** Unemployed people are unable to access all the essentials of life such as medical care, food and this causes more human suffering and poor standards of living.

3) **Increases the government expenditure on the unemployed.** The government spends heavily through providing unemployment benefits and on public goods and services since individuals have limited capacity to provide private goods hence budgetary deficits.

4) **Low government tax revenue through direct taxes.** In situations of high rate of an employment, income tax reduces since majority has low incomes to tax.

5) **Leads to social unrest/instabilities in families.** This is due to human misery especially where people do not have adequate means of subsistence leading to conflicts among families.

6) **Worsens incomes and wealthy inequalities.** This happens between those employed and the majority unemployed which exposes an economy to disadvantages of income inequality.

7) **Leads to high crime rates/immorality among** easy for the unemployed groups to engage in such a prostitution, murder, alcoholism, pick pocketing process of trying to look for means of survival.

8) **Causes unpopularity of the government political tension or unrest/instability.** High rates erodes government popularity since it faces stiff opp The frustrated unemployed can easily be co government organs or rebel groups. This instability/unrest, riots,protests and hostile ground

9) **Reduces aggregate demand for goods and** unemployment imply limited income leading to purchase goods and services. This limits the level o

10) **Leads to brain drain.** High rates of unemployme by poor working conditions; low wages which force skillent and professional man power to migrate to greener pastures hence limited supply of skilled labo

11) **Leads to low production levels hence low** services that would have been produced by unemplo realised hence retarding economic growth.

12) **Leads to declines in the level of acquired** unemployed labour become increasingly outdated in job requirements. This result from redundancy of get employment and therefore quality of labour retur

13) **Discourages investment in education.** As resources in training labour that ends up bei enrolment in educational institutions and qual discourages some people from investing further edu

14) **Leads to under exploitation of productive labour.** This is because the unemployed lack the employ other resources which leads to resource wa

15) **Increases rural urban migration and its effects.** The unemployed tend to migrate to numbers due to high prospects of securing jobs in

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CHAPTER 7: INFLATION

Inflation is the persistence increase in general price level for goods and services in a given period of time. During inflation, the value of money is continuously falling. This implies that the purchasing power of the countries currency is persistently falling and this is reflected by too much money purchasing too few commodities

Inflation does not mean that prices are high. If prices increase and stabilize at a certain higher level for some time, such a situation is not referred to as inflation but just a high cost of living.

Inflation has been a major macroeconomic problem in Uganda and other developing countries with adverse impact on such economies which has been forcing the government to tighten monetary and fiscal policies.

STATE OF INFLATION.

This refers to the rate or speed at which prices are increasing in an economy. The state of inflation can be creeping or galloping.

a) Mild/Creeping/Gradual/Go Slow Inflation.

Mild inflation is where persistent increase in the general prices of commodities proceeds at a low rate usually not exceeding 10% per annum.

Or

Its one which is characterized with the slow rise in general price level usually less than 10% per annum. It is a single digit inflation and desirable in the economy as it may even be induced by the government so as to stimulate investment and employmentlevels. The increase in the price may not easily be noticeable by the general public.

UNEB 2005

i) Distinguish between creeping inflation and galloping inflation. (02 marks)

ii) Mention any two positive effects of creeping inflation in your economy. (02 marks)

POSITIVE EFFECTS OF CREEPING INFLATION

- Promotes commercialization of the economy.
- Stimulates the effort/incentives to work harder.
- Generates more employment opportunities due to increased investment.
- Encourages more production hence high output.
- Increases the better utilization of resources.
- Increases profit margins of the firms.
- Encourages innovations and creativity.
- Encourages labour mobility.

- Promotes entrepreneurial ability as more people are encouraged to take up the business ventures.
- Increases the government tax revenue since production level is increased.

b) Hyper /Galloping Inflation /Runaway Inflation.

This is where the persistent increase in the general price of goods and services proceeds at a very high rate, the increase taking place in hours, days, weeks and usually above 20% per annum. The percentage point increase per annum is over 20%. or, it is one which is characterized by a rapid rise in the general price level of goods and services in a given period of time. The increase taking place in hours, minutes, days, or weeks. The percentage increase per annum is over 20%. For example in September 2011 in Uganda,it was 28.3% and the highest since 1998. This form of inflation can easily be noticeable by the public and it is generally undesirable since it discouragesconsumption, savings and investment

UNEB 2010

i) Distinguish between suppressed inflation and hyper inflation. (02 marks)

ii) Mention any two effects of hyper inflation. (02 marks)

Effects of hyper inflation in an economy.

- Discourages savings.
- Leads to industrial unrest.
- Leads to loss of confidence in a country's currency.
- Leads to uneven distribution of income.
- Makes government unpopular.
- Leads to low standard of living.
- Leads to unemployment.
- Leads to brain drain.
- Makes planning difficult.
- Discourages local and foreign investors.
- Landing is discouraging as creditors stand to lose.
- Worsens balance of payment problem.
- Fixed income earners suffer.
- Encourages illegal activities.
- Promotes speculation and its disadvantages.
- High costs of production may lead to reduced production.

Measurement of inflation.

Inflation is measured using price index and it is expressed in percentage over a period of a year.

The retail price index which records changes in the prices of goods and services will help.

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Inflation rate = $\frac{P1 - Po}{Po} \times 100$

Where,

Po is last year's price level.

P1 is the current year's price level.

UNEB 2006.

i) *Distinguish between demand pull inflation and cost push inflation. (02 marks)*

ii) *State any two causes of demand pull inflation in your country. (02 marks)*

TYPES/THEORIES OF INFLATION.

a) **Demand pull inflation/excess demand inflation.**

Demand pull inflation refers to (one) persistent increase in general price level which arises as a result of excessive aggregate for goods and services compared to aggregate supply in conditions of full employment.

Or

This refers to one or a form of inflation that arises out of excessive aggregate demand for goods and services over aggregate supply at full employment of resources.

Causes of demand pull inflation.

1. **Excessive government expenditure** which results into increase in income and aggregate demand leading to a rise in general price level.
2. **Excessive issuing of currency by the central bank.** Government printing more money through the central bank and circulating it into the public which increases money supply and aggregate demand leading to increase in general price level.
3. **Increased demand for exports** which reduces the amount of goods in the domestic economy leading to increase in general price level.
4. **Persistent increase in wages/salaries of workers** which increases their purchasing power and aggregate demand leadingto persistent increase in general price level.
5. **Un controlled credit creation by commercial banks** which increases money in circulation leading to arise in general price level.
6. **Excessive inflow of incopmes from abroad/increased capital inflows.** i.e. increased foreign investments, increased export earnings, grants and returns from nationals aboard leading to increase in general price level.

Solutions to demand pull inflation.

- Reduce excessive government expenditure so as to reduce spending thus reducing aggregate demand.
- Increase direct taxes. i.e. use of progressive taxation to reduce income and aggregate demand.
- Use of wage freeze/control wages for workers especially high income brackets leading to reduced aggregate demand.
- Fix a minimum price for major commodities to bring down general price level.
- Adopt a restrictive monetary policy to reduce money supply i.e. increase the bank rate and in turn commercial banks increase rates on loanable funds. This reduce money supply and aggregate demand.

UNEB 2002

i) *Distinguish between structural inflation and demand pull inflation. (02 marks)*

ii) *Mention any two effects of demand pull inflation in your country. (02 marks)*

POSITIVE EFFECTS OF DEMAND PULL INFLATION OR

- Employment opportunities are expanded.
- Promotes productivity hence increased economic growth.
- Encourages hard work among people.
- Debtors stand to gain real terms if it is high.
- Increases investment when it is mild.
- Encourages innovations and creativity.
- Results into increased tax revenue.
- Increases resource utilization.

NEGATIVE EFFECTS OF DEMAND PULL INFLATION OR

- Discourages increased savings in case it is very high.
- Leads to loss of confidence in a country's currency.
- Worsens balance of payment problems.
- Fixed income earners lose and suffer.
- Worsens the problem of income inequalities.
- Creditors lose which discourages lending.
- High rates of demand pull inflation makes growth difficult.
- Raises interest rates which discourages borrowing.

b) **Cost push inflation.**

Cost push inflation is (one) persistent increase in general price level that arises as a result of increased/rising costs of production/prices of final products.

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The increase in cost of production is shifted to consumers of final goods and services in form of high prices.

Inflationary spiral or spiral inflation.

Inflationary spiral is where persistent increase in general price level is used to demand for higher wages by workers which increases cost of production, leading to increase in prices which again increases demand for higher wages.

Causes Of Cost Push Inflation.

1. **Increases in indirect taxation** to producers which increases cost of production hence high prices.
2. **Increase in interest rate charged on borrowed capital/loans to producers.** This increases costs of production hence high prices.
3. **Increased cost of inputs** such as high prices of raw materials. This increases cost of production leading to inflation.
4. **Increased wages and salaries of workers** usually influenced by trade unions and government fixing a minimum wage. These are reflected on high prices of goods produced.
5. **Increased in cost of transport** due to underdeveloped roads, railways.
6. **Increase in cost of advertising.** Extensive competitive sales promotional activities among producers especially where substitute commodities are produced is reflected on increased commodity prices.
7. **Increase in electricity charges** arising from power shortages.
8. **Increased storage costs.** This is especially due to high ware housing facilities especially due to high ware housing facilities especially during importation of commodities.

Solutions To Cost Push Inflation.

- **Use of maximum price legislation.** This helps to lower the prices of goods due to reduced cost of production hence reduced general price level.
- **Provision of subsidies to producers to cut down costs of production.** This reduces cost of production hence lowering general price level.
- **Selective taxation and granting of tax holidays to some producers.** This reduces cost of production hence lowering general price level.
- **Emphasize wage control through wage freeze.** Government control on trade union activities especially demand for higher wages thus keeping production costs low thus reducing general price level.
- **Encourage development of infrastrucrure.** This reduces cost opf transport hence reduce d price level.
- **Controlling interest rate on borrowed capital** through monetary policy such as reduced bank rate. This reduces cost of production and general price level as well.
- **Provision of non monetary rewards to workers.** This helps to reduce increased demand for higher wages hence reduced cost of production and general price level as well.

c) Bottleneck/structural /scarsity inflation.

Structural inflation is (one) persistent increase in general price level as a result of supply rigidities leading to shortages in supply of commodities in the domestic economy.

Or

It refers to one or a form of inflation arising out of supply rigidities which cause shortages of goods and services in the domestic economy. It results from structural problems in an economy.

UNEB 1999

Give any four causes of structural inflation in an economy. (04 marks)

UNEB 2010

i) What is structural inflation? (01 marks)
ii) Give any three causes of structural inflation in your country. (03 marks)

UNEB 2014

(i) Distinguish between structural inflation and cost-push inflation. (02 marks)
(ii) Give any two causes of cost-push inflation. (02 marks)

UNEB 2012

i) Distinguish between cost push inflation and bottleneck inflation. (02 marks)
ii) Mention any two causes of bottleneck inflation in your country. (02 marks)

Causes Of Structural/Bottleneck Inflation.

- **Unfavourable natural factors/natural hazards.** Failure in agricultural production due to uncontrollable factors such as changes in weather leading to limited output leading to high prices.
- **Breakdown in industrial production** i.e. break down of machinery due to limited spare parts, limited skilled labour thus low output leading to high prices.
- **Infrastructural breakdown.** Whenever productive infrastructure breaks down, it limits supply of commodities to some areas. For instance poor road and railway network leading to high prices.
- **Persistent shortages of inputs/exhaustion of raw materials** implying that production levels reduce leading to high prices.
- **Speculation by the business community** which creates a scarcity of goods and services through hoarding thus high price

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- **Existence of political instability.** This discourages production thus low output levels and high prices.
- **Persistent foreign exchanges** due to poor export performance thus less foreign exchange to increase imports and expand production at home thus high prices.

UNEB 2009

i) Define the term structural inflation. (01 marks)
ii) Mention any three measures that can be taken to control structural inflation in an economic. (03 marks)

Solutions To Structural Inflation.

1) **Improve infrastructure,** i.e. repairing existing railways and roads building dams to generate hydro electric power and increase the output leading to reduced prices.
2) **Agricultural modernisation** to increase agricultural output thus reducing prices.
3) **Ensure political stability and security** to stimulate production leading to high output and reduced prices.
4) **Increased importation of then majour raw materials.** This increases production levels hence reduced prices.
5) **Improvement and expansion in the industrial sector** by rehabilitating crippled industries hence oincreasing the industrial output and reducing prices.
6) **Provision of investiment incentives** to encourage private local and foreign entrepreneurs to stimulate production levels and reduce the price.
7) **Encourage economic liberalization** to attract several economic activities and increase the output hence reducing prices.
8) **Adopt better methods of production.** This is intended to increase the output levels.

d) **Imported Inflation.**

Imported inflation refers to the persistent increase in the general price levels in an economy as a result of importing goods from inflation hit /prone economies.

Or

This is one which arises as a result of importing goods and services from countries experiencing inflation.

In 2011, the Uganda shilling was ranked one of the world's worst performing currency .the shilling lost 21.5%against the dollar hence driving up the prices of imported goods.

Causes Of Imported Inflation.

- High prices for fuel on the world market
- Importation of the consumer goods from a country /importation of the already inflated commodities.
- Rising prices for goods and services on the world market.
- Depreciation of the countrys currency . higher for leading to high cost of importation .

Solutions To The Imported Inflation.

- Protectionism by restricting imports from the countries.
- Adopt import substitution industrial strategy.
- Subsidize importers of raw materials and the government so as to sell at low prices.
- Economic integration to allow trade creation importation of cheaper goods from the member co
- Control foreign exchange rates.

e) **Suppressed/Controlled Inflation.**

Suppressed inflation is a situation where demand the effect of this on general price level is reduced b rationing.

It's a situation where price when inflationary tendenc economy.

When the aggregate demand is greater than ag government can suppress inflation by the use of p fixing the maximum price. The government comes becomes undesirable.

Effects Of Suppressed Inflation.

- Emergence of black markets.
- Discourages investment.
- Controls speculation.
- Increases the unemployment.
- Leads to the misallocation of resources.

f) **Monetary Inflation.**

Monetary inflation is one arises from the exce supply which increases aggregate demand that corresponding supply of commodities in an economy According to monetarists, increase in the genera increase in the money supply which is not bac production .

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It occurs especially when the central bank prints more money into circulation and is not followed by increasd supply in the commodities.

Causes Of Monetary Inflation.

1. Increased supply of money by the central bank.
2. Reduction in the taxes.
3. Increase in the government expenditure.

However an increase in t he money supply may not necessarily lead to the inflation because of the following;

- When there is an effective price control measure and therefore inflation is suppressed.
- When there is a corresponding increase in the rate of production of commodities.
- Incase marginal propensity to save is highimplying thatmoney is not spent.
- When an increase in the money supply is used to purchase capital goods and not consumer goods.

g) **Speculative Inflation/expectional inflation.**

This is one which rises due to expected shortages of commodities in the future which leads to excessive buying which forces the prices to rise high. When people predict that the prices will increase in future , they tend to purchase in the current period to avoid paying high prices in future but this leads to excessive buying wich forces the prices to rise.

NB.

Underlying inflation. This is the measure of the rate of inflation for all goods and services excluding food stuffs. This measures changes in the prices of goods excluding food stuffs in a given economy over time.

Headline inflation. This is the measure of the rate of inflation for all goods including food prices. This measures the changes in the price levels of goods and services including the food stuffs in an economy over time.

UNEB 2006

(i) Distinguish between the deflation and relation. *(02 marks)*

(ii) Mention any two instruments of reflationary policy. *(02 marks)*

DEFLATION AND REFLATION

Deflation.

Deflation refers to the persistent decrease in the general prices of the goods and services in an economy. This is mainly caused by the fall in aggregate demand. Prices of goods and services are on a downward trend.

Reflation.

Reflation refers to a deliberate government policy to stimulate production by increasing prices to recover an economy from a depression.

It is a policy taken by the government to lift an economy out of an economic depression by increasing prices.

Instruments of reflationary policy in an economy.

(how can reflation be achieved)

- *Reducing direct taxes.*
- *Encouraging exports to other countries.*
- *Increasing wages of workers.*
- *Increasing government expenditure.*
- *Use of expansionary monetary policy.*

UNEB 2007.

i) What is meant by stagflation *(01 marks)*

ii) Suggest any three measures that can be taken to reduce stagflation in an economy. *(03 marks)*

Stagflation.

Stagflation refers to a situation in which high rates of inflation co-exists with high levels of unemployment in an economy.

Or

It refers to a situation where there exits both high levels of unemployment and high rates of inflation in an economy.

Costs/Effects Of Stagflation.

- Increases the country's cost of living.
- Reduces levels of investment.
- Widens income inequality.
- Reduces tax revenue.
- Rapid decline in people's welfare or standard of living .
- Increases social tension and distress in society.
- Increases dependence burden.

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Measures that can be taken to reduce stagflation in an economy

1. Reduce taxes to increase disposable income to increase investment
2. Increase government expenditure to encourage more production
3. Increase output through reduction in factor input costs
4. Liberalize monetary policy to realize interest rate on capital and encourage more investment

UNEB 2009.

(i) Distinguish between cost-push inflation and demand-pull inflation. (04 marks)

(ii) Account for the persistent inflation in your country. (16 marks)

UNEB 2011.

a) Explain the causes of inflation in your country. (10 marks)

b) What policy measures are being undertaken to control inflation in your country. (10 marks)

UNEB 1997.

a) Examine the causes of inflation in your country. (12 marks)

b) Why may a low rate of inflation be desirable in an economy. (08 marks)

UNEB 2015

a) Explain the causes of inflation in an economy. (06 marks)

b) Suggest measures that should be taken to control inflation in an economy. (14 marks)

GENERAL CAUSES OF INFLATION IN UGANDA

NB. These causes should be discussed as forces that lead to high money supply, increase supply rigidities that causes supply shortages and other direct forces that cause the general price level to increase.

Forexample in December 2011, inflation in Uganda was between 29-30.4% and was partly attributed to increased aggregate demand against constrained supply of commodities.

Over the years, inflation in Uganda has been a major macroeconomic problem. During 1970's and 1980's Uganda was faced with hyper inflation. The amount of money in an economy was increasing at an alarming rate leading to sky rocketing prices but in early 1990's, it was reduced to about 23%.

Inflation over the years in Uganda has been due to the following factors.

1. **Excessive issuance of currency/excessive printing by central bank.** Government normally directs the ... more money into circulation which leads to ... leading to high aggregate demand compared to the ... levels/ production of commodities leading to ... general price level.
2. **Unfavourable natural factors in agriculture/...** leads to poor performance of the agricultural sector leading to persistent increase in general price level. Agriculture continues to perform poorly and ... rigidities because of uncontrollable natural factors ... pests and diseases thus increase in prices of food ...
3. **Increased/excessive inflow of incomes from ...** continues to come from abroad inform of direct ... returns by nationals abroad, donations, grants and ... local currency which increases money supply ... aggregate demand thus persistent increase in general ...
4. **Greed for excessive profits by business ...** persistently charge high prices in order to accumulate very quickly as possible due to increased level of ... inflation.
5. **Excessive exportation of essential goods/... exports.** This is especially essential commodities ... neighbouring countries and accompanied by ... leading to shortages in supply in the domestic ... increase in general price level.
6. **Excessive government expenditure.** This is ... production of commodities and as a result aggregate ... excessive compared to aggregate supply thus ... general price level.
7. **Poor political climate/political instability in ...** a poor investment climate which limits production ... in supply of goods hence persistent increase in general ... Political unrest in Uganda normally disrupts ... percentage of government expenditure on military ... economic sectors money for investment causing ... in the entire country.
8. **Break down infrastructure.** Breakdown ... communication facilities imply high cost of ... services and limited supply of commodities ... industrial production leading to shortages in ... increase in general price level.
9. **Declining value of local currency ... currencies/depreciation of the local currency**

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This creates foreign exchange shortages and makes it expensive to import, makes exports cheaper which increases exports and reduces domestic supply thus increase in general price level.
There is frequent depreciation of the Uganda currency against other currencies which increases import prices since many firms import raw materials and intermediate inputs.

10. **Uncontrolled/excessive credit creation by commercial banks.** Commercial banks continue to attract borrowers by production loans which lead to excessive money supply which creates excessive aggregate demand leading to persistent increase in general price level.
11. **Persistent rising costs of production.** This is through rising prices of fuel, interest rates, high indirect taxes, demand for high wages, fuel prices, high cost of advertising, interest rates which makes it expensive to produce and creates supply shortages which forces producers to translate the increased costs to consumer's hence persistent increase in prices.
12. **Speculation by businessmen who hoard commodities. This is very common among many traders.** This is intended to create artificial scarcity of commodities thus creating supply shortages which leads to persistent increase in prices.
13. **Increased importation of goods and inputs from economies experiencing inflation.** At times raw materials and final products are imported from economies experiencing inflation thus high production costs leading to high prices in the domestic economy.
Uganda is hit by rising prices of petroleum products which are imported at high prices.

UNEB 2001

Give any four measures applied to control inflation in your country.

(04 marks)

UNEB 2000

i) Differentiate between creeping inflation and runaway inflation. (02 marks)
ii) Give any two policy instruments of controlling inflation in your country. (02 marks)

POLICY MEAUSRES TO CONTROL INFLATION IN UGANDA/DEVELOPING COUNTRIES

NB. These measures are generally intended to increase aggregate supply, reduce aggregate demand, reduce cost of production, reduce supply rigidities, reduce money supply thus scaling down general price level.

- **Use of restrictive/contractionary monetary policy.** This is done by selling government securities to the public, increasing bank rate which reduces money supply hence reducing aggregate demand and finally reduce general price level.
For instance in September 2011, in a move to reduce inflation of 28% in Uganda, the bank rate was increased to 23% which forced commercial banks to increase interest rate on borrowed capital thus limiting borrowing for consumption.
- **Increase direct taxes through progressive taxation.** This reduces disposable income and aggregate demand due to reduced purchasing power. This reduces aggregate demand hence reduced inflationary pressure.
- **Control exportation of certain goods such as scarce goods.** This helps to control the volume of exports especially essential goods such as food stuffs hence maintaining increased supply in the domestic economy and controlled prices.
- **Encourage importation from cheaper and friendly sources.** The government encourages importation from alternative sources at relatively low prices which increases domestic supply of commodities thus reducing general price level. For instance from Asian countries such as china.
- **Provision of a conducive investment climate (investment incentives).** This is through giving tax holidays, tax exemptions and subsidies to potential producers of scare commodities. This stimulates production at a low cost hence increasing aggregate supply and reduces prices.
- **Further privatization of public enterprises.** Continued transfer of public to private sector stimulates more production in the long due to increased efficiency hence increasing supply of commodities and cuts down prices.
- **Further liberalization of the economy.** Giving more liberty to private individuals to participate in economic activities without undue government controls attracts many producers hence increased production and supply of commodities thus reduced general price level.
- **Control issuance of the currency/reduce government borrowing from the central bank.** This reduces money supply and cuts down excessive aggregate demand. This reduces chances of frequent printing of money especially in the periods of deficit financing. This ensures money supply matches with the growth of output hence reduced general price level.
- **Improve and build necessary infrastructure.** Building and modernising roads, railways and power supply facilities helps to modernise production in sectors such as agriculture and industry at a reduced cost, increases mobility of factors of production leading to increased supply of commodities and reduced general price level.

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- **Reduce excessive government expenditure on** provision of non-essential goods. This helps to reduce excessive aggregate demand arising from increased money supply and stabilize prices
- **Improvement in political climate to ensure political stability.** Stable political climate gives confidence to local and foreign investors to commit their resources in expanding the productive capacity of the economy hence increasing the level of economic activity and supply of commodities thus reduced general price level
- **Promote modernization of agriculture.** This helps to remove bottlenecks or rigidities in supply of agricultural products as well as reducing dependence on nature through irrigation practices which reduces supply shortages thus reduced prices of food stuffs
- **Encourage establishment of import substitution industries.** This helps to increase domestic production of formerly imported commodities which reduces imported inflation
- **Reduce indirect taxes on essential goods.** A reduction in indirect taxes especially on goods demands by both the rich and the poor helps to reduce cost of production which forces prices to go downwards

UNEB 2008.

a) Distinguish between creeping inflation and galloping inflation. (04 marks)

b) Explain the effects of inflation in an economy. (16 marks)

UNEB 2004.

a) Differentiate between imported inflation and structural inflation. (04 marks)

b) Assess the impact of inflation in your country. (16 marks)

UNEB 2003.

a) Distinguish between inflation and reflation. (04 marks)

b) Assess the impact of inflation in an economy. (16 marks)

EFFECTS OF INFLATION IN AN ECONOMY.

Inflation as a macro economic problem has both positive and negative effects on an economy depending on the state of inflation and the type of inflation.

POSITIVE EFFECTS /IMPACT OF INFLATION IN AN ECONOMY.

Inflation impacts positively on an economy especially when it is mild in the following ways.

1. **Stimulates people's effectors and hard work.** The inflation makes people work harder to maintain habits. It acts as an incentive for people to engage
2. **Increases marginal efficiency of capital due to** Mild inflation increases profits among firms which expand production which stimulates more investment
3. **More employment opportunities are created, reduces unemployment.** More job opportunities are created encouraged where there is a lot of money to spend production to take advantage of high profits during
4. **Promotes forced savings.** Mild inflation forces people commodities and also invest in the near future investment in the long run.
5. **Increases utilization of idle resources.** High profits mild inflation stimulate potential producers to fully resources and earn more income leading to economic
6. **Increases government tax revenue.** This is through away of taxing profit margins of firms during mild infl
7. **Helps to pull an economy from an economic depression** is a depression in an economy, mild inflation helps to interest since it forces prices upwards.
8. **Increases innovations and creativity in an economy.** people strive higher to find means of maintaining consumption and expenditure levels.
9. **Stimulates the level of investment thus economic growth.** attracts more investors to increase the level of production high prices charged on commodities which increases profits
10. **Debtors/borrowers stand to gain in real terms.** pay back the borrowed money at a reduced value borrowing.
11. **Encourages mobility of labour.** In an effort to services and earn income for a living so as to maintain living attracts more labour mobility both occupationally which reduces labour shortages.
12. **Helps to monetize/commercialize the economy.** helps to break the large subsistence sector and highly commercialized during inflation thus subsistence sector.
13. **Encourages adoption of import substitution industrialization.** This promotes industrialization reduce imported inflation during mild inflation.
14. **High profits stimulate entrepreneurship.** development of a large entrepreneurship class

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UNEB 1999

a) What is meant by stagflation. (04 marks)
b) Under what circumstances may inflation be desirable in an economy (16 marks)

Under what circumstances may inflation be desirable in an economy

Inflation becomes desirable especially when it is mild in the following ways

- When there is need to stimulate economic growth since it makes people work harder hence increasing more investment and the level of output.
- If there is need to increase marginal efficiency of capital by increasing profit margins of producers, inflation becomes desirable since high profits increase production andmakes it profitable to employ an additional unit of capital.
- Incase there is need to increase investment by the government, it helps to attract potential investors due high prices.
- When there is a need to lift an economy from an economic depression using mild inflation since it increased investment expenditure thus increasing aggregate demand.
- When there is a need to redistribute income from wageearners with low marginal propensity to save to profit earners with high marginal propensity to save.
- When the economy is producing at excess capacity, mild inflation becomes desirable to attract investors to exploit idle resources and ensure that they are fully utilized.
- Incase there is a need to promote forced savings hence encouraging investment in the longrun instead of introducing new taxes which may be unpopular.
- When there is need to increase employment where investors may be attracted by high prices. Leading to high investment and increased job creation.
- Incase the government wants to encourage people to invest in assets such as land and houses which normally gain value with inflation instead of holding cash which loses value very quickly.
- When there is a need to stimulate demand for commdoties in an economy, mild inflation becomes desirable.

UNEB 2013

a) Distinguish between mild inflation and hyper inflation. (04 marks)
b) Explain the effects of hyper inflation in an economy. (16 marks)

NEGATIVE EFFECTS/IMPACT OF INFLATION IN AN ECONOMY.

Inflation is generally undesirable because it produces serious social, political and economic problems in an economy. This happens during hyper inflation.

1. **Fixed income earners suffer.** Individuals living on pensions and past savings suffer because as prices rise their real income falls since they tend to remain fixed.
2. **Lenders/creditors stand to lose which discourages lending.** The value of capital repayment becomes less than the value of the original loan which discouragest more lending by commercial banks.
3. **Leads to loss of confidence in a country's currency.** As a medium of exchange, money loses value. During hyper inflation, large sums of money are used to purchase a few commodities than before thus the currency loses value.
4. **Widens problem of income inequality.** During hyper inflation, income groups such as businessmen become well off while fixed income earners and non income earners become worse off. The poor and the middle class become impoverished and the business community becomes well off as a result of charging high prices.
5. **Worsen balance of payment problems/encourages capital outflow.** Hyper inflation makes prices of domestic commodities increase more than those of competitors thus exports become expensive and lose market hence low foreign exchange earnings and increased preference of cheap imported goods.
6. **Leads to unemployment.** Inflation reduces level of savings and investment and some firmsa close down thus laying off of workers.
7. **Discourages investment by both local and foreign investors.** Prospective investors despise earnings in a weak currency and due to rising costs of raw materials and other inputs during hyper inflation, investment is discouraged. It also makes borrowing for investment more expensive due to high interest rate.
8. **Leasds to industrial unset.** During hyper inflation,there is constant demand for high wages by labour to match with increase in the cost of living.
9. **Makes economic planning difficult.** Various government development projexcts are likely not to be achieved since the value of government budget estimates is reduced at the time of implementing the plans especially during hyper inflation jence plan failure.
10. **Leads to brain drain.** hyper inflation forces skilled and professional manpower wgo are fixed income earners to migrate to stable stable economies for greener pasturesand better conditions of work which limits inventive and innovative ideas at home.

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11. **Encourages trade malpractices/illegal activities**. Inflation encourages speculation , gambling and black marketing as people try to make quick profits and look for survival in a move to meet high cost of living.

12. **Reduces social welfare or standard of living/encourages consumption of inferior and low quality goods**. Hyper inflation increases the cost of living hence poor standards of living. This is because such commodities appear to be cheap during hyper inflation and this reduces standard of living

13. **Discourage s savings**. This is due to constant loss of money value during hyper inflation and this may affect future investment negatively

14. **Causes unpopularity of government in power/political unrest**. This is because during hyper inflation, people's lives become miserable and they turn against the ruling government.

15. **It promotes speculation and its disadvantages in an economy**. This causes irregular supply of commodities in a move to earn excessive profits by producers.

16. **Reduces output/production**. This is because of increased cost of production which discourages producers as some firms close down.

17. **People are strained in an attempt to cope with the rising cost of living**. This is in an attempt to maintain standard living.

CHAPTER 6: ECONOMIC GROWTH, DEVELOPMENT AND DEVELOPMENT.

Economic growth refers to a sustained or persistent growth in the country's volume of goods and services produced in a given time

Or

It refers to the persistent quantitative increase in the output of economy overtime

Or

It is a steady process by which the productive capacity of the economy increase to bring about rising levels of national output and income.

Economic growth is measured by an increase in GDP in a given time.

UNEB 2009.

a) Explain the factors that determine economic growth.
b) Explain the benefits of economic growth to a country

DETERMINANTS OF ECONOMIC GROWTH IN AN ECONOMY

NB. Neutral points are presented and explained in two ways each factor favours/fosters growth and how it limits economic

These factors are responsible for either increasing national output levels which promotes increased economic growth or investment thus low output levels which limits increased economic

1. **Availability and level of utilization of natural resources**. Supply of natural resources such as fertile lands, minerals resources which are highly exploited increase investment hence high economic growth while limited natural resources leads to limited chances of increasing investment and limits economic growth.
2. **Level of technological progress.** High level of technology country's capacity to produce more goods and services increased economic growth while low level of technology output which retards the level of economic growth
3. **Size and quality of labourforce/level of skills**. A labourforce with highly developed skills means an increase capacity of manpower thus increase in investment fosters increased economic growth whoile a small labourforce with poor skills reduces production thus low chances of attaining economic growth.
4. **Size of existing capital stock.** The greater the stock and liquid capital, the greater its capacity to

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output hence increased economic growth compared to a small size of the capital stock which limits production thus limited possibilities of achieving economic growth.

5. **Government policy on investment/nature of government policies.** Favourable government policies such a s sound currency, tax holidays, tax exemptions and subsidies to producers encourage investments thus high output leading to economic growth while unfavourable government policies such as high taxes and limited subsidies to producers discourage production which retards economic growth.

6. **Political climate.** Political stability attracts all forms of investment that increase output and thus high economic growth while political instability discourages production which limits economic growth.

7. **Population growth rate.** High population growth rate increases dependence burden which reduces savings, investments thus low output which limits economic growth while a low population growth rate increases savings and investments leading to high output economic growth.

8. **Level of monetization of an economy/size of subsistence sector.** A highly monetized economy encourages increased production for market leading to economic growth while a large subsistence economy is associated with low output for domestic market which retards economic growth.

9. **Level of entrepreneurial ability.** Where entrepreneurial skills are available, other factors of production are well organized and used efficiently to increase investment and output thus high economic growth whereas a small entrepreneur class is associated with underutilization of other factors of production which limits investment and economic growth.

10. **Market size.** A large market size both at home and abroad for produced oputput facilitates more production thus high economic growth while a small domestsic and foreign market for produced output discouruges more production whjich limits economic growth.

11. **Rate of inflation/economic climate.** A stable economy free from persistent inflation attracts more investments leading to high output and economic growth while an economy frequently subjected to inflation, interest rate changes discourages potential investors thus low output which limits economic growth.

12. **Level of infrastructure development.** High level of infrastructure development through sound and modern social-economic infrastructure helps to coordinate production leading to high output economic growth while underdeveloped social and economic infrastructure discourages investment thus low output which limits economic growth.

13. **Level of planning and plan implementation.** High level of planning and successful plan implementation facilitates increased production hence high economic growth while unsuccessful planning limits increased production which limits economic growth.

14. **Cultural factors.** Such as conservation. Unfavourable cultural factors limit social transformation leading to limited production and economic growth while favourable cultural factors promote economic growth.

15. **Nature of foreign influence.** Favourable foreign influence promotes increased domestic production leading to high economic growth while unfavourable foreign influence limits increased production thus limiting economic growth.

(UNEB 2006,

a) Distinguish between economic growth and economic development. (04 marks)

b) Examine the implications of economic growth in an economy. (16 marks)

(UNEB 2015

a) Distinguish between economic growth and economic development. (04 marks)

b) Explain the benefits of economic growth in an economy. (16 marks)

BENEFITS/POSITIVE IMPLICATIONS OF ECONOMIC GROWTH IN AN ECONOMY

- **Increases employment opportunities which reduces unemployment.** This is because of new and expanding industries which increase the productive capacity and employ more labour.
- **Increases government tax revenue.** This results from increased investments and people's income and the government is able to provide more social services.
- **Results into improvement in balance of payment position.** It increases production which expands the export docket of the country thus high foreign exchange earnings and reduced foreign exchange expenditure in imports.
- **Leads to development of necessary infrastructure.** Both social and economic infrastructure such as roads, railways, banking institutions, power supply, health centres and recreational facilities which are put in place to facilitate production.
- **Promotes industrial development and increased urbanisation.** Economic growth is associated with the attraction of both local and foreign investors to participate in industrial production and therefore industries are setup.
- **Involves advancement in technology due to inventions and innovations.** There is high degree of dynamism and this improves the

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quality of goods produced which makes them very competitive in the export markets leading to technological development.

- **Increases resource utilisation which increases production.** Because of increased production in all sectors of the economy the existing resources are fairly utilised thus reducing underdevelopment.
- **Improves labour skills.** In the process of production, workers are trained to increase output through on job training in the process of production thus increased supply of skilled labour.
- **Provision of avariety of goods and services.** This enhances consumer choice and welfare of people because of increased economic activity coming up.
- **High economic growth promotes political stability.** As the population is more contented with service delivery from government due to increased output, political stability is achieved leading to increased government support.
- **Leads to removal of socil obstacles to growth.** Conservative and backward cultutres are reduced in the process of achieving growth leading to social transformation.
- **Leads to improved standard of living.** This is due to increased consumption of produced goods and services.
- **Reduced income inequalities.** This is especially when the benefits of economic growth are fairly spread across different sections of the population in relation to employment opportunities.
- **Leads to increased humanitarian activities.** This is because the rich societies will reach out of the poor societies.
- **Promotes price stability.** This is due to increased output on the market which keeps prices at a lower level thus encouraging further production.
- **Reduces external dependence.** This results from increased domestic production leading to reduced importation of commodities leading to a self reliant economy.

UNEB 2012

a) Distinguish between economic growth and economic development. (04 marks)

b) Explain the costs of economic growth in your country. (16 marks)

UNEB 2005,1999

i) What is economic growth. (01 marks)

ii) State any three costs of economic growth in an economy. (03 marks)

COSTS OF ECONOMIC GROWTH/NEGATIVE IMPLICATIONS OF ECONOMIC GROWTH

NB. These are given as negative effects that result form the process and activities of achieving economic growth.

i) Involves foregoing leisure so as to increase [illegible] *overwork and fatigue is foregone in the short run. E* [illegible] *volume of goods and services thus low standard* [illegible] *growth requires more hours of work as indicated* [illegible] *various economic activities.*

ii) Involves foregoing/sacrifice of current [illegible] *forgo/postpone current consumption to save and* [illegible] *growth, which promises more goods tomorrow* [illegible] *consuming fewer goods today. This is a primary cost* [illegible] *thus decline in welfare.*

iii) Increases social costs such as noise pollution, [illegible] *pollution in the process of production through* [illegible] *environmental degradation. The current serious pollu* [illegible] *directly from the activities of rapid economic growth.*

iv) Increases technological unemployment. Due to [illegible] *capital intensive technology to increase output* [illegible] *redundant as it is replaced by machines.*

v) Leads to over exploitation of available resources. [illegible] *resources are over utilized so as to increase output,* [illegible] *resource depletion. The current high rate of deforestation* [illegible] *economies results directly form the struggle to* [illegible] *economic growth.*

vi) Increases rural urban migration and its associated [illegible] *production units are located in urban areas, more people* [illegible] *such areas and this is associated with congestion,* [illegible] *development.*

7) Leads to increased public debt burden due to [illegible] *External debts are acquired in a move to increase* [illegible] *and output which increases public debt servicing and* [illegible] *external dependence.*

8) Leads to erosion of social cultural values. [illegible] *traditional culture in favour of the modern culture* [illegible] *devoted to serious commercial production and* [illegible] *and urbanized life styles are emulated.*

9) Increases/widens income inequality leading [illegible] *owners and those who have access to finance and* [illegible] *the expense of other groups of the population.* [illegible] *activities of economic growth are concentrated* [illegible] *economy.*

10) Leads to occupational or industrial hazards [illegible] *caused by machines and lung cancer caused by* [illegible] *process in a move to increase output which reduces* [illegible]

11) Leads to profit/resource repatriation. [illegible] *most productive ventures are owned by foreigners* [illegible]

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take part of profits to their home countries thus limiting further investment.

(d) **Results into displacement of people.** Due to increased economic activities through industrialization, people are displaced.

ECONOMIC DEVELOPMENT

Economic development refers to the persistent qualitative and quantitative increase in the volume of goods and services produced in an economy over a long period of time. It involves positive structural changes in the political, social and economic set up of the country.

Or

It is the persistent quantitative and qualitative increase in the production capacity of the economy. It involves positive structural changes in the political, social and economic set up of the country.

To attain economic development, economic growth has to be followed by positive structural changes such as reduced dependence on nature, fair income distribution, increase in employment opportunities and developed infrastructure.

Therefore economic development is wider than economic growth. In other words, it includes improvement in economic, social and political aspects of the whole society.

INDICATORS OR FEATURES OF ECONOMIC DEVELOPMENT IN AN ECONOMY.

For a country to be considered to have achieved economic development, desirable conditions must be imbedded in the social, political and economic set up of the country.

- ✓ Expansion of monetary production. i.e. an economy is highly commercialized.
- ✓ Increased volume of savings.
- ✓ High level of consumption per person/increased consumer choice for goods and services.
- ✓ Increased purchasing power among individuals implying high disposable income.
- ✓ Reduced dependence on nature i.e. there is agricultural modernization.
- ✓ High level of economic stability therefore no constant changes in price, increase in interest rate and therefore low cost of living.
- ✓ Increased infrastructure development both social and economic.
- ✓ Reduced social hindrances to development, therefore there is reduced conservatism and other backward social beliefs (social transformation).
- ✓ High level of literacy which implies increased access to quality education.
- ✓ Desirable population growth rate i.e. regulated birth rates.
- ✓ High life expectancy and low mortality rate therefore
- ✓ Reduced economic dependence. High level of indigenization of the economy and forces of development are firmly rooted in the domestic economy.
- ✓ High quality of goods and services produced.
- ✓ High level of political maturity i.e. there are free and fair elections and respect of human rights such as freedom of press, religion and association.
- ✓ Creation of more employment opportunities. Low levels of unemployment and under employment of human resource.
- ✓ Fair distribution of income/wealth and reduced poverty.

UNEB 2011

State any four features of economic development in an economy. (04 marks)

Indicators/features of economic development in Uganda.

- Expansion of monetary production/reduced subsistence production.
- Increased literacy levels.
- Improved infrastructure development.
- Improved political climate.
- Reduced cultural rigidities implying social transformation.
- Expansion of manufacturing sector.
- Improvement in technology.
- Increased production of consumer goods.
- Reduced economic dependence.

UNEB 2000

Mention any four reasons why economic growth may not be accompanied by corresponding rate of economic development.(04 marks)

CIRCUMSTANCES UNDER WHICH ECONOMIC GROWTH MAY NOT NECESSARILY MEAN ECONOMIC DEVELOPMENT/(WHEN MAY HIGH RATES OF ECONOMIC GROWTH NOT NECESSARILY MEAN ECONOMIC DEVELOPMENT.)

1. When there is uneven distribution of income and therefore, the economic distance between the rich and the poor is wide. Increase in GNP is in the hands of few individuals and majority is suffering from absolute poverty.
2. When the quality of goods and services produced is poor and therefore living standards are not raised, there no economic development.
3. When there is increased production of capital goods than consumer goods which limits consumer choice. These capital goods do not improve welfare directly.
4. In case there is still high level of, conservation and illiteracy and people's attitudes have not changed.
5. When there is high rate of economic instability such as inflation. This reduces aggregate demand.
6. When there is high rate of unemployment and under employment with in the growing economy.

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7. When people are overworking and foregoing leisure. This implies that workers are overstrained without enjoying leisure.
8. In case there are high social costs such as air pollution which implies poor standards of living due to reduced life span.
9. When there are unfavorable conditions of economic policies such as high taxation, retrenchment and cost sharing in government institutions.
10. When the majority of the people forego current consumption to increase output and hence high output does not mean that there is development.
11. Whenthere is persistent political instabilities leading to loss of lives and property.
12. Incase there is no change in the techniques of production implying increased use of labor intensive techniques of production.
13. When there is more spending on the non productive activities such as military expenditure rather than spending on the social services.

UNEB 2002.

Mention any four objectives of economic development in your country. (04 marks)

OBJECTIVES OF ECONOMIC DEVELOPMENT IN UGANDA.

- To reduce economic dependence and attain self sustenance.
- To reduce unemployment.
- To attain price stability.
- To attain equal and fair distribution of income.
- To improve on labor skills through improved training and education.
- To create security for life and property.
- To control population growth rate to desirable levels.
- To attain high rates of economic growth.

STAGES OF ECONOMIC GROWTH ACCORDING TO W.W ROSTOW.

Professor W.W Rostow explained the path of the economic growth in a historical perspective. Development according to him follows specific stages. MDCs were once 3rd world countries but later they progressed through various stages of growth.

He classified the societies according to their level of economic growth and he used capital accumulation as a driving force of the economy through the various stages of economic development from the subsistence to highly industrialized economies.

In 1960, in his book, he identified 5 stages of economic growth.

1. The traditional stage.
2. The pre-condition for take off stage /transitional stage.
3. The take off stage.
4. The drive to maturity stage.
5. The age of high mass consumption.

i) THE TRADITIONAL STAGE

According to ROSTOW, the economy in this stage is stagnant. Stagnation is undesirable economic period of static economy characterized by no new investments coming up, low income, few job opportunities and constant GDP growth rates.

According to him this is the first stage of economic growth, characterized by the following.

1. Rudimentary technology is used.
2. Agriculture dominates the economy and subsistence agriculture.
3. Incomes are very low leading to low savings of almost zero.
4. The economy is closed and therefore no external trade in the society.
5. Traditional and cultural beliefs play a very important role in allocation, there is communal ownership of most resources.
6. High level of illiteracy in an economy.
7. There is barter trade exchange in an economy.
8. Vicious circle of poverty prevails.
9. Limited degree of specialization in production.

UNEB 2015

State any four features of Rostow's transitional stage. (04 marks)

b) PRE- CONDITION FOR TAKEOFF /TRANSITIONAL STAGE.

This is a transitional stage in which traditional economic activities the economy starts growing.

The economy lays a foundation for takeoff into a self sustaining economy.

This stage is characterized by:

- The society starts to imitate the advanced society's ways.
- Low but rising rates of investment of about 5% of GDP.
- Low but rising rates of savings of about 5% of GDP.
- Investments are directed towards the development of infrastructure such as banking institutions, roads and health facilities.
- New enterprising people begin to come up forming entrepreneur class.
- Reduction in illiteracy rates due to improvement in education.
- Technological improvement is realized in agriculture.
- More foreign capital resources begin coming in.
- Small-scale industries start to develop especially consumer industries.
- Dualism becomes the major characteristic.
- There are changes in political systems from colonization and then to political independence.

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NB. Looking at the above characteristics, one would suggest that Uganda's current level of development is at this stage and most of other LDC's

UNEB 2009, 2001

c. What are the characteristics of Rostow's take off stage of economic growth (03 marks)

d) Give any two limitations of this theory (02 marks)

c) TAKE OFF STAGE.

At this stage, the economy becomes self sustaining and reduces on foreign dependence. An economy experiences a breakthrough in the vicious circle of poverty and overcomes obstacles of development.

This stage is characterised by

- High level of investment of between 10% to 15% of GDP/ national income/ GNP.
- High level of savings of between 10% to 15% of GDP/national income/GNP.
- High level of employment due to increased economic activities. A big proportion of the labourforce becomes employed in the industrial sector.
- High level of modern technology especially in agriculture which increases output to support the growing urban and commercialised labourforce.
- High level of industrialization with both backward and forward linkages.
- High level of urbanization.
- Emergence of new economic and political institutions.
- High literacy rates/ social transformation.
- Self sustained growth/self reliant economy. Reduction in foreign dependence as the economy becomes self sustaining in most of its requirements.
- Emergence of new markets both domestic and foreign markets.
- High level of infrastructure development. High level of investment in social, economic and capital infrastructure.

The take off stage is the most critical of all stages in which an economy starts to develop.

At this stage there is emergence of some leading or significant sectors of the economy for instance USA, RUSSIA, CANADA began with grain production.

UNEB 1999.

State any four features of Rowstow's drive to maturity stage of economic growth. (04 marks)

d) DRIVE TO MATURITY STAGE

This follows after a long period of sustained growth. The economy progressively grows and drives to extent modern technology over all its economic activities. It is characterized by.

1. High rate of savings of between 15% to 20% of GDP.
2. Heavy industrialization and productivity is rising, goods formerly imported are produced at home.
3. Increased use of modern and efficient technology in the production process, i.e. new production techniques replace the old ones in all sectors of the economy.
4. High rate of investment of between 15% to 20% of GDP.
5. Increased employment opportunities. Increase in the proportion of white collar jobs arising from the expansion of tertiary sector such as banking, insurance companies, telecommunications, transport sector and tourism.
6. Increased urbanization and most people, prefer to live in urban areas.
7. Population growth rate is very low.
8. Existence of bureaucracy and high level of management and the economy is highly sophisticated.
9. High level of monetization of an economy.
10. Increased use of professional and highly skilled labour.
11. High level of infrastructure development.

NB. New import requirements develop and new export commodities are developed to match with imports. The economy starts experiencing BOP surplus.

The economy finds its place in the international economy, i.e high export trade and reduction in level of importation.

e) AGE OF HIGH MASS CONSUMPTION.

Countries which have reached at this stage include USA, Japan, Germany, UK and France. It is the stage where an economy is at its climax. It is characterized by;

- Large section of the skilled labourforce which is employed in tertiary sector.
- High level of technological maturity in all sectors of the economy.
- Most of the resources are allocated to social welfare and security which leads to emergence of a social welfare state/high preference of leisure to work as working hours generally reduce. There is increase in leisure enjoyed by the majority and the population is highly adventurous.
- Mass production of advanced consumer luxury goods and services such as refrigeration's, cookers, cameras, cars and televisions, electronic equipment.
- The country experiences balance of payment surplus.
- The savings rate is more than 30% of GDP.
- There is heavy investment in foreign economies.
- The country becomes more influential in political, social and economic aspects of other economies.
- The investment rate is more than 30% of GDP.
- Industrialization is at maximum and it involves production of high quality goods.
- The economy starts giving's a lot of foreign aid to needy countries.

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- Population is predominantly urban and many people live in cities and big towns.
- Full utilization of resources. All resources are fully utilized.

The problem in this stage is not how to make income but how to distribute the already accumulated income. The problem of the economy is not how to produce but how to consume.

CRITICISMS OR WEAKNESSES OF ROSTOW'S STAGES OF ECONOMIC GROWTH.

1) There is considerable over lapping of stages. He was not clear on the demarcations and boundaries between different stages i.e. it is difficult to distinguish stage four from stage five since characteristics of one stage are found in another stage.
2) It is not true that all countries go through all stages of growth because some countries skip some stages. The traditional stage is not essential for development. Some countries such as USA, Canada were born free of traditional stage.
3) He looked at capital accumulation the major driving force for growth and ignored other factors such as availability of natural resources, political atmosphere, skills which influence economic growth.
4) He assumed that there is no discontinuity in the road of growth i.e. one stage leads into another stage and that this trend is continuous which is unrealistic because there are factors that lead to a decline/ delays in economic growth.
5) Resources are not homogenous in different countries hence countries cannot take the same trend of development.
6) He did not consider external factors that influence economic performance and later growth such as foreign aid.
7) It doesnot consider the nature of distribution of income.
8) High level of savings may not necessarily lead to economic growth.

THE CONCEPT OF UNDERDEVELOPMENT.

Underdevelopment refers to a situation where there is underutilization of resources and low standards of living characterized by poverty, low level of productivity, low rate of economic growth, low consumption levels, low level of productivity.

Or

Underdevelopment is a situation where a country has not fully utilized her productive resources and has low levels of productivity.

It involves a situation where a country has the resources but has failed to put them to maximum exploitation to increase economic growth and economic development. It is a situation where the country's resources are not fully utilized.

Such countries are often referred to as third world countries, low income countries, less developed countries and they are mainly found in Africa, Latin America and Asia.

CHARACTERISTICS/FEATURES OF UNDERDEVELOPMENT

- **High debt burden.** This is due to ... persistent budget deficits hence high ... servicing.
- **High income inequality.** ... of people live on income below the ...
- **High population growth rate** ... is due to high birth rates and low ... economy.
- **Agriculture dominates the economy.** Farmers see themselves as subsistence ... the population lives in rural areas and ...
- **High illiteracy rates.** Many people ... write.
- **Low life expectancy.** Many people ... an early age due to various causes ... horselessness and diseases.
- **High rates of unemployment** and ... levels of investment and limited ... rampant, structural unemployment ... wide spread.
- **BOP deficits are experienced** and ... because of high foreign exchange ... hardware and low prices of exports.
- **Poor quality of human resource ... labour.** Most of the workers are ... training and poor education ...
- **High level of economic dependence** ... other countries for basic resources ... skilled labour. This is in form of ... dependence and direct economic ...
- **High traditional rigidities** and ... to change from traditional ways ... work or travel on certain days ... most of the time is spent on ...
- **Limited entrepreneurial ability** ... organize other factors of production ... foreign entrepreneurs and ... underdeveloped countries and ... development.
- **Limited domestic and foreign** ... purchasing power and foreign ... because of ...

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- **Weak/small industrial sector.** The industrial sector is very small where major industries exist in urban areas and produce basically low quality products and consumer goods and it contributes less to national income.
- **Underdeveloped infrastructure.** Both social and economic infrastructure are in poor state especially roads, railways an even times impassable.
- **Large substance sector.** Many people basically produce for home consumption which leads to low output.
- **Under utilization of resources.** Most of the natural resources such as minerals, water resources remain untapped due to poor technology and inadequate capital.
- **Existence of political instability and high political immaturity.** Most under developed economies are politically unstable and this tends to discourage production.
- **Prevalence of economic dualism.** This leads to high rate of rural urban migration, income inequality.
- **Low income levels.** This limits savings and investment leading to low capital accumulation.

UNEB 2008,2001.

State any four features of underdevelopment in your country. (04 marks)

UNEB 1999.

a) What is the difference between economic growth and economic development? (04 marks)

b) Explain the features of economic underdevelopment. (16 marks)

FEATURES/CHARACTERISTICS OF UNDERDEVELOPMENT IN UGANDA.

- ✓ Weak industrial sector.
- ✓ Predominance of subsistence agriculture.
- ✓ Low income levels/GDP.
- ✓ Dualism such as rural areas and urban areas.
- ✓ Underutilization of productive resource s.
- ✓ Prevalence of economic dependnece.
- ✓ Political immaturity/political instability.
- ✓ Low level of skills
- ✓ High population growth rate.
- ✓ Limited domestic and foreign markets.
- ✓ High rational rigidities and conservatism.
- ✓ Use of poor and inappropriate technology.
- ✓ Underdeveloped /poor infrastructure.
- ✓ Low standard of living.
- ✓ Low levels of life expectancy.
- ✓ High rates of unemployment and underemployment.

UNEB 2004.

a) Explain the concept of underdevelopment. (04 marks)

b) Account for the low rate of economic development in your country. (16 marks)

UNEB 2010.

a) Distinguish between balanced growth and unbalanced growth strategies. (04 marks)

b) Account for the low rate of economic development in your country. (16 marks)

UNEB 2009, 2006.

a) Define the term economic under development. (04 marks)

b) Explain the causes of underdevelopment in your country. (16 marks)

CAUSES OF UNDERDEVELOPMENT IN LDCs/UGANDA.

(Reasons for low levels of economic development in LDCs)

The causes of under development in the thirdworld countries are both internal and external .these factors are responsible for limiting investment, production levels leading to low levels of resource utilization.

- **Poor infrastructure.** The social and economic infrastructure is not well established to coordinate production and increase resource utilization which discourages investment and productivity which leaves resources not utilized.
- **Inadequate supply of basic/strategic natural resources.** This is in terms of their quality, quantity and variety. Most LDCs lack enough strategic resources such as minerals to lead to rapid industrialization and employ factors of production thus low investment leading to the under utilization of resources.
- **Low levels of technology.** Rudimentary tools dominate most o the economic sectors such as agriculture, mining, industry and this limits the large scale production and volume of exports leading to the under utilization of resources.
- **High rate of brain drain.** Experienced professionals overwhelmingly migrate to other countries for greener pastures and this limits innovative and inventive ideas in various aspects of the investment which leaves local resources underutilized.
- **Heavy dependence on foreign aid.** Most LDCs depend on the various forms of the foreign aid which kills initiatives at home, its unreliable, inconsistence and inadequate hence retarding the development and implementation of the plans which leads to under utilization of the resources.
- **Existence of the unfavorable terms of trade.** There is a exportation of the cheap and low quality goods and services which implies low earnings from exports and therefore less revenue from the exports is available to increase investment hence increase in the resource utilization.
- **Poor political climate.** Political unrest in most LDCs scares away the potential investors, disrupts economic activities and takes a large

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percentage of government expenditure through the military hard ware instead of investing in the resourceutilization which leaves the resources underutilized.

- **High rate of capital outflow/high rate of the income and profit repatriation.** Majority of the nationals in the LDCs prefer to keep their money in the foreign economies which are stable and there is high rate of profit repatriation.
- **Narrow domestic and external markets.** There is internal poverty and people cannot afford to purchase on the large scale and the foreign market is highly competitive and has high levels of protectionism, this discourages large scale production hence limiting resource utilization.
- **Insufficient supply of the entrepreneure/poor managerial skills.** Entrepreneurs in most LDCs are limited implying inability to organize other factors of production hence poor organisation of the scarce low level of the entrepreneurial skills implies limited managers to undertake risks in profitable investments thus resource underutilization.
- **High population growth rate.** The growth rate of the population is above 3% in most LDCs and this creates high dependence burden and limits the levels of savings and investment to increase resource exploitation.
- **Heavy dependence on the agricultural/low levels of the industrialization.** Most LDCs depend on agriculture and it is associated with the diminishing returns and constant fluctuations in the prices and this denies economy constant revenue for economic development.
- **High levels of corruption and embezzlement/low levels of accountability.** Most funds are diverted from the productive projects and misused by the planners and project implementers and this retards the rate at which the resources are utilized since it reduces funds for the investment thus resource under utilization.
- **Poor investment culture.** This is characterized by the limited subsidies to the producers, heavy taxation on producers and high cost of trade license. Such policies discourage production which limits resource utilization.
- **Price and exchange rate instabilities.** These are in form of hyper inflation and foreign exchange instabilities increase cost of production which discourage increased investment and resource utilization.
- **Unfortunate structural adjustment programs of IMF** such as retrenchment of civil servants thus reducing their income, dictating unfair economic policies countries. This limits proper development planning relevant to increase resource utilization.
- **Poor land tenure system.** Few individuals in LDCs have access to large expanses of land and such people do not utilize it productively leading to low production and resource underutilization.
- **High level of conservation/poor attitude towards work.** Some cultures do not welcome new and innovative changes in development,

there are food taboos and a lot of time is spent on ... This limits adoption of new methods of production ... utilization.

- **Heavy public debt burden and problem of low ...** are faced with huge debts both internal and external ... expenditure on debt servicing which limits capital ... to underutilization of local resources.
- **Existance of large subsistence sector/dominance ... sector.** Most LDCs are dominated by subsistence ... productivity and this limits increased resource ...
- **Limited labour skills/limited skilled manpower.** ... labourforce does not possess the required skills ... education system which leads to low productivity ... underutilization. This leads to heavy dependence ... manage key sectors.
- **Low income levels/poverty.** This is due to wide ... and underemployment which limits the level ... leading to low capital accumulation.

UNEB 2013, 2006.

i) *What is meant by a development goal?* (01 mark)

ii) *Give any three economic development goals in ...*

GOALS OF DEVELOPMENT IN UGANDA.

A development goal is a present target or objective ... to be achieved in an economy in a specific period of ...

Or

It refers to an intended growth and development objec... achieving in a given period of time. This target may ... economic.

Uganda like any other developing nation has cer... development. According to policy statements, Uganda ... social, political and economic goals to achieve.

Goals Of Development In Uganda Include.

- Achieving fair distribution of income and wealth.
- Reducing all forms of economic dependence/... and self sustaining economy.
- Controlling and regulating population growth ra...
- Achieving a higher rate of economic growth and ...
- Attaining a stable/favourable balance of payment ...
- Attaining full employment of resources especially ...
- Achieving price stability by reducing inflation.
- Eliminating illiteracy/attaining a large pool of ...
- Providing security to people and their property/... political stability.

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CHOICE OF DEVELOPMENT STRATEGY.

A development strategy refers to a broad policy of guideline that a country takes on and follows in formulation and execution of its policies aimed at attaining specific development goals and objectives. It therefore shows the right course of action that will cause development to take place in an economy.

Major components / elements of a development strategy

1. **Choice of appropriate implementation machinery**. i.e. whether by private sector or public sector or by both in planning process and production. Uganda is a mixed economy and both the private and public sector participate in planning and production.
2. **Choice between import substitution industrial development strategy and export promotion industrial development strategy**. More emphasis in Uganda has been put on import substitution industrial strategy.
3. **Choice of the pattern and the rate of capital accumulation**. i.e. whether to mobilize domestic savings or external resources and Uganda relies on both to achieve high levels of capital accumulation.
4. **Choice between balanced growth strategy and unbalanced growth strategy**. The one selected will depend on the available resources in a country.
5. **Choice of appropriate technology**. i.e. whether to use labor intensive technology or capital intensive technology. Uganda places more emphasis on labor intensive technology to use the abundant labourforce.
6. **Choice between leading production sectors.** i.e. whether industry, agriculture or infrastructure development. In Uganda, the leading sector is agriculture but the industrial sector is also steadily growing and emphasis is also being put on development of social and economic infrastructure.
7. **Choice of goals and objectives to be achieved.** i.e. self reliance, human liberty, attaining full employment, political stability and security. These are necessary to guide the economy in the trend of growth and development.
8. **Choice of the social economic organization.** i.e. whether to pursue socialism, capitalism or mixed economy. Uganda is a mixed economy.

STRATEGIES OF GROWTH.

For economic growth and development in an economy to be achieved, choice should be made with the sectors to begin with and which sectors to develop the economy later and majorly three theories have been put forward for sector priorities.

3) The big push theory.

A. BALANCED GROWTH STRATEGY (By Ragnar Nurkse).

Balancedgrowthstrategy is the one which emphasizes harmonious and simultaneous development of all the sectors of the economy so that they complement each other and grow at a more or a less the same pace.

This strategy emphasizes a simultaneous and harmonious development of different sectors of the economy so that they all grow at a more or less pace.

It requires a balanced between the different sectors of the economy during the process of the economy growth.

Different sectors of the economy should match with each other in terms of demand and supply.

Since there is investment in all sectors of the economy at the same time, a certain minimum investment capital termed as **'Critical minimum effort'** is required to enable investment in all sectors of the economy at the same time.

CRITICAL MINIMUM EFFORT.

Critical minimum effort is the minimum investment/sacrifice required to attain massive capital stock necessary for an economy to take off.

The lowest level of initial investment required for the massive investment in all sectors of the economy which are developed simultaneously after which they become the interdependent and self sustaining.

The balanced growth strategy calls for;

- A balanced between investment in agriculture and industry which are complements.
- A balance between direct productive and activities such as agriculture, industry and developmental industry and social over head capital such as health, education and transport facilities.
- A balance between investment in human capital and physical capital.
- A balance between consumer goods industries and producer goods industries.
- A balance between production for domestic market and production for foreign market.

UNEB 2003.

a) Distinguish between balanced growth and unbalanced growth strategies of development. (04 marks)

b) Examine the advantages and disadvantages of balanced growth strategy in developing countries. (16 marks)

ADVANTAGES OF BALANCED GROWTH STRATEGY IN LDCs.

1. **Widens the tax base.** Various sectors developed together act as bases on which the government imposes taxes for increasing public expenditure.

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2. **Increases utilization of local resources.** Since resources such as minerals, land, forests are demanded in all sectors of the economy, there are high chances of being fairly and maximumly utilized thus reducing underdevelopment.
3. **Increases employment opportunities.** Various production units in different sectors help to absorb the existing labourforce and thus reduces unemployment of human labour.
4. **Reduces regional imbalances in development.** This is because all sectors of the economy in different regions grow at a more or less the same pace thus promoting harmonious development.
5. **Leads to fair distribution of income.** Since all sectors are developed at the same rate, the chances of given individuals to accumulate more income at the expense of others are very minimal.
6. **Reduces economic dependence.** The economy reduces dependence on their communities suitable most of the goods and services are produced at home. Dependence on foreign resources reduces since there is production of various goods and services in several sectors which reduces importation thus promotes self reliance.
7. **Creates inter-sectoral linkages.** Both backward and forward linkage are created by sectors which are complementary and interrelated such as agriculture and industrialization thus inter-sectoral development.
8. **Leads to acquisition of skills in different fields.** This results from the fact that labour is employed in different fields of production and this leads to efficiency in the long run.
9. **Eases the country's balance of payment deficit.** High output from all sectors helps to increase the volume of exports thus high foreign exchange earnings and reduction in the volume of imports.
10. **Promotes rapid development of infrastructure.** The strategy encourages improvement in infrastructure such as roads, railways, power supply so as to enhance coordination and development of different sectors thus increased production.
11. **Facilitates economic growth and increased in gross domestic product.** The strategy is associated with high output from different sectors of the economy and this increases the country's GDP.
12. **Widens consumer's choice due to a variety of goods.** This is because of a variety of economic activities in different sectors of the economy. A variety of economic activities in different sectors help to reduce dangers of over reliance on one or a few sectors of the economy.
13. **Widens market for goods and services.** This is because of increased economic activities in different sectors of the economy especially where sectors are interdependent leading to further production.

DEMERITS OF BALANCED GROWTH STRATEGY IN LDCs.

- **Leads to heavy losses in case of project failure.** There is high level of interdependence between sectors, incase of project failure, it leads to a heavy economic losses ultimately due to [illegible] which is not reliable.
- **Leads to resource wastage because of** [illegible] leads to over production and yet in LDCs [illegible] at home and abroad to absorb [illegible] development of all sectors of the economy.
- **Leads to heavy borrowing which** [illegible] **debt servicing problems.** The critical [illegible] country to borrow to invest in all sectors [illegible]
- **It is very expensive and costly.** Since [illegible] economy requires a lot of capital which [illegible] to raise.
- **It over strains government planning** [illegible] countries have limited qualified man power [illegible] lot of pressure is put on the existing [illegible] plan for various sectors.
- **It results into an inflationary situation** [illegible] **massive expenditure in all sectors.** It [illegible] increase aggregate demand thus resulting [illegible]
- **Leads to over exploitation of resources** [illegible] due to high demand for inputs among [illegible]
- **Promotes external dependence.** This is [illegible] on skilled manpower, capital and foreign [illegible] in various sectors of the economy.

UNEB 2004,2003.

i) Define the term "critical minimum effort" [illegible] strategy.

ii) Give any three factors which limit the [illegible] strategy.

UNEB 2014

(i) What is meant by the balanced growth [illegible] (01 marks)

(ii) State any three factors that limit the [illegible] strategy in developing countries.

LIMITATIONS OF BALANCED GROWH STRAT[illegible]

1. **Inadequate capital to invest in all sect[illegible]** of the economy at the same time would [illegible] LDCs are not able to raise.
2. **Poor investment climate.** This is [illegible] taxes, limited subsidies, costly trade [illegible] investors to enable private individuals [illegible]
3. **Corruption and embezzlement of** [illegible] mismanaged through rampant corrupt[illegible] for development thus limiting investment

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sectoral development in given areas, scares away potential investors and takes a large percentage of government expenditure and yet the strategy requires a stable economy politically

5. **Weak linkages existing between sectors.** There is a need for strong linkages between sectors for it to be successful, but sectoral linkages are very weak in LDCs

6. **Uncoordinated economic planning.** Comprehensive planning is not effective in LDCs due to limited supply of planning machinery and therefore there is poor planning and coordination between plan implementers and formulators.

7. **Poor infrastructure.** Existence of poorly developed social and economic infrastructure exist in LDCs thus difficulty to coordinate production in all sectors of the economy.

8. **Small size of entrepreneur class.** The strategy requires the presence of many entrepreneurs to organize other factors of production for increased investment in all sectors and yet the entrepreneur class in LDCs is still limited

9. **Inadequate/limited markets.** The small markets in LDCs cannot sustain the development of all sectors at the same time. Local and foreign markets are not enough for increased output from all sectors of the economy thus wastage of resources.

10. **Poor technology.** Low levels of technology in LDCs limit production in all sectors of the economy at the same time and yet the strategy requires modern technology.

11. **Limited skilled labour.** LDCs do not have enough skilled labour to be employed in different sectors of the economy.

12. **High level of conservatism.** This implies that some people are not ready to receive new changes in methods of production in various sectors.

13. **Poor land tenure system.** The strategy requires supply of adequate land and yet there is increased land fragmentation in developing countries thus limiting investment in given sectors such as agri...

B. UNBALANCED GROWTH STRATEGY (by Prof. Albert Hirschman).

Unbalanced growth strategy advocates for investment in one or few vital/key /leading sectors of the economy that would ultimately lead to growth of other sectors through linkages

Or

It states that leading sectors with strategic importance be selected and expanded so that they pull up or develop other sectors through linkages.

Given limited resources in LDCs, large investments should be made in strategic leading sectors which will create external economies of scale to stimulate investment in other sectors.

It advocates for maximum forward and backward linkages and export oriented industrialization strategy.

ADVANTAGES OF UNBALANCED GROWTH STRATEGY IN LDCs.

- **It is cheap and affordable/requires relatively less capital resources which LDCs can easily raise.** LDCs do not have adequate capital resources and the little available are channeled to a few leading sectors to pull other sectors in the long run.
- **Forward and backward linkages are maximumly enjoyed.** For instance agriculture and industry if they are developed together ensure maximum linkages.
- **Encourages specialization which increases benefits from international trade.** This happens on the basis of comparative cost advantage theory which results into fair competitiveness of commodities on the world market.
- **Suits LDCs small domestic and foreign market.** The strategy is more appropriate in countries where market is limited and can only sustain few sectors. There is limited market for produced goods and services in LDCs and this makes unbalanced growth strategy suitable since it associated with manageable output.
- **Development is easy to plan for and coordinate.** Since there are few sectors to handle, it does not necessitate comprehensive planning which is very difficult to effectively carryout. Plan formulation and implementation is made easier since there are few sectors to handle.
- **No huge economic losses are likely to be incurred in case of project failure.** It is not very risky because of limited resources invested in a few sectors.
- **Saves the country's resources from quick exhaustion.** Existing natural resources are used by few sectors.
- **Minimize on public debt burden since it does not necessitate heavy borrowing.** This is because the strategy reduces borrowing implying limited debt serving problems.
- **Does not require presence of large skilled personnel.** It makes it easy for LDCs to acquire the required skilled labour to work in the leading sectors.
- **It suits the limited technology in LDCs.** Most developing countries lack developed technology to employ in all sectors which makes this strategy suitable.
- **It suits LDCs with insufficient planning machinery.** Lack of sufficient planning machinery in most LDCs makes this strategy suitable for development.

NB. Most MDCs depended on certain leading sectors to develop their economies, so LDCs to should adopt unbalanced growth strategy to accelerate growth in specific sectors and later overall development.

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DISADVANTAGES OF UNBALANCED GROWTH STRATEGY

- **It is associated with income inequality.** Few people are employed in few developed sectors and accumulate more income at the expense of others.
- **Limits exploitation of domestic resources.** Some natural resources cannot be absorbed in the key leading sectors implying production at excess capacity.
- **Leads to balance of payment problems.** The strategy leaves a room for high import expenditure as most of the requirements are not produced internally and limited export revenue is realized.
- **Leaves a room for economic depended.** The strategy leaves behind a room for external dependedcie because there is importation of goods which are not produced locally.
- **Limits government tax revenue.** Tax base remains narrow since some areas of production are ignored.
- **Leads to limited job opportunities.** The strategy is not likely to reduce unemployment problem affecting most of LDCs especially in sectors that are not developed in the short run.
- **Results into regional imbalance in development.** Some regions where sectors are prioritized develop at the expense of others. This creates social and political problems.
- **Associated with inflationary tendencies.** Shortage of commodities in sectors which are neglected in the short run result into structural inflation.
- **Limits production of a variety of commodities.** It discourages diversification and consumer's choice is reduced thus reduced standard of living.
- **Leads to low economic growth and gross domestic product.** Unbalanced growth strategy leads to low output from the few sectors which limits economic growth.
- **Promotes rural urban migration and its evils.** People migrate to towns where given projects have been established leading to congestion, high crime rate.

UNEB 2008, 2005.

(i) State the big push theory of economic growth. *(01 marks)*

(ii) Mention any three limitations of the big push theory in developing countries. *(03 marks)*

C. THE BIG PUSH THEORY (by Paul Rodan).

The big push theory states that, LDCs require a massive investment programme in industries and economic infrastructure in order to take off into a self sustained growth.

Or

The big push theory states that, for a developing ... self sustained growth, a massive investment in ... economic infrastructure is required.

The strategy emphasizes massive investment ... infrastructure so as to transform the ... sustaining economy.

A large comprehensive programme is ... amount of investment to overcome the ... proceeding step by step will not launch the ... map.

It calls for a sudden sharp increase in the ... requires,

1. Adequate natural resources.
2. Maximum government direction.
3. Mobilizing enough savings.
4. Investment in social overhead capital ...
5. A sizeable market to ensure favourable ...
6. Political stability.
7. Adequate skilled man power.
8. Economic stability.
9. Strong private sector.

ADVANTAGES OR MERITS OF BIG PUSH THE...

- Rapid economic growth is attained.
- More employment opportunities are created.
- Promotes external economies of scale due to ...
- Increases intersectoral linkages. It leads to ... activities.
- Increases inter sectoral linkages. It leads to ...
- Increase supply of goods which reduced infl...
- Reduces dependence of the economy on oth... reduction in the volume of imports.
- Encourages maximum and fair utilizatio... resources.
- Increase direct foreign investments becaus... industries.
- Promotes acquisition of kills by labourers.
- Promotes technological development due to ...
- Government tax revenue is widened as the ...
- Promotes the growth of manufacturing sec...

DISADVANTAGES OF BIG PUSH THEORY.

- Leads to excessive government expenditur...
- Leads to technological unemployment.

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- Creates income inequality in the short run when other sectors of the economy are not yet developed.
- Ignores immediate development of other vital sectors of the economy such as agriculture.
- Leads to rural urban migration since industrialization and infrastructural development normally target urban areas.
- Promotes resource or profit repatriation since industries in LDCs are normally owned by foreigners.
- Leads to heavy debt burden because the country is to borrow to undertake such investment.
- Increases social costs.
- Leads to inflationary pressure in the short run because of high investment expenditure alongside shortage of consumer goods.

LIMITATIONS OF BIG PUSH THEORY IN DEVELOPING COUNTRIES.

1. **Limited skilled man power** for planning and get employed in industrial and infrastructure development hence dependence on foreign manpower.
2. **Limited capital.** Launching of a high initial investment capital for social overhead is way expensive for LDCs.
3. **Poor and tenure system.** This discourages investment in certain regions and scares away potential industrialists.
4. **Political instability.** This discourages investment in certain regions and scares away potential industrialists.
5. **High level of corruptionand embezzlement in resource allocation** This frustrates investors in industrial production.
6. **Unfavourable investment climate.** This is inform of limited subsidies and high taxes on industrialists.
7. **Limited supply of entrepreneurs or poor managerial skills.** Thus results into failure to initiate industrialization in LDCs.
8. **Limited supply of basically raw materials.** This failed to support massive investment in industrial sector.
9. **Limited basic infrastructure.** These are inform of poor roads, limited railways and this limits investment in the industrial sector.
10. **Inadequate market for the produced goods.** Both domestic and foreign are limited which limits large scale production in industrial sector.
11. **Low levels of technology.** This limits large scale investment in industrial sector.

UNEB 2010

a) *What is meant by the term economic development strategy* *(04 marks)*

b) *Explain the merits of diversification in production and an economic development strategy.* *(16 marks)*

***Economic development strategy** is a broad policy guideline which a country takes on and follows in the formulation and execution of its policies aimed at attaining specific development goals and objectives.*

MERITS OF DIVERSIFICATION PRODUCTION AS AN ECONOMIC DEVELOPMENT STRATEGY.

1. **Widens consumers' choice by providing a variety of goods and services.** This is because, it involvesproduction of various goods and services hence improving welfare of consumers.
2. **Overcomes the problem of inflation or price fluctuations and its negative effects.** Diversification leads to high output which keeps prices stable leading to further production.
3. **Reduces the problems of dependance on a few products or one sector.** This implies that diversified output helps to reduce effects of failure in one sector.
4. **Helps to avoid risks and uncertainties in some sectors such as agriculture.** This is because of diversified agricultural production.
5. **Promotes linkages between different sectors (market and raw materials).** This promotes intersectoral development especially those that are highly related such as agriculture and industry.
6. **Reduces regional imbalance in development.** It accelerates growth in various economic activities in different regions since different sectors are promoted.
7. **Expands the tax base.** Various economical activities act as tax bases on which government imposes taxes for increased public revenue.
8. **Widens the export base hence increase on foreign exchange earnings.** This is because of increased diversified production for export hence increased forex earnings.
9. **Expands employment opportunities.** Many people get employed in various economic activities thus reduced seasonal unemployment.
10. **Increases utilization of existing resources.** Resources such as minerals forests are fairly utilized in various economic activities undertaken thus reducing under development.
11. **Reduces income and wealth inequalities.** Various economic activities promote fair income distribution due to increased employment opportunities.
12. **Increases the country's GDP.** This is due to increased output from different economic activities under taken.
13. **Leads to development of infrastructure.** Venturing in various economic activities necessitates development of different forms of infrastructure such as road network to accelerate further production.

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CHOICE FOR INDUSTRIAL DEVELOPMENT STRATEGY.

Industrialization is the process of building up the country's capacity to process raw materials to manufacture consumer and producer goods as well as building up infrastructure.

A proper industrial development strategy involves choice of industrial policy guide line to achieve objectives of industrialization and development.

There basically two industrial development strategies namely;

1. Import substitution industrial strategy (Inward looking strategy)
2. Export promotion industrial strategy (Outward looking strategy)

UNEB 2010.

i) *Differentiate between import substitution and export promotion strategies of industrial development.* *(02 marks)*

ii) *Mention any two merits of import substitution strategy in industrial development.* *(02 marks)*

UNEB 2014

(i) *What is meant by the term import substitution strategy of industrial development?* *(01 marks)*

(ii) *State any three disadvantages of adopting this strategy in developing countries.* *(03 marks)*

IMPORT SUBSTITUTION INDUSTRIAL STRATEGY (INWARD LOOKING INDUSTRIAL STRATEGY).

It refers to an industrial development strategy of producing domestically or internally the formally imported industrial goods.

Or

It refers to a strategy of establishing industries in the domestic economy to produce goods that were formed imported.

This is aimed at reducing foreign exchange expenditure. Production is undertaken to produce the formally imported commodities for domestic markets to minimize the outflow of forex.

NB. Import substitution industries are industries that are set up in the domestic economy to produce formally imported commodities. This mainly intended to reduce foreign exchange expenditure.

Examples of import substitution industries in Uganda are sugar processing industries, beer brewing industries, textile industries, soft drink industries, cement manufacturing industries, food processing industries and mattress industries.

UNEB 2007.

"developing countries should adopt import substitution strategy for industrial development if there are to achieve their development goals. Discuss. (20 marks)"

UNEB 1998, 2003, 2001

a) *Distinguish between export promotion and import substitution strategies of industries development.*

b) *Explain the merit and demerit of adopting import substitution development strategy.* *(16 marks)*

UNEB 1997.

To what extent is the inward looking industrial strategy relevant to your country. *(20 marks)*

ADVANTAGES OF IMPORT SUBSTITUTION INDUS

✓ **Helps to save scarce foreign exchange** would have been used on the imports is now

✓ **It reduces the extent of foreign depend** of the self reliance since goods formerly imp This reduces foreign influence at home.

✓ **Facilitates the development of the** facilitates the development of the local skills

✓ **It controls the imported inflation.** since most commodities are domestically the inflation prone countries are minimal

✓ **More domestic resources are exploi** industries use the available resources to m resources such as the minerals are exploited to support he industries which increases economic growth.

✓ **Increases employment opportunities.** expand, more laboris employed by such skilled, semi skilled and the unskilled labo unemployment.

✓ **Improves on the balance of pay** expenditure on theimports leads to its expenditure hence improvement to the BOP

✓ **Promotes and expands the industrial s** industrial growth and this strategy is s the strategy increases the number of in development.

✓ **It facilitates the transfer of the** This strategy attracts more foreign also come up with new and modern hence increase in the quality of the

✓ **Facilitates the infrastructural** of the industries requires the railways, andpower supply which promote transport.

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- **Which increases the government revenue.** More revenue is generated by taxing the different industries established and people employed in such industries. This is necessary for the increase government revenue.
- **Foreign exchange is earned i the long run through exports.** In the long run these industries start producing for the export. When surplus output is produced and sold to the outside world when the domestic markets are satisfied, foreign exchange is earned.
- **Encourages increased inflow of the foreign capital.** It leads to attract more foreign investors into the country in the industrial sector hence increased international relations.
- **Creates linkages in the industrial sector.** This promotes development of a variety of industries especially among related industries.
- **Increases incomes of producers.** This is basically those that are engaged in the production for foreign exchange which promotes the savings and investment.

DEMERITS /NEGATIVE ARGUMENTS AGAINST/ NEGATIVE IMPLICATIONS OF IMPORT SUBSITUTION INDUSTRIAL STRATEGY.

- **Leads to the production of low quality goods due to protectionism.** This strategy advocates for the protectionism which reduces the level of competition between the local industries and the imported goods thus low quality products.
- **Leads to the high government expenditure on the subsidies.** This is through increased government subsidies to attract the investors in such industries. It is very expensive to the government because it requires a lot of the protection and the subsidies from the government.
- **Leads to the high domestic prices.** This is because of the high production costs since the industries are infant in nature leading to the reduced demand.
- **Leads to the production ofthe excess capacity due to the limited markets.** In LDCs there is insufficient domestic consumer market.
- **Increase capital outflow on the intermediate inputs.** It requires importation of the machinery, raw materials and capital equipment from abroad to support such industries which worsen balance of payment problems.
- **Tends to concentrate on the production of the consumer goods than the capital goods.** This leads tp limited capital goods for development thus low rate of economic growth.
- **Promotes monopoly tendencies.** This is because of high level of the protectionism for the domestic industries from the foreign competition and therefore consumer exploitation and the poor quality products are realized
- **Leads to the beggar-my-neighbor policy/retaliation.** This is due to the problem of over protectionism which reduces foreign earnings in an

economy, as a country stops the importing other countries revenge by doing the same which also limits the smooth international trade.

- **Leads to the technological unemployment.** This is because it encourages the use of the capital intensive techniques of production which replace humanlabor hence increasing the unemployment.
- **Leads to the limited variety of goods and services on the market.** Consumer's choice is limited dueto the increased protectionism that limits importation of the substitute goods. This lowers the consumer sovereignty and the standard of living.
- **Leads to a fall in the government tax revenue.** This is due to the decline in the import duties since the importation is reduced hence budgetary deficits.
- **Leads to a high profit repatriation** because most of the industries are usually owned by the foreigners which worsens the budgetary deficits.
- **Leads to high social costs** such as pollution of air, water, land and water. This is dire dangerous to the human life.

UNEB 1998.

a) *Why should developing countries industrialize?* *(08 marks)*

b) *Examine the limitations of import substitution strategy of industrial development. (12 marks)*

LIMITATIONS OF IMPORT SUBSITUTION INDUSTRIAL STRATEGY IN LDCs.

1. **Limited capital resources.** LDCs do not have the required capital and this limits the establishment and expansion of theose industries.
2. **Inadequate skiled manpower.** There are few skilled people in the LDCs to start work, and manage import substitution industries.
3. **Inaxdequate basic raw materials.** LDCs lack the enough raw materials to use in these industries limits further industrial production .
4. **Narrow market for goods and services.** The domestic market is still low in most LDCs thus encouraging small scale production.
5. **Poor infrastructure.** Theseare in form of the poor roads, poor railways, and this limits access to the raw materials and market hence high costs of production.
6. **Low levels of technology.** Poor techniques of production in LDCs limit thelevel of domestic production.
7. **Political instability in some areas.** Political unrest in some LDCs discourages the establishment and expansion of such industries.
8. **High inflation rates thus high production costs.** Persistent inflation in most LDCs discourages industrialists.
9. **Demonstration effect on the consumption.** There is high marginal propensity to import due to high preference of imported commodities to locally produced goods in most LDCS thus discouraging producers.

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10. **Weak private sector and therefore government can not afford to invest in such industries alone**. The private sector is still weak in most LDCs and therefore limited investment in such industries.
11. **Excessive capital outflow**. High profit repatriation and the nationalspreferring to invest in their foreign economies deny scarce resources to invest in these industries.
12. **Unfavorable government policy in relation to the subsidisation and taxation**. Heavy taxes are imposed on the industrialists and limited subsidies discourage industrialists.
13. **Low level of entrepreneurial skills**. This leads to the failure to effectively organise other factors of production and expand import substitution industries.
14. **A lot of protectionism is required which is very costly and disadvantageous**. This is necessary to protect the established industries from foreign competition.

EXPORT PROMOTION INDUSTRIAL STRATEGY (OUTWARD LOOKING STRATEGY).

It is an industrial strategy of promoting domestic manufacturing industrieswith the aim of increasing goods for export.

Or

It is a deliberate government policy to expand the volume of exports by setting up the domestic manufacturing industries to produce for export.

NB. Export promotion industries are industries set up to produced manufactured goods purposely for foreign markets. This is intended to increase foreign exchange earnings from the exports.

UNEB 2006.

a) What are the merits of adopting the export promotion strategy of industrialization? (08 marks)

b) Explain the factors that limit theadoption of this strategy in your country. (12 marks)

UNEB 2000.

a) Differentiate between import substitution and export promotion strategies of industrialization. (04 marks)

b) Examine the merits and demerits of export promotion strategies of industrialization. (16 marks)

ADVANTAGES OF EXPORT PROMOTION INDUSTRIAL STRATEGY.

- **It increases the foreign exchange earnings.** This results from the increased export volume which can be used to acquire goods which are not locally produced.
- **Increases the employment opportunities.** More labor gets employed because of the increased production especially where labor intensive techniques of production are used thus reducing unemployment.

- **Widens the tax base.** As the export promotion ... government gets the capacity to impose more ... hence increased revenue.
- **Helps to diversify foreign markets/expands ... services.** Increases the production for export ... hence reducing the geographical concentration ... promotes trade between various countries ... production.
- **It adds value to agricultural products/raw ...** export primary agricultural products but this strategy ... to process them before they are exported so as to ...
- **Encourages exploitation of idle resources.** ... such as minerals are exploited and used as ... industries to expand production for export ... development.
- **It promotes international understanding and ... countries.** Mutual understanding between trading ... and this is important for international trade, ... foreign aid.
- **Facilitates development of the necessary infra...** the need to stimulate large scale production for ... such as roads, poor supply facilities, railways ... promoting further production.
- **Encourages technological development.** In ... quality goods to meet the export market demand ... employed.
- **Leads to the production of the high quality ...** promotion is associated with the production ... that can compete favorably on the world market.
- **Improves the balance of payment position ...** through increased production for the export ... earnings.
- **Reduces dominance of the subsistence ...** commercial production.
- **Increases the economic growth /GDP/output ...** increased production since most of such ... scale.
- **Promotes the growth of the industrial sector ...** of comparative advantage thus increasing the ... trade.
- **Promotes specialization in the production ...** of comparative advantage thus increasing ...
- **Promotes development of the entrepreneur ... inventions.** This promotes further investment ...

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DEMERITS OF EXPORT PROMOTION INDUSTRIAL STRATEGY

- **Leads to the production of the highly produced goods.** Most export promotion industries involve high costs of production thus high prices for exports.
- **Leads to high expenditure on the imported raw materials and technology/involves a need for high investment capital.** This is because most LDCs import the technology and required raw materials needed in these industries.
- **Causes shortage of the commodities in the domestic market.** This is because the production is mainly aimed at external market and creates shortage in the domestic market.
- **Involves high government expenditure on the market research.** It requires a lot of research and advertising in he foreign media and giving subsidies to the industrialists.
- **Leads to over exploitation of the domestic resources.** Due to increased production to meet the foreign market, available natural resources are over utilized.
- **Increases social costs.** Export promotion industries normally pollute theenvironment hence affecting the standard of living among the people.
- **Promotes economic dependence.** It increases the extent to which the country relies on other countries for market, raw materials and skilled labor.

UNEB 2013.

a) why may a country adopt an export promotion strategy of industrial development. *(10 marks)*

b) Explain the limitations of the export promotion strategy of industrial development. *(10 marks)*

LIMITATIONS OF EXPORT PROMOTION INDUSTRIAL STRATEGY IN LDCs.

- **Inadequate capital.** Capital in most developing countries is not enough to establish and expand export industries.
- **Limited market among LDCs due to production of the similar commodities.** Most developing countries produce similar primary products hence cannot utilize their own markets and this leads to flooding of the foreign markets.
- **Low levels of technology.** Most LDCs use poor technology of production of low quality products whose market at the international market remains inadequate.
- **Limited supply of the skilled man power /limited skills.** Shortage of the manpower in the LDCs leads to the increased over dependence on the foreign expatriates who are very costly to pay
- **Poor infrastructure to stimulate production.** Existing infrastructure is not modernized in form of poor roads, limited railways in most LDCs and this is cannot expand export promotion industries throughout the country.
- **Productions of the expensive goods due to high costs of production/firms are usually high cost producers.** Since most of these industries are infant in nature, they produce at high average costs which reduce demand for highly priced items on the world market.
- **Protectionist policies of developed countries/imposition of trade restrictions by the MDCs.** MDCs normally impose trade barriers against the commodities from the LDCs through tariffs and non tariff barriers thus reducing volume of the LDCs exports.
- **Limited entrepreneurial skills/ poor managerial skills.** Most LDCs lack enough highly trained managers to promote the development of then established export promotion industries.
- **Limited local natural resources and inter mediate inputs.** Inadequate supply of necessary inputs cannot expand the capacity of the established industries to produce more output for export.
- **High levels of corruption and embezzlement/low levels of accountability.** This is in the process of resource allocation for instance in giving subsidies. This frustrates investors intending to invest in the export promotion industries.
- **Political instability.** The existence of political unrest discourages large scale investors into expanding export promotion industries.
- **Low quality output that cannot favourably compete on the world market.** Most LDCs produce low quality commodities and such can cannot compete favorably on the world market for fair price.
- **High cost of advertising /market research.** This should be carried out in the foreign mediate increase market for the produced commodities.
- **Limited export promotion facilities/institutions.** These are necessary to encourage and direct exporters but they are less developed.
- **Poor land tenure system.** This discourages establishment of the large scale industries.

CHOICE OF THE APPROPRIATE TECHNOLGY.

LDCs are faced with the problem of deciding on the technique to employ in the production because of their economic constraints.

There are basically three types of production techniques.

1. Labor intensive techniques of production.
2. Capital intensive of production.
3. Intermediate intensive of production.

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1. LABOUR INTENSIVE TECHNIQUES OF PRODUCTION

It is a method of production which relatively /proportionately uses more labor than other factors of production especially capital. For instance hand hoe and cottage industries in LDCs it is canalso be referred to as capital saving **technology.**

Capital saving techniques of technology refers to the method which employs less capital than other factors of production especially labor. Or These are methods of production that employ a big proportion of labour relative to capital and other factor

2. CAPITAL INTENSIVE TECHNIQUE OF PRODUCTION

This is a method of production that uses relatively more capital and other factors less especially labor. It is also referred to as **labor saving technology.**

Labor saving techniques of production refer to production methods which employ less labor than the other factors of production especially capital.

Or

These are methods/techniques of production that employ a big proportion of capital relative to labour and other factors.

UNEB 2007.

i) What is technology transfer. *(02 marks)*

ii) Distinguish between labor saving and capital saving techniques of production *(02 marks)*

UNEB 2005.

'Developing countries should mainly adopt labor intensive techniques of production.' Discuss. *(20 marks)*

ADVANTAGES OF LABOUR INTENSIVE TECHNOLOGY IN LDCs.

- **It does not require complex skills.** It is appropriate to LDCs because of limited skilled manpower and technical managerial know how to handle complicated capital intensive technology. This makes it affordable and sustainable.
- **Does not encourage employment of foreign manpower or expatriates.** Foreign expatriates are only familiar with capital intensive technology and this reduces foreign dependence and capital outflow.
- **Reduces social costs** inform of air pollution, since it is not associated with the activities of heavy industrialization to pollute the environment.
- **Reduces external dependence and save scarce foreign exchange.** This is because it is not associated with importation of the heavy machinery of the commodities to aid with production and uses locally available resources.
- **Reduces income inequality.** A big percentage of labor force gets employed and therefore has access to the income earnings.
- **Increases the government tax revenue.** The incomes of the salaried individuals. This is because employed in this technology.
- **It is cheap and relatively affordable.** The abundant and it requires simpler tools such as pangas, hoes, and axes especially in the case need spare parts from other countries.
- **It helps to reduce the unemployment rate.** technique employ employs mainly a large section laborforce.
- **It is required where the human judgment** is picking and coffee picking where the capital difficult to use. This makes it suitable for agri dominant in the LDCs.
- **Increases exploitation of the rural vast pot rural urban migration.** This is because many are of labor intensive are of small scale in nat in the rural areas.
- **Reduces the over exploitation of the resou** limitedcapacity to over utilize the available re

DISDVANTAGES OF LABOUR INTENSIVE TECH

- **Does not maximize output per unit of labo low.** This limits economic growth due to the use low levels of education among workers.
- **Low quality output is produced.** This is be employed are either unskilled or semi-skilled a not likely to compete favorably on the world mar
- **Discouraged private foreign investments.** The investors are only familiar with capital intensi easily cope up with labor intensive technology.
- **The method is very expensive and costly in t** run, it increases the wage bill, cost of welfa medical facilities to workers. This reduces pro because of increased production costs.
- **Limited technological development.** Labor associated with limited innovations and inven limited introduction of new technology.
- **Leads to high chances of industrial unrest.** and demonstrate over demand for higher wage which retards production.
- **Results into under utilization of re** technology has inadequate capacity to fairly u resources.

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- **Increases the government tax revenue.** This is through taxing the incomes of the salaried individuals. This is because many people get employed in this technology.
- **It is cheap and relatively affordable.** This is because labor is abundant and it requires simpler tools and equipments such as pangas, hoes, and axes especially in the agriculture and does not need spare parts from other countries.
- **It helps to reduce the unemployment existing in the LDCs.** the technique employ employs mainly a large section of the unemployed labourforce.
- **It is required where the human judgment** is vital for instance in tea picking and coffee picking where the capital intensive technology is difficult to use. This makes it suitable for agricultural sector which is dominant in the LDCs.
- **Increases exploitation of the rural vast potential which minimizes rural urban migration.** This is because most of the activities which are of labor intensive are of small scale in nature which is carried out in the rural areas.
- **Reduces the over exploitation of the resources.** This is due to the limitedcapacity to over utilize the available resources.

DISDVANTAGES OF LABOUR INTENSIVE TECHNOLOGY.

- **Does not maximize output per unit of labor/labor productivity is low.** This limits economic growth due to the use of rudimentary tools and low levels of education among workers.
- **Low quality output is produced.** This is because majority of people employed are either unskilled or semi-skilled and such commodities are not likely to compete favorably on the world market.
- **Discouraged private foreign investments.** This is because most foreign investors are only familiar with capital intensive technology and cannot easily cope up with labor intensive technology.
- **The method is very expensive and costly in the long run.** In the long run, it increases the wage bill, cost of welfare facilities, housing and medical facilities to workers. This reduces profit margins of producers because of increased production costs.
- **Limited technological development.** Labor intensive technology is associated with limited innovations and inventions in production thus limited introduction of new technology.
- **Leads to high chances of industrial unrest.** Workers are likely to strike and demonstrate over demand for higher wages, good conditions of work which retards production.
- **Results into under utilization of resources.** Labor intensive technology has inadequate capacity to fairly utilize the available natural resources.

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- **It is slow and time consuming.** Labor intensive technology takes a lot of time for labor to perform a given task for instance in cultivation, mining and quarrying.
- **Makes it very hard to standardize output**. Output produced is never identical and this makes transactions very difficult especially in the international market.

ADVANTAGES OF THE LABOUR INTENSIVE TECHNIQUES OF PRODUCTION (CAPITAL -SAVING TECHNIQUES) OF PRODUCTION

- They reduce the social costs
- Do not encourage employment of the foreign manpower or capitalists
- They are cheap and relatively affordable
- Reduceerampant unemployment existing in the LDCs
- Reduce income inequality
- Yield high government tax revenue
- They do not require complex skills

DISADVANTAGES OF LABOUR INTENSIVE TECHNIQUES (CAPITAL-SAVING TECHNIQUES) OF PRODUCTION.

- Result into under utilization of the resources
- Are slow and time consuming.
- Make it very hard to standardize output.
- Lead to high chances of industrial unrest.
- They do not maximize output per unit of labor
- They limit technological development.
- Low quality output is produced.
- Discourage foreign private investments.

UNEB 1998.

Examine the merits and demerits of using capital intensive techniques of production in your country. (20 marks)

UNEB 2012.

i) What is meant by labor-saving techniques of production? (02 marks)

ii) Mention any two merits of labor-saving techniques of production (02 marks)

UNEB 2015

(i) Define the term capital intensive technology. (01 marks)

(ii) Give any three factors that limit the adoption of capital intensive technology in your country. (03 marks)

ADVANTAGES OF CAPITAL INTENSIVE TECHNIQUE OF PRODUCTION.

1. **It is useful where labor is scarce and expensive.** In LDCs where there is limited supply of skilled labor, this method of production is suitable.

investment.

2. **Encourages the large scale produc**
enjoyed due to large scale production
the capital intensive technology thus
economic growth.
3. **Leads to the production of high quality**
quality is realized with the capital
compete favorably for the high prices
4. **Promotes infrastructure development**
used in construction of the roads,
and this is an indicator of economic
5. **Reduces the industrial/labor**
technology,chances of strikes are
workers over wagesincrement, conflicts
few workers are employed and therefore
6. **It is time saving and less tiresome.**
shortest time possible by the machine
quicker and faster.
7. **Facilitates fair utilization of the**
utilization such as minerals, land,
techniques of production and this reduces
8. **Equips the labor with modern skills/**
This increases laborefficiency. It is a
to be able to use the machines effectively
of the skills.
9. **Reduces wage bill and costs of**
medical facilities, housing facilities
This reduces the cost of production hence
10. **Facilitates technological transfer**
importation of major technology
development through inventions and
11. **Promotes rapid growth of the**
industries require machinery in their
industrialize the economy by employing
12. **Makes the output easy to**
capital intensive technology is ever
makes trade transactions continuous

DISADVANTAGES OF THE CAPITAL
PRODUCTION

1. **It is associated with the**
workers andemploys limited labor
unemployment.

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4. **Promotes income inequality**. It employs a few section of the labor force with the required skillsand it is owned by the few firms and this income concentrates to the limited sections of the employed population.

5. **Worsens the balance of payment problems due to the high foreign exchange**. Heavy imports of capital and spare parts lead to high foreign expenditure.

6. **Leads to the high social costs**. It is responsible for the air pollution and the current global warming is highly attributed to rapid advancement.

7. **Encourages over exploitation of the available resources**. Natural resources such as minerals, forests, and waterresources are over utilized and this leads to their quick decision.

8. **Increase foreign dependence and dominance**. Most capital intensive techniquesof production used I the LDCs are imported from the MDCs hence increased foreign dominations by the foreigners.

9. **Requires complex skills/involves high training of the labor for the required skills**. This leads to the importation of the skilled man power to run such technology hence retarding the development of the indigenous skill.

10. **Leads to the marketing problems due to the surplus output.** It leads to excessive production which leads to the resource wastage. This makes it not suitable for the existing market in the LDCs.

11. **It is not applicable where the human judgment is needed such as in the tea picking**. This means that it cannotbe avoided especially in the agriculture.

INTERMEDIATE TECHNOLOGY

Intermediate technology is a technique of production which is neither capital intensive nor labor intensive but combines both capital and labor in the fair proportions. **Or**

This is a techniqueof production that liesbetween the advanced expensive capital intensive technology and cheap labor intensive technology.

Features Of Intermediate Technology.

- It is mainly rural based i.e. basically rural oriented technology.
- It is mainly based on the local; production.
- Suits the geographical and ecological conditions of a country.
- It is mainly based on the local research and expertise.
- It is based on the prospects of the local inventions and innovations.
- It is geographically spread.
- It relatively uses more units of labor than capital.
- It is technically and economically efficient.

UNEB 2004.

i) *What is appropriate technology* *(01 marks)*

ii) *Give any three factors which have affected the developments of the appropriate technology in your country.* *(03 marks)*

FACTORS WHICH AFFECT OR INFLUENCE THE DEVELOPMENT OF THE APPROPRIATE TECHNOLOGY IN UGANDA.

- *Availability of funds.*
- *Influence of the natural factors.*
- *Cultural factors.*
- *Level of inventionsand innovations.*
- *Degree of the external influence.*
- *Level of entrepreneurship skills.*
- *Market size.*
- *Government influence on the technological development.*
- *Level o the skills and education.*

FEATURES OF THE APPROPRIATE TECHNOLOGY.

- *Should improve efficiency and productivity.*
- *Should encouragecapital formationstimulate growth.*
- *It should solve the local problems of a country.*
- *It should make use of the local resources.*
- *I should b simple and comparatively cheap.*
- *It should be static and dynamic with time.*

TECHNOLOGY TRANSFER.

This is the movement of new and efficient production techniques from one economy to another mainly from the developed counties to the less developed countries.

It involves movement of the managerial, administrative technical knowhow and capital equipment from one country to another especially from the developed countries of the less developed countries.

REASONS FOR TECHNOLOGYTRANSFER.

- ✓ To overcome the backwardness and increase skills.
- ✓ To reduce the production costs.
- ✓ To accelerate the rate of the economic growth.
- ✓ To reduce the labor unrest rampant I the LDCs.
- ✓ To increase the labor productivity and efficiency.
- ✓ To reduce the technological gap between the LDCs and MDCs.
- ✓ To stimulate rapid industrialization.
- ✓ To develop the key and basic infrastructure such s power supply, roads, railways, banking facilities and telecommunication facilities.

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- To increase exploitation of the resources which involves high technology such as oil mining?
- To improve on the quality of goods and services produced/ to make the products from the LDCs more competitive on the world market
- To attract foreign investments

DANGERS OF THE TECHNOLOGY TRANSFER IN THE LDCs

- Worsens the problem of technological unemployment. This technology replaces human labor.
- Retards the development of the local skills that suit the local conditions.
- Worsens balance of payment problem because it requires the large foreign exchange expenditure.
- Contributes to high social costs, leads to heavy pollution of the environment.
- Worsens income inequality due to a considerable volume of foreign investors who are concentrated in the urban areas and employ a few technical manpower.
- Breeds foreign domination and dependence.LDCs continue to rely on the technical manpower, spare parts from the MDCs
- Worsens the rural urban migration. It tends to concentrate in the urban areas and attracts the people from the rural areas to urban areas and associated problems such as slum development.
- Leads to over exploitation of the available resources. Modern technology exploits resources at a high rate leading to the resource depletion.
- Worsens the profit repartition due to the use of the foreign expatriates and it is normally owned by the foreigners.
- Leads to the over production. This results into wastage of the resources when the surplus output is not purchased.

MAJOR OBSTACLES TO THE TECHNOLOGY TRANSFER FROM THE MDCs TO THE LDCs.

1. **Limited scientific skills to maintain the technology.** LDCs do not have the required skills to adoptand maintain the technology.
2. **Limited capital resources in the LDCs.** Most of the developing countries do not have the required money purchase the modern technology which is very expensive.
3. **Prohibition by the patent rights.** The owners of such technology want to remain monopoliesand do not sell their technology to other countries.
4. **Limited size of the market.** LDCs have limited market which does not require mass production using modern technology.
5. **Poor infrastructure to facilitate the technology.** Modern technology requires supportive infrastructure such as roads, railways which are in short supply in most MDCs.
6. **High levels of conservation.** People in ... conservative in nature and do not want to change technology to modern technology.
7. **High levels of protectionism by the MDCs.** ... not want to extend their modern technology ... impose heavy restrictions on its transfer.

UNEB 2004.

Uganda should adopt an agricultural rather than ... strategy if it is to attain a faster rate of ... (20 marks)

AGRICULTURAL DEVELOPMENT STRATEGY

DEVELOPMENT STRATEGY.

MERITS OF AGRICULTURAL DEVELOPMENT STRATEGY

1) **Source of food to the rapidly growing ...** investment in agriculture. Provides food for the ...
2) **Provides more employment opportunities** ... Employs many people either directly or ... unemployment.
3) **Generates more foreign exchange.** ... exportation of agricultural products.
4) **Supplies raw materials to agro based ... prices.** This promotes rapid industrialization.
5) **Generates government tax revenue.** ... agricultural activities which is used for ...
6) **Promotes equitable income ... inequality.** This is because it encourages ...
7) **Reduces rural urban migration.** This is ... employs in agriculture in rural area.
8) **Promotes regional balance in terms of ...** because it can be widely spread in ... promoting harmonious regional development.
9) **Encourages rapid development of ...** establishment of infrastructure such as roads ...
10) **Contributes greatly to GDP.** This results ... output.
11) **Provides backward and forward linkages ... to industrial goods.** This is especially with ...

DEMERITS OF AGRICULTURAL DEVELOPMENT ...

1. **It is affected by natural vagaries of weather ... floods.** This leads to low output.
2. **Causes seasonal and disguised ...**

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- **Suffers from frequent price fluctuations** because of over production and perishability of agricultural products. This leads to instability in income.
- **It yields low government tax revenue** because production is largely done on subsistence level and low prices are offered for marketed output because of high population growth rate. It is land intensive.
- **It requires a lot of land which is increasingly becoming scarce** due to continued use of land and in the long run output reduces.
- **Agriculture is subject to diminishing returns.** There is reduced fertility
- **Leads to unfavourable terms of trade.** This is because prices of agricultural products tend to fluctuate greatly compared to prices of imported manufactured commodities.

MERITS OF INDUSTRIAL DEVELOPMENT STRATEGY.

- **Generates high employment opportunities in the long run.** This is especially in tertiary and secondary industries.
- **It widens tax base.** Generates more revenue to the government through taxation which widens the tax base.
- **It leads to increased economic diversification.** Promotes production of a variety of commodities which increases consumers' choice.
- **Provides market for agricultural products.** Provides linkages with other sectors for instance the agro-based industries which provides market to output from such sectors.
- **Promotes innovations, inventions thus technological development.** In a move to expand industrial production and compete with imported products, extensive research is carried out.
- **It supplies the agricultural sector with required inputs** such as fertilizers, machinery.
- **Increases utilization of idle resources.** This reduces underemployment.
- **It is not much subject to vagaries of weather** such as drought because it is not dependent on nature and this sustain the economy through out.
- **Results into rapid economic growth.** Its gestation period is very short and output is increased in the short run. This contributes highly to GDP.
- **It is a source of foreign exchange which improves balance of payment position.** This is achieved by establishing export promotion industries and import substitution industries.

DEMERITS OF INDUSTRIAL DEVELOPMENT STRATEGY.

- **It is very expensive in terms of costs.** Promoting rapid industrialized requires a lot of money which is insufficient in LDCs.
- **Encourages external economic dependence** through importation of major raw materials and machinery to run industries.
- **Results into high social costs** such as air pollution and associated negative impacts.

- **Encourages rural urban migration** and its associated negative effects since most industries tend to be located in urban areas.
- **Worsens the problem of income inequality.** This is because it employs more of skilled labour and few people have the capacity to start industries.
- **Leads to over exploitation of resources** such as minerals which leads to their quick depletion.
- **Leads to regional imbalances in development.** Most industries tend to concentrate in urban and strategic areas with suitable infrastructure and such areas develop at the expense of other areas.
- **Low prospects of employment creation especially in the short run.** Most industries use capital intensive technology and employ a small section of the labourforce.
- **Promotes capital flight.** Most industries especially large scale industries tend to be owned by foreign investors who repatriate profits to their home countries thus low multiplier effect.

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CHAPTER 9: POPULATION AND LABOUR

Population refers to the total/aggregate number of people living in a given country at a given period of time. The population of an area includes both permanent and temporally residents. The size of the population of a country is known by carrying out population census.

POPULATION CENSUS

This is the physical counting of people living in a given country at a particular period of time. In most countries including Uganda, population census is carried out once in 10years.

Statistics reveal that Uganda's population has been increased over the years.

1954	5.0 Million people
1959	6.5 Million people
1969	9.5 Million people
1980	12.6 Million people
1991	16.5 Million people
2002	24.6 Million people
2014	37.58Million people

From the above statistics, it is clear that the population growth rate is high. This is due to birth rates and declining death rates.

REASONS WHY POPULATION CENSUS IS CARRIED OUT.

- To establish the correct size of the population in numbers which acts as a basis of government planning.
- To establish the age distribution of the population so as to determine the size of labourforce.
- To discover population distribution among different regions.
- To establish sex composition/sex ratio of the population.
- To establish the rate of migration i.e. local and international migrations.
- To establish the quality of the population in terms of the level of education and health.
- To establish the population growth rate of the country. i.e. borht rates and death rates. This helps to formulate necessary population policies.
- To compute percapita income of people living in the country. This is a good measure of standard of living.
- To establish the occupational distribution of the population. This is important in manpower planning.
- To establish the rate of unemployment. This helps to put in place relevant policies to reduce unemployment.
- To establish the number of dependents i.e. the young and old.
- To solicit foreign funds to finance various population programmes.

IMPORTANT TERMS/CONCEPTS USED IN POPULATION.

-Population explosion. This is the a rapid increase in population of a given area more than what the available resources can sustain. Or

it is a rapid/sudden increase in population size which available resources can sustain. It is normally brought immigrations which may be due to wars or epidemics, birth rates,a sudden decrease in death rates.

Life expectancy. This i the average number of years expected to live under the prevailing conditions after birth 2002, life expectancy for females was 43years and for Uganda.

Fertility rate. This is the number of births or children woman bears in her productive period. It tends to be high countries and lower in developed countries. It is dete traditional beliefs.

Dependence ratio. This refers to the proportion of depe population in a given country.

Dependence ratio = Total number of dependence x
Total population.

Worked example.

1) Given that the working population in a country is young population is 14,000,000 and the elderly is 4, the country's dependence ratio.

Dependence ratio = Total number of dependa
Total population.

14,000,000 +4,000,000 x 100
14,000,000 +4,000,000 + 12,000,000
18,000,000 x 100
30,000,000

Dependence ratio = 60% or 3:5

Demerits of such a population.

- Low savings and investment.
- Underutilization of resources leading to und
- Low labour productivity in the economy.
- Heavy government expenditure to provide e

2) Given that the size f labour force in a country is young population is 4,000,000 and those above 6 people. Calculate the country's dependence ratio.

Dependence ratio = Total number of dependan
Total population.

4,000,000 +6,000,000
4,000,000 +15,000,000 +6,000
10,000,000 x 100
25,000,000

Dependence ratio = 40%

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Mortality rate. This is the number of people who die before reaching their life expectancy. It may be infant mortality, child mortality or adult mortality.

Population projection. This is the estimation of future population in a country basing on the prevailing rate of population growth. Predications are made on future population size.

Population growth rate. This is the rate at which a given population of a country increases over a given period of time. It is measured by annual percentage increase in population. In Uganda it has been 3.4% on average over the period of 1991-2011.

Types Of Population Growth.

1. **Natural population growth.** This is due to birth rates and death rates.
2. **Artificial population growth.** This results from migration i.e. emigration and immigration.

MAJOR DETERMINANTS OF POPULATION GROWTH.

There are basically three determinants of population growth i.e.

1. Birth rate.
2. Death rate.
3. Migration

BIRTH RATE.

Birth rate refers to the number of children who are born alive in a year out of 1000 population/per 1000 population. The higher the birth rate, the higher the population growth and the lower the birth rate the lower the population growth.

DETERMINANTS OF BIRTH RATE.

- Fertility rate of women.
- Proportion of women getting married.
- Average age of marriage. The earlier the women get married, they are likely to bear many children compared to those that get married at an old age.
- Cultural values and beliefs among the population.
- Willingness/desire to have children.
- Level of education among men and women.
- Sex composition of adults. High number of women in society than men, birth rates are likely to be high.
- Influence of birth control measures.
- Status of women in society. If women are regarded as child bearing women, birth rates become high.
- Level of urbanization and cost of living.

DEATH RATE.

Death rate refers to the number of people who die in a year per 1000 of the population. The higher the death rate, the lower the population growth and the lower the death rate, the higher the population growth.

DETERMINANTS OF DEATH RATE.

- Nutritional levels/standards.
- Level of occurrence of natural disasters such as earth quakes, floods and landslides.
- Quality and quantity of medical facilities available.
- General political climate.

Migration rate (emigration and immigration).

When immigrants exceed the emigrants, the population growth rate is likely to increase and when emigrants exceed the immigrants, population growth rate becomes low.

MEASUREMENT OF POPULATION GROWTH.

The growth rate of population is expressed as a percentage. The calculation is carried out when the births and deaths have been established or expressed in rates per 1000 people in a given period of time.

$$\text{Population growth rate} = \frac{\text{Birth rate} - \text{death rate}}{1000} \times 100$$

UNEB 2007, 2003

a) What is meant by the term optimum population. (04 marks)

b) Examine the implications of a high population growth rate in your country. (16 marks)

UNEB 1997.

a) Distinguish between under population and over population. (04 marks)

b) Explain the effects of a high population growth rate in an economy (16 marks)

ADVANTAGES OF A LARGE POPULATION SIZE OR A RAPIDLY GROWING POPULATION/AN INCREASING POPULATION IN AN ECONOMY.

1. **Leads to high market potential.** It raises the number of potential customers for goods and services leading to a bigger market for commodities.
2. **High potential for labour force/increases labour supply.** Young people are energetic, inventive and willing to receive new ideas and this implies that various productive sectors such as agriculture, industry are able to get the required workers thus expanding production.
3. **Creates high tax revenue potential.** In case such a large population is employed, the government becomes able to obtain enough revenue through taxation for public spending which helps to develop different sectors of the economy.

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4. **An incentive for future investment/stimulates investment levels.** High population induces business men to establish various investments opportunities due to prospects of increased demand.
5. **Increases innovativeness and inventions among the young.** A large population stimulates a spirit of innovativeness and inventiveness especially among the young.
6. **It encourages high mobility of labour.** Young energetic labour moves form one occupation or geographical area to another in the process of securing employment which promotes employment thus reducing labour shortages in some areas.
7. **Awakens the government to provide necessary infrastructure.** The government is forced to provide necessary infrastructure such as roads power supply, hospitals and schools which in turn leads to development and caters for the population.
8. **It increases resource utilisation.** Facilitates fair and optimum utilization of resources such as agricultural land, forests, water sources and minerals to support the growing population thus reducing underdevelopment.
9. **It initiates efforts to work harder.** This is intented to sustain the predominantly dependent population.

DISADVANTAGES OF A LARGE POPULATION SIZE OR A RAPIDLY GROWING POPULATION/AN INCREASING POPULATION.

i) **Leads to high dependence burden.** This is especially when the majority are below working age and above 65yeras. This proportion consumes without producing hence low capital accumulation leading to low savings.

ii) **It overstrains the available infrastructure.** A large population creates excessive demand for social services such as hospitals, schools and roads thus over utilizing such facilities.

iii) **Increases problems of unemployment and underemployment.** As the population size increases, the number of people entering the labour market also increase but in most cases the population doesn't match with increase in investment leading to low rate of job creation.

iv) **Increases rural urban migration and its associated problems.** As the population size increases, many people move to urban areas in search for jobs which leads to congestion,theft, prosititution, shortage of housing facilities, water and sanitation problems, development of slums and shanty towns.

v) **It results into demand pull inflation.** Unless there is increased production to support the increase in population, there is increased aggregate demand over aggregate supply and country sufferes from inflation.

vi) **Worsens balance of payment problem.** There is increased demand for imported commodities to support the population and reduced

exportation because of increased consumption. Th
foreign exchange outflow relative to foreign to
vii) **It leads to over utilization of resources.** Large
strain on land, water bodies, forests and
deforestation, land and air population, soil exhaus
in productivity of such resources which limits
viii) **Increased income inequality.** Large population
shortage of educational facilities, increase in illite
and income concentrates in the hands of few educa
ix) **Increases government expenditure on social**
increase in population size implies an increase in
support this population in provision of public servi
deficits.
x) **Worsens external dependence.** Dependen
economies(foreign aid) increases and its associate
to support the growing population.
xi) **It leads to low percapita income and poor**
Because of associated problems of high popula
dependence burden, there is limited rate of saving
increase national income thus low standard of living

UNEB 2015

a) Describe the population structure of your country
b) Examine the economic implications of such a popula

UNEB 2005

a) Describe the population structure of your country. (8
b) Examine the economic importance of such a po
(12 marks)

STRUCTURE OF UGANDA'S POPULATION.

- It is dominated by young people who constitute appro
and the aged above 65 years contribute the smallest pr
- Females are more than males where females constitu
constitute 49%
- It has a high population growth rate of approximately
due to high birth rates.
- The population is mainly rural based and approxi
population live in rural areas
- There is uneven spatial population distribution
concentrated in central part with Kampala approxim
persons per square km and Moroto with 20 persons pe
- Production force of the population is mainly engaged
such as agriculture.

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- there are mainly high illiteracy rates and approximately 32% of the population do not know how to read and write.
- Majority of the population are semi skilled and unskilled which reduces labour productivity.

IMPLICATIONS OF UGANDA'S POPULATION STRUCTURE.

Positive Implications Of Uganda's Population Structure.

NB. *Explanation must be justified by the feature from the population structure.*

1. **Leads to high market potential.** This is because of high population growth especially for essential commodities which stimulates further production.
2. **High potential for labour force.** The high population growth rate creates a large section of people gradually joining the labouring for various productive sectors. This increases labour supply and expands production.
3. **Awakens the government of its responsibility to provide social infrastructure** such as education, hospitals, roads due to high population growth which increases demand for such services which helps to cater for the high population.
4. **An incentive for increased future investment/encourages and stimulates more investments.** There is increased effort in production so as to meet the increasing aggregate demand created by a high population growth rate.
5. **A high potential for increased resource utilization.** Resources such as minerals, land, water resources are fairly utilized due to increased demand for food to support the high growing population which reduces underutilization of resources.
6. **Encourages efforts to work harder.** High population growth rate leads to high dependence burden which forces people to work so as to support the large number of dependants.
7. **Increased labour mobility.** This is because of high population density and high dependence burden which force labour to move to different places and occupation for employment. This reduces labour shortage in some areas.
8. **Increased innovations and inventions among the young.** It leads to emergence of a young population that is usually innovative and inventive.

UNEB 2000

Mention any four problems of an increasing population in a country.
(04 marks)

Negative Implications Of Uganda's Population Structure.

NB. *Explanation must be justified by the feature from the population structure.*

1. **High dependence burden thus low savings.** Majority of the population are in the age bracket of 0-15 years who are economically unproductive and depend on the small percentage of working population and this reduces savings.
2. **Increases unemployment and underemployment problems.** The population growth rate is greater than the rate at which jobs are created and majority are semi skilled thus low income.
3. **Worsens balance of payment problems.** More is imported to support the rapidly growing population, increases external borrowing and less is exported in return leading to high foreign exchange expenditure.
4. **Over straining the available infrastructure** due to high growing population, congestion is experienced in public hospitals, schools and roads due to excessive demand for such infrastructure.
5. **Lead to rural urban migration and its problems.** The rate of job creation in villages to absorb the rapidly growing population is low and majority of the population opt to migrate to urban centres leading to development of slums, high crime rates.
6. **Over utilization of resources leading to a decline in their productivity and quick depletion.** This is due to high pressure on land, existing forests created by a rapid growing population thus creating environmental threats which limits future production.
7. **Leads to high government expenditure.** Government spends heavily to support high population growth in provision of social services and this leads to budgetary deficits.
8. **Results into demand pull inflation.** There is rising aggregate demand as a result of population increase leading to increase in general price level.
9. **Increased income disparities.** This is between the few skilled and very many unskilled and semi-skilled labour. This is worsened by high dependences burden and limited access to jobs.
10. **Encourages external resource dependence** such external dependence on foreign man power due to limited skills possessed by local labour, foreign capital which limits local initiatives.
11. **Leads to brain drain.** This is because of high unemployment rates, low wages and poor working conditions created by a rapidly growing population.
12. **Leads to low per capita income and standard of living.** Majority of the people still live below the poverty line, there is low labour productivity and large number of dependants leading to poor standard of living.
13. **Leads to high social costs.** This is in form of pollution due to rapidly growing population which negatively affects the population.
14. **Makes effective planning by government very difficult.** This is due to rapidly growing population hence plan failure

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UNES 2009, 2004, 1999

a) Explain the Malthusian theory of population (10 marks)

b) To what extent is this theory relevant in developing countries (15 marks)

UNES 1998

a) Explain the Malthusian population trap theory (10 marks)

b) To what extent is the theory applicable to your country? (15 marks)

UNES 2012

a) State the Malthusian population theory (04 marks)

b) Explain five ways in which the Malthusian population is relevant to developing countries. (10 marks)

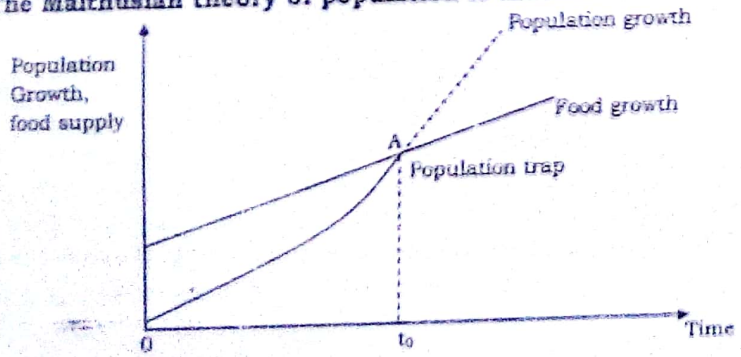
c) State six limitations of the theory (06 marks)

MALTHUSIAN THEORY OF POPULATION.

The theory was put forward by a British economist Rev Thomas Malthus who lived in England at the time of industrial revolution.

- The Malthusian theory explains the relationship between population growth and food growth rate or supply i.e. population growth depends on food supply.
- The theory states that whereas population grows at a much faster rate in a geometric progression/rate i.e. 2,4,8,16,32,64,..... food supply grows at a slow rate arithmetic progression/rate (by a constant amount) i.e. 2,4,6,8,10,12,.....
- The theory further states that there will be a point when population growth equals food supply i.e. population trap beyond which food production would not be enough to sustain the population leading to famine, suffering, starvation and death.
- To reduce this calamity, Malthus suggested use of negative checks such as celibacy and late marriages, moral restraint to control population, otherwise positive checks like wars and diseases would start operating to reduce population growth to match with food supply.

The Malthusian theory of population is illustrated as below.



- Point A is the population trap

RELEVANCY/APPLICABILITY OF THE MALTHUSI POPULATION IN UGANDA/LDCs

The Malthusian theory is population is to a lesser e relevant to my country/developing countries in that;

- Land problems are common issues in Uganda today i population growth rate such as in Kisoro.
- In Uganda, there are communal land quarrels and in some cases resulted into high population.
- Food shortages are being experienced in some areas Karamoja, Kisoro, Bunyoro region due to rapid popula
- Natural family planning methods are being used i such as late marriages, celibacy and these were sugge
- Land is fixed in supply and subject to diminishing re an increasing population and

Malthus' theory is based on this situation.

As the population size increases there is less and les the worked upon by each person. For instance in Kiga

- Positive checks such as epidemics, wars, famin population growth in Uganda today. This is also pres such as Somalia, Rwanda and DRC

LIMITATIONS/IRRELEVANCIES/CRITICISMS OF T THEORY OF POPULATION IN UGANDA/LDCs

To a greater extent, the Malthusian theory of popula in my country/ developing countries.

(Direct your explanation to where the question is e either to your country of developing countries.)

Malthus was however criticized by several scholars looked at the world in a very narrow perspective.

1. The theory does not foresee technological improve constant technology and yet technology is Uganda/LDCs with time which increases food produ
2. There is no mathematical relationship as regar population growth in my country, population g geometric rate and food supply does not grow at an country.
3. Malthus ignored the possibility of getting foreign aid other countries yet this enables my country/LDCs supplies to support the growing population.
4. The theory ignores other factors that affect populati food supply and yet there are other factors such as population growth.

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reduce the population to a crude economically apply such as famine, wars, earthquakes and epidemics.

- The limits of population growth would be determined by the supply of food.
- The theory was based on the belief that man's biological capacity to reproduce himself is far better than the capacity to produce food for himself.

Assumptions Of Malthusian Theory Of Population.

1. Assumes that land is fixed and subject to the law of diminishing returns.
2. Assumes operation of positive and negative checks to control population.
3. Assumes fixed technology
4. Assumes a closed economy
5. Assumes a subsistence economy where everything is meant for domestic consumption.

UNDER POPULATION, OPTIMUM POPULATION AND OVER POPULATION.

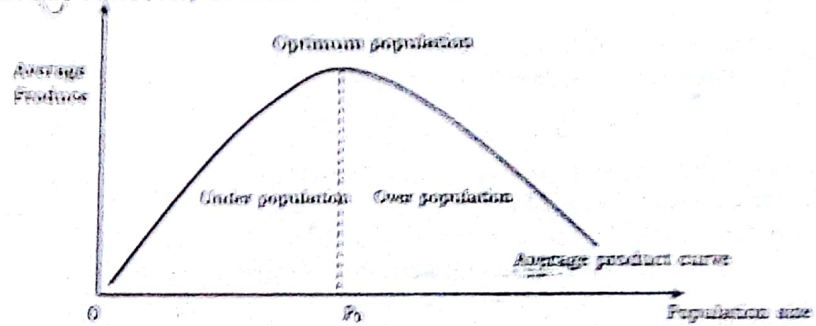

Figure 9.2: Under population, optimum population and over population

- P_0 represents optimum population

2010

(i) Define the term under population. (01 mark)

(ii) Mention any three disadvantages of under population in your country. (03 marks)

UNDER POPULATION

Under Population is the population size which is lower than the existing cooperant factors of production leading to low average product/low income per capita.

Or

It is the population size that supplies insufficient labourforce relative to other existing factors of production (other resources) leading to low output per worker/low income per capita.

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There is insufficient labourforce relative to other factors of production to make the best use of them thus low output per worker. Output per person increases as the population increases.

Effects Of Under Population

- Shortage of labourforce/limited supply which forces a country to depend on expatriates.
- Under utilization of economic resources.
- High expenses of government in providing social services per head.
- Limited market size which discourages investment and a disincentive to large-scale production.
- Limited government revenue as the tax base is narrowed.
- Low investment levels.
- Low level of inventions and innovations.
- Low output hence economic growth.

OPTIMUM POPULATION.

Optimum population is the population size which supplies sufficient labourforce which when combined with other existing cooperant factors of production (other resources) yields maximum output per worker/average product/income per capita.

Or

This is the population size that supplies labourforce to exploit existing available resources leading to maximum output per worker.

Below the optimum population, there is under utilization of resources (under population) while above the optimum population, resources are over utilized (over population).

Effects Of Optimum Population.

1. High per capita income.
2. High standard of living.
3. Fair utilization of resources.
4. Limited desire for population increase or decrease.

OVER POPULATION.

Over population is the population size that is greater than what the available resources can sustain resulting into a fall in average product as population increases.

Or

It is the population size that is greater than the available cooperant factors of production leading to a fall in average product as population increases.

Or

This is the population size where the ratio of population to other resources is very great making average output to fall as population increases. The existing resources cannot sustain the existing population.

UNEB 2011

(i) Distinguish between optimum population and (02 marks)

(ii) State any two demerits of over population. (02 marks)

Demerits Of Over Population In An Economy.

- *Leads to high rate of unemployment and underemployment.*
- *Overstrains the existing infrastructure.*
- *Leads to over population of existing resources.*
- *Leads to dependence burden hence low savings and ...*
- *Leads to unfavourable balance of payment position.*
- *Causes demand pull inflation.*
- *Increases crime rates.*
- *Makes planning difficult.*
- *Leads to income inequality.*
- *Worsens rural urban migration and its evils.*
- *Leads to increases government expenditure on social ...*
- *Leads to brain drain.*
- *Creates pressure on land thus land conflicts.*
- *Leads to food shortages.*
- *Leads to low per capita income.*

AGEING POPULATION.

Ageing population is the population where the number ... 64 years is higher than other age groups in the coun... about by good feeding, improved health care, education, ... age, rapid industrialization and urbanization, rise in ... increased status of women and control of diseases. ... feature of developed countries such as USA, Fr... Switzerland.

Positive Implications Of An Aged Population.

- Low pressure on natural resources such as land.
- Reduced pressure on social infrastructure.
- Limited brain drain and its disadvantages.
- Limited rural urban migration.

Negative Implications Of An Aged Population.

- Low labour supply because most of them are ungrou...
- High dependence burden on few productive labourfor...
- Changes in consumption patterns hence reductio... demand for walking sticks, hats and long clothes.
- Increased labour immobility both geographically and ...
- Reduced labour efficiency and productivity since the...

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- high conservation and low levels of innovativeness. This retards development hence technological stagnation.

DECLINING POPULATION

A declining population is the population that is continuously reducing in terms of numbers in relation to the available resources. This is due to death rate, rising birth rates, rising emigration and falling immigration.

Positive Implications Of A Declining Population.

- Reduces pressure on existing infrastructure
- Eases planning on side of the government
- Reduces pressure on natural resources
- Reduces dependence burden on working labourforce and government
- Increases job opportunities.

Negative Implications Of A Declining Population.

- Reduction in size of labourforce.
- Reduction in government revenue as the tax base narrows
- Fall in aggregate demand for goods and services which limits investment
- Underutilisation of natural resources
- Reduces people's efforts to hard work leads which leads to reduce inventions and innovations

MAN POWER PLANNING.

Man power planning refers to a long-term government forecast/projection between demand and supply of labour in order to establish a balance where for labour is equal to supply of labour. This is where forecast is made on man power demand to match with man power supply depending on the existing economic conditions in the country.

It is intended to establish a balance where demand for jobs is equal to supply of jobs.

It about a balance between demand for labour and supply of labour.

MAN POWER PROBLEMS IN LDCS.

1. **Shortage of skilled man power** such as doctors, engineers, accountants and economists.
2. **High rate f brain drain.** This is due to poor conditions of work and low wages in the domestic labour market.
3. **Excessive supply of labourforce in some fields and shortage of manpower in other fields.** For example high supply of teachers than doctors.
4. **Inappropriate education system** which is theoretical and creates more job seekers instead of job makers
5. **High levels of unemployment and underemployment.** Many people are not employed and some who are employed are not fully employed due to high rate of disguised unemployment.
6. **Misallocation of available skilled man power.** i.e. a tendency of appointing individuals on jobs which they are not academically qualified to do. For instance a doctor being employed on a political job.
7. **Excessive use of expatriates in some fields.** This undermines man power development programmes since they are not permanent and are very costly.
8. **High level of discrimination in the labour market.** There are imperfections in the labour market based on age, sex, religion and family background thus failure to get jobs among some job seekers.

Solutions To Man Power Problems In Developing Countries.

- Ensure proper manpower planning which helps to balance and supply of labour
- Setting up more training institutions to equip labour with modern skills.
- Train local labour to reduce heavy dependence on expatriates.
- Educational reforms to encourage more practical subjects and increase job creators.
- Improve working conditions and this helps to discourage brain drain.
- Encourage population control measures to reduce unemployment.

WAGES.

A wage is a reward for hiring labour as a factor of production for services rendered in production process. It differs from a salary because a salary is a fixed reward for labour as a factor of production and it mainly applies in activities where time spent on work is considered for instance teaching.

IMPORTANT TERMS.

Nominal wage/money wage. This is a payment to labour expressed in monetary terms. For example Uga shillings 500,000 per month.

Real wage. This is the purchasing power of the nominal wage in terms of goods and services.

Or

It is the amount of goods and services which one's nominal wage can purchase.

$$\text{Real wage} = \frac{\textit{Nominal wage}}{\textit{Market price of goods and services}}$$

Determinants of Real wage.

- General price level
- Size of nominal wage
- Availability of subsidiary earnings/side income
- Level of non pecuniary benefits on occupation i.e. accommodation medical services
- Level of direct taxation.

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Living wage: This is a payment to labour which is sufficient to provide the basic needs of life

Or

It is a wage sufficient/adequate to a worker to provide his basic necessities of life.

It enables a worker enjoy a reasonable standard of living. It is sufficient to provide basic needs to a worker.

It is a reward that is adequate for a worker and his family to survive comfortably.

Basic wage: This is a payment to labour without benefits or allowances attached.

Subsistence wage: This is a payment to a worker which is just enough to meet only basic needs and nothing more.

UNEB 2015

a) How are salaries and wages determined in your country? (06 marks)

b) Account for the differences in salary and wages rates in your country. (14 marks)

UNEB 2008

a) Account for the wage differentials in an economy. (10 marks)

b) Examine the merits and demerits of setting a high minimum wage. (10 marks)

UNEB 1997

a) What is meant by a subsistence wage? (04 marks)

b) Account for existing differences in wages in your country. (16 marks)

CAUSES OF WAGES DIFFERENTIALS IN AN ECONOMY.

NB. *This requires one to employ the phrase DIFFERENCES and each point should be explained in two sides showing an element of high wages and low wages.*

- **Differences in level of education and skills.** Highly educated and skilled workers are more efficient at work and earn higher wages compared to their counter parts with low level of education and skills who get low wages. For instance a degree teacher holder is paid more than a certificate teacher holder.
- **Differences in cost of living.** Workers in areas where the cost of living is high especially in urban areas are usually paid higher wages while those in areas where cost of living is low especially in rural areas are paid low wages.
- **Differences in working experience/seniority.** Senior and experienced workers get higher wages compared to junior and less experienced workers.
- **Differences in nature of jobs/occupations.** Workers in jobs are paid a higher wage than those who do less risky low wages. For instance pilots are paid highly than
- **Differences in bargaining strength of individuals.** with high bargaining power and ability to negotiate terms of service get higher wages while workers power for wages are paid low wages.
- **Differences in physical strength/ability to do work.** where wages a based on how much work has been method). Those who are physically strong and willing wages.
- **Difference in the number of hours worked.** are based on the number of hours worked (time are physically strong and willing to work earn physical weak labour produces less output and
- **Differences in elasticity in demand for the product.** Where demand for the product is high profits and pay their workers high wages while product is low, workers are paid low wages.
- **Discrimination in the labour market.** Labour paid higher wages while that is not favoured is based on age, sex, religion, colour, political and some workers are therefore given high wages same jobs with their counter parts who are paid
- **Differences in natural talents.** Highly musicians, and footballers usually exploit their wages than less talented workers are paid low
- **Differences in elasticity of labour supply.** is mostly associated with high wages while to low wages since there are limited chances in the wage. For instance surgical doctors Nurses.
- **Differences in strength of trade unions.** to agitate for higher wages for their members unable to agitate for high wages for members of Uganda law society are paid more
- **Government policy on wages which tends** Workers end up being paid different wages fixed by the government. For instance from
- **Differences in employer's ability and** Labourers who work with employers whose

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higher wages while those who work with employers whose ability to pay is low, are paid low wages.

WAGE LEGISLATION.

Wage legislation is a government policy of fixing/setting wages by law in an economy either a minimum wage or maximum wage. This is intended to favour both workers and employers.

MINIMUM WAGE.

Minimum wage a payment to labour/wage set by the government above the equilibrium wage (ruling market wage) below which it is illegal for employers to pay workers. This wage is normally set when labour market conditions are expected not to favour workers especially during high rates of unemployment. The government sets this wage because it considers the equilibrium wage to be too low for workers.

MINIMUM WAGE LEGISLATION.

Minimum wage legislation is a government policy of setting/fixing a wage above equilibrium wage below which it is illegal to pay a worker.

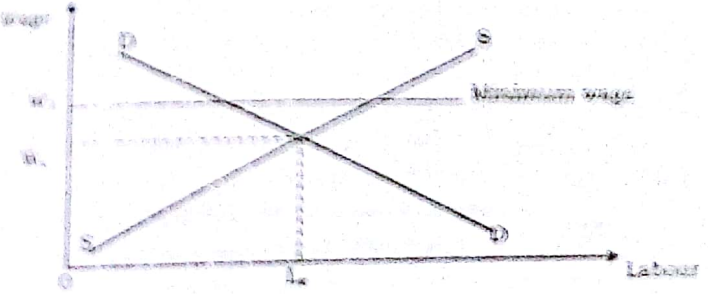

Figure 9.3: Minimum wage

UNEB 2008

a) Account for wage differentials in an economy. *(10marks)*

b) Examine the merits and demerits of setting a high minimum wage. *(10marks)*

ADVANTAGES / POSITIVE EFFECTS OF FIXING A MINIMUM WAGE

1. **Helps workers to meet increasing cost of living/improves standard of living workers.** It is fixed at a higher level that covers worker's basic necessities which helps them to meet increasing cost of living.
2. **Protects workers against exploitation/low wages by their employers.** This reduces low wages among given workers.
3. **Increases efficiency and productivity or workers.** It boosts their morale hence high labour productivity and effectively.
4. **Minimizes brain drain.** It is an attractive payment to skilled workers and become interested in working in the domestic country.
5. **Minimizes industrial unrest/promotes industrial peace.** Strikes and riots by workers are highly reduced hence industrial peace.
6. **Increases demand for goods and services.** This is because of increased workers' purchasing power hence more production due to increased incomes.
7. **Enables the government to win political support/good for politicians' desires.** It helps the government to win political support especially towards general elections since it is a high wage. This encourages public participation in development.
8. **Reduces wage differences between different categories of workers.** There are limited chances of under paying some workers if it nationally implemented.
9. **Increases supply of labour/attracts more labourforce.** It attracts more labourforce thus reducing ordinary unemployment.
10. **Discourages malpractices among workers such as corruption and embezzlement.** This is because it is a high wage for labour which increases satisfaction among workers.
11. **Increases revenue to the government through taxation.** This is important for government spending.
12. **Increases savings and investment.** This is because it increases income among workers thus increasing their savings.

DISADVANTAGES/NEGATIVE EFFECTS OF A MINIMUM WAGE.

- **Results into technological unemployment.** Employers decide to replace workers using capital intensive technology which is considered to be cheap.
- **Increases rural urban migration and its associated evils.** Such a wage is normally emphasized and maintained in urban areas where the cost of living is high which attracts workers to urban areas.
- **Discourages investments.** This is a very high wage and scares away both local foreign investors which this reduces the rate of foreign capital inflow.
- **Increases income inequality between the employed and unemployed.** This happens if it is not evenly implemented. This happens especially between rural Pleasants and urban wage earners.
- **Increases cost of production leading to cost push inflation.** Increases costs of production due to high labour costs i.e. increases average cost of such a wage is reflected on prices in form of increased prices of final commodities produced by such labour. This reduces standard of living.
- **Leads to excessive supply of labour in relation to its demand.** This increases unemployment.
- **Reduces profit levels of producers which discourages entrepreneurship.** This results from the high cost of production.

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MAXIMUM WAGE.

Maximum wage a payment to labour/wage fixed by the government above the equilibrium wage/ruling market wage above which it becomes illegal for employers to pay workers. It is normally fixed to favour producers. The government sets this wage because it considers the equilibrium wage to be a very high wage to be paid by employers

Maximum Wage Legislation.

Maximum wage legislation is a government policy of setting/fixing a wage below equilibrium wage above which it is illegal to pay a worker.

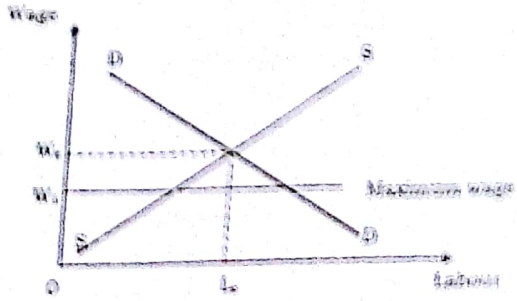

Figure 9.4 Maximum Wage

THE ECONOMY OF HIGHER WAGES.

Economy of higher wages is a situation where wages are increased with hope that the practice increase efficiency of labour to compensate employers for the greater cost of labour. The government and other employing agencies set high wage levels to motivate workers and increase their productivity. This increases costs of production.

It is a situation where workers are paid higher wages in order to stimulate their productivity. Its existence is recognized by big firms which strive to encourage permanence and higher labour productivity.

ADVANTAGES OF THE ECONOMY OF HIGHER WAGES.

- Reduces brain drain
- Reduces labour unrest by trade unions
- Increases labour productivity
- Reduces voluntary unemployment
- Increases aggregate demand hence market expansion.

DISADVANTAGES OF THE ECONOMY OF HIGHER WAGES.

- Results into an inflationary spiral
- Worsens income disparity between wage earners and non wages earners
- Labour is overworked to compensate for a higher pay given.
- Leads to increased cost of production.

METHODS OF WAGE PAYMENT/HOW ARE WAGES ... ECONOMY.

a) **The piece rate.**

Piece rate is a method of wage payment where wages ... to the amount of work done/task accomplished. Workers who works for more output get higher wages ... work for less output get low wages. The wage depends ... worker. The greater the effort, the higher the wage and ... the lower the wage for instance in brick making, tea ...

UNEB 2006

a) Distinguish between piece rate and time rate meth... (04 marks)

b) Explain the merits and demerits of piece rate meth... (16 marks)

UNEB 1999, 2010

(i) What is meant by piece rate method of wage paymen... (01 marks)

(ii) Mention any three advantages of piece rate meth... (03 marks)

MERITS OF PIECE RATE METHOD OF WAGE PAY...

1. **Workers become more creative and innovative.** ... finish the work in a short time and they come up w... production.
2. **Workers do the work at their own pace.** This ... payment is done according to amount of work done.
3. **Employers can easily forecast/predict output.** ... work is measurable and one can determine time ta...
4. **Higher output is realized.** Since workers intend ... they increase output.
5. **Eliminates a need for constant supervision.** ... supervision is required since the work done is m... workers proceed at their own pace.
6. **Lazy and weak workers are stimulated.** This is ... identified from the output produced. This therefo... work harder in order to increase their earnings.
7. **Promotes a spirit of team work.** This is espe... work in small groups.
8. **Protects employers from falsified payment...** employers pay for exact output produced by worke...

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concentration of workers on the activity to get payment.

10. **Faster workers get more remuneration/are fairly** workers are highly rewarded.

11. **It is easier to calculate the wage.** This is because measurable.

12. **Helps employers in identifying suitable employees.** This is based on the amount of output realized by each worker.

13. **It eliminates disagreements/conflicts** over payments. This minimizes industrial unrest thus promoting production.

DISADVANTAGES OF PIECE RATE METHOD OF WAGE PAYMENT.

- **Leads to over working among workers.** This is because of the fact to earn high wages and therefore an attempt to do more work hence worsening health conditions of the workers.
- **Workers are no assured of regular payment.** Income keeps on fluctuating from time to time depending on one's ability and when one misses work or falls sick, he is not paid for the days missed.
- **Does not apply to certain occupations where output cannot be quantified.** For instance medical practice, teaching and office work.
- **Reduces the quality of work done.** Leads to decline in quality of output because workers are interested in quantity than quality.
- **Very slow but careful workers are discouraged.** Slow workers but producing high quality work are demotivated.
- **Results into over production.** Workers produce high output to get high wages thus wastage of resources in case there is limited market.
- **There are disagreements about wage payment.** This is because it is very difficult to fix a fair rate and when work is done poorly.
- **High risks of industrial hazards.** Such as industrial accidents. This is because workers become very speedy in a accomplish work quickly.

b) Time rate.

Time rate is a method of wage payment where workers are paid according to the time spent at work. it can be in terms of hours, days, weeks and months. The period is agreed up by both parties i.e. the employer and the employee.

UNEB 2000

(i) Differentiate between piece rate and time rate methods of wage payment (02 marks)

(ii) State any two advantages of using time rate method of wage payment. (02 marks)

ADVANTAGES OF TIME RATE METHOD OF WAGE PAYMENT.

- It is applicable where output is difficult to measure such as teaching, legal service and medical service.
- It is easy to calculate the wage to be paid to workers.
- It is easily understood by both the employer and the employee which leads to industrial peace.
- There is regular income to workers even during the time of sickness, absenteeism. This leads to stability in income.
- High quality work is done. The work cannot be speeded up for increased output by the worker and it under close supervision.
- Encourages unity among trade unions because of uniformity in wage payments.
- Risks and accidents at work are reduced.

DISADVANTAGES OF TIME RATE METHOD OF WAGE PAYMENT.

- Requires a lot of supervision which is very costly.
- Less output is realized. Where workers are lazy, inefficient and work for less hours, low output is realized.
- Reduces incentives to work, it is unfair since both hard working and lazy workers get the same payment.
- Very difficult the value of output per worker thus a possibility of paying a high wage than the marginal product value.
- Encourages laziness among workers because regular payment is assured.
- It is tiresome for the employer to record all the number of hours worked.

c) Sliding scale system.

This is a method of wage payment based on changes in the cost of living. When the cost of living increases, the wage rate increase and when the cost of living reduces the wage rate also reduces. This enables a worker to maintain his real income.

d) Profit sharing.

This is where an employer puts aside a certain percentage of the total annual profits to be shared among his workers. The percentage of profits put aside for wages will depend on total profits made.

e) Bonus payment.

This is a payment to a worker which is over and above his fixed for exceptional contribution in production. It is always given when the employer is impressed with the good work done or when he wants to morale boost his workers in order to increase their productivity.

f) Market forces of demand and supply of labour.

Forces of demand and supply of labour interact and determine equilibrium wage.

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g) Government policy of wage legislation.
The government sets either a minimum wage or a maximum wage.

h) Collective bargaining between trade unions and employers.
Representatives if trade unions and employers sit on around table through peaceful negotiation and determine the wage.

i) Individual bargaining between the employee and the employer.
The wage paid to a worker depends n his bargaining strength.

j) Employers setting the wage.
This is where a wage is effectively set by the employer especially where bargaining power on the basis of take it or leave it.

UNEB 2000

a) How are wages determined in your country?
(06 marks)

b) Account for wage differences in your country.
(14 marks)

HOW ARE WAGES DETERMINED/METHODS OF WAGE DETERMINATION IN UGANDA?

- Market forces of demand and supply of labour
- Collective bargaining through trade unions
- Employers fixing the wage
- Piece rate method of wage payment
- Time rate method of wage payment
- Individual bargaining between the employer and employee
- Government policy on salary structures.

UNEB 2001

(i) *Distinguish between wage freeze and wage restraint.* *(02 marks)*
(ii) *Give any two causes of wage differentials in your country.* *(02 marks)*

WAGE FREEZE.
This refers to legally backed holding of wages at their existing level for a specific period of time so as to control/check inflation.

WAGE RESTRAINT.
This is a voluntary restriction of wage increases where the government appeals and encourages trade unions and employers to moderate demand for wage increase in order to control / check inflation.

WAGE LEADERSHIP.
This is where employers set their wage level according to lead... of large employers who provide a standard wage and other... follow. This is normally done so by employers dealing ... similar or related products/in the same industry.

WAGE THEORIES.

1) SUBSISTENCE WAGE THEORY OR IRON LAW OF WAGES.
It states that workers should be paid a bare minimum/subsis... that they can work harder after experiencing hardships and ... It emphasizes that the wage level should correspond with ... level of living at which people could just maintain the existing ... any increase in the wage above the subsistence level ... population which results into stiff competition for jobs which ... back to the subsistence level.
On the other hand, a decrease in wages below the bare minim... in malnutrition and increase death rates which eventually ... wage rate back to the subsistence level.

2) BARGAINING POWER THEORY OF WAGES.
According to the theory, a wage is determined by the ba... between workers through their trade unions and employers ...
According to the theory, labour markets are assumed t... where the amount of wage paid to workers in an industry ... bargaining strength of the trade unions concerned in ... with employers.
This brings about wage differences on the strength of t... individual workers to bargain successfully.

3) MARKET THEORY OF WAGES/MODERN T... WAGES/MARKET FORCES OF DEMAND AND SUPPLY...
This is based on the fact that wages are determined by ... of demand and supply of labour in the labour market.
If there is excessive supply of labour than its demand, wage... is excessive demand for labour than its supply, wages increa...
Equilibrium wage is attained where supply of labo... demand for labour

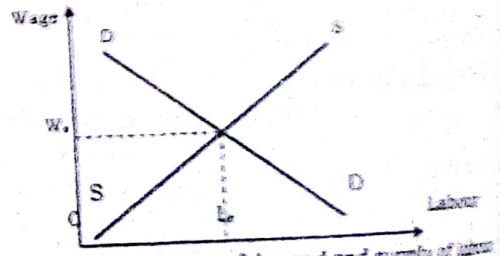

Figure 9.5: Interaction of market forces of demand and supply of labo...

- W_e is the equilibrium wage

Assumptions Of The Market Theory Of Wages.

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- produced
- No government intervention in wage determination.
- All units of labour are assumed to be homogenous
- There is perfect competition among labour for jobs.
- There is perfect knowledge in the labour market
- Perfect mobility of labour.
- There is perfect competition among employers of labour

UNEB 2010

a) Explain the factors that determine the level of wages in an economy. (06 marks)

b) What are the limitations of marginal productivity theory of wage determination. (14 marks)

UNEB 1998

a) Explain the marginal productivity theory of distribution as applied to labour. (06 marks)

b) What are the limitations of marginal productivity theory of distribution in the determination of wages? (14 marks)

4) MARGINAL PRODUCTIVITY THEORY OF WAGES/MARGINAL PRODUCTIVITY THEORY OF DISTRIBUTION.

It states that a workers should be paid a wage which is equal to the value his marginal product.

Wage = marginal Revenue product of labour (value of marginal product of labour)

Marginal revenue product = marginal product x price of each additional unity of output

This means that when the marginal product of labour increases, the wage should also increase and when it reduces, the wage should also be reduced by the same amount.

The extra unit of labour employed should be able to produce additional unit of output and this output should be in position to fetch extra revenue which must be paid to workers.

The wage will be equal to the amount of extra value added to the total product by one additional worker. The worker has to keep on adjusting the level of employment until the value of the marginal product of labour is equal to the wage or cost of employing an extra worker.

NB.

Marginal revenue product of labour refers to additional revenue obtained as a result of employing an extra worker.

Marginal Revenue Product = Marginal Product x Price

Assumptions Of The Marginal Productivity Theory Of Wages.

- Employers and labour can calculate the value of marginal product of labour.
- All units of labour are assumed to be homogenous.
- Output is qualified in measurable units.
- There are no activities of trade unions in wage determination.
- No government intervention in wage determination.
- All factors of production are substitutable.
- Labour is assumed to be perfectly mobile.
- The law of diminishing returns operates at all times.

UNEB 2008, 2002

(i) *State the marginal productivity theory of distribution.* (02 marks)

(ii) *Give any three limitations of this theory.* (03 marks)

LIMITATIONS/CRITICISMS OF MARGINAL PRODUCTIVITY THEORY OF WAGES/MARGINAL PRODUCTIVITY THEORY OF DISTRIBUTION.

1. The theory assumes no government interference in wage determination, yet the government normally intervenes and fixes a minimum wage for different reasons.
2. The theory ignores the influence of historical factors in wage determination such as inherited salary structures in fixing wages. This is not related to marginal product of labour.
3. It wrongly assumes absence of trade union activities in wage determination yet they influence wages through collective bargaining.
4. Labour therefore may be paid a wage which is higher than the value of its marginal product.
5. The theory does not consider current exploitation of labour by capitalists and therefore wage paid to labour may be below the value of marginal product of labour so as to maximize profits.
6. Sometimes employers use the subsistence level as a measure of fixing wages and such wages may be above or below the value of marginal product of labour.
7. The theory does not apply when the marginal product of labour in some occupation such as teaching, legal services since output cannot be qualified.
8. Labour is not homogenous and workers' marginal productivity therefore varies. There are skilled, semi skilled and unskilled labour.
9. The law of diminishing returns does not apply at all times, with increase in technology there may be increasing returns.
10. Labour is not perfectly mobile as assumed by the theory, it is immobile to some extent since it is limited by factors such as old age and limited skills.

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11. Labour cannot be wholly substituted for instance use of capital intensive technology requires labour to operate the machines highly skilled labour cannot be wholly substituted.
12. Labourers and employers cannot determine the exact value of marginal product of labour because output is produced by many factors of production.
13. It ignores the possibility of paying wages according to level of education and training without relating to marginal product of labour.

UNEB 2010

a) Explain the factors that determine the level of wages in economy.
(06 marks)

b) What are the limitations of the marginal productivity theory of wage determination? (14 marks)

UNEB 2005

(i) Distinguish between a minimum wage and a living wage.
(02 marks)

(ii) State any two factors that influence the level of wages in your country.
(02 marks)

FACTORS THAT INFLUENCE/AFFECT THE LEVEL OF WAGES IN UGANDA.

NB. Neutral points must be presented and each explained in two showing high wages and low wages for labour/workers.

1. **Market forces of demand and supply of labour.** High demand for labour than its supply leads to high wages while low demand for labour than its supply leads to low wages.
2. **Bargaining strength of individual worker.** Strong bargaining power for wages leads to high wages while low bargaining for wages leads to low wages.
3. **Level of experience/seniority.** High level of experience among workers leads to high wages while low level of experience among workers leads to low wages.
4. **Nature of the job/occupation.** Some jobs are highly paying such as risky jobs while others pay low wages especially non risky jobs.
5. **Level of natural talents.** Highly talented labour gets higher wages while low talented labour gets low wages.
6. **Employer's willingness and ability to pay workers.** High ability and willing to pay workers leads to high wages while low ability and willing to pay workers leads to low wages.
7. **Number of hours worked.** Long hours at work normally leads to high wages while limited hours at work leads to low depending on time rate method of wage payment.
8. **Discrimination in the labour market.** This is ... religion, colour. Those who are favoured are paid ... those who are not favoured are paid low wages.
9. **Cost of living.** High cost of living is normally associated ... especially in urban areas while low cost of living ... especially in rural areas.
10. **Level of education and training.** High level of ... leads to high wages while low level of education and ... wages.
11. **Strength of trade unions through collective ...** Trade unions are able to agitate for high wages for ... Trade unions are unable to agitate for high wages for ...
12. **Government legislation policy on wages.** Where ... set, high wages are offered while where a maximum ... wages are offered.
13. **Physical ability of workers to do work.** The ... method of wage payment.

TRADE UNIONS.

Trade unions are labour organizations or associations ... particular industry formed to pursue common objectives ... for increased wages and improved conditions of work for ...

Or

Trade unions are organizations or associations ... particular industry with the primary objective of ... wages and improved conditions of work for their ... They are formed with the major aim of protecting ... interests of their members such as advocating for ... improved conditions of work for their members.

Examples of trade unions in Uganda;

- Uganda National Teachers' Union
- Uganda Manufacturers' Association.
- Uganda Law Society.
- Uganda Sports Press Association
- Uganda Railway Workers Union
- Makerere University Academic Staff Association
- Uganda Medical Workers Association.

OBJECTIVES OF TRADE UNIONS.

- To bargain for better working conditions of the ... attractive fringe benefits in form of better housing ... the welfare of workers.

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- To increase wages for members to a desirable level by increasing bargaining power of workers in wage determination through collective bargaining.
- To protect rights of workers and maintain their human rights as laid down in the labour law such as social security benefits.
- To protect workers against unfair treatment such as dismissal by their employers hence ensuring job security for members.
- To improve skills of members through training by use of seminars, workshops so as to increase workers' productivity and efficiency thus high wages.
- To advise the government on man power planning, employment policies and wage policies.
- To unite for a common cause and ensure that there is unity among members and thus limits conflicts among members.
- To maintain consistent membership and ensure continuous supply of labour.

TYPES OF TRADE UNIONS.

1) **Craft trade unions/professional unions.** These are associations of workers organized according to their skills such as lawyers, Doctors and teachers.

2) **Industrial trade unions.** These are associations of workers that bring together all workers in a particular industry regardless of the type of work done by a particular worker such as workers in a bank.

3) **Company Trade unions.** These are associations of workers for one establishment. For instance workers in brick making industry.

4) **Closed shop trade unions.** These are associations of workers which agree with the employer to hire labour only registered with a particular trade union.

5) **Open shop trade unions.** These are associations of workers where all types of workers irrespective of their skills and occupations are free to join employment. Membership of the trade union is not a condition if getting employed by a certain firm. For instance National Union of workers.

TOOLS/METHODS USED BY TRADE UNIONS TO ACHIEVE THEIR OBJECTIVES.

- **Collective bargaining/round table discussion.** This is a peaceful round table negotiation between representatives of trade unions and employers regarding wages and better conditions of work.

Or

It refers to a process by which representatives of trade unions and employers reach and enforce agreements in regard to wages and conditions of work.

The terms agreed upon are contained in a document signed by both parties.

- **Use of court action/industrial court.** This is where workers report their grievances to the industrial court which is meant to settle disputes among workers and employers to have their wages increased.
- **Press or media role.** This is where trade union members contact journalists and write in media so that their demands are clearly spelt out to attract public sympathy and force employers to increase their wages. This include use of radios, televisions, newspapers where workers approach newsmen and clearly state their conditions of service and their demands to win public support.
- **Go slow tactic.** This is a situation where workers reduce on the amount of labour supplied by reducing on the number of hours worked per day and this reduces output and attract employers to increase their wages.
- **Sit down strike.** This is where workers report to their work place and do nothing in order for employers to respond to their demands and have their wages increased. This is a situation where workers withdraw their labour completely. All their operations come to a stand still and hence the output is prevented.
- **Boycott/sabotage/decampaigning of the products.** This is where workers' representatives persuade or convince the public to stop the consumption of products of a particular firm until their demands are attended to and probably have their wages raised.
- **Picketing.** This involves trade union members positioning themselves at the entrance of their work places to prevent their fellow workers from proceeding to work until their demands are fulfilled such as increased wages. This is intended to make employers feel the impact of their absence.
- **Go on strike/destructive strike.** This is where workers strike violently after which property of the firm is destroyed so that employers are forced to address their problems until their wages are increased. This causes financial loss to the employer. This is the last resort when all other tools have failed.
- **Use of demonstrations.** This is where workers hold peaceful demonstrations to attract public sympathy so that employers can respond to their demands by increasing their wages.
- **Industrial arbitration or mediation.** An independent body is approached to mediate the workers and employers in a move to have workers' demands fulfilled such as increasing wages.

WHAT ARGUMENTS DO TRADE UNIONS PRESENT WHEN DEMANDING AN INCREASE IN WAGES? / REASONS WHY TRADE UNIONS DEMAND FOR HIGH WAGES.

1. **A rise in cost of living argument.** High prices for goods and services stimulate trade unions to demand for high wages so that members are able to meet their required lifestyle since their real wages reduce.

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2. **Comparative wage rate argument.** Workers compare their wages with those of other workers doing the same job in different industries therefore if others are paid more, then the trade unions demand for high wages.
3. **Increased profits argument.** When trade unions realise that profits made by the firms have increased abnormally, they demand for high wages.
4. **Increased marginal productivity of labour.** Workers demand for high wages after realising that their contribution to the production process is high.
5. **Increase in demand for the product which workers produce.** An increase in demand for a firm's products is used by workers as a basis for demanding high wages.
6. **Inelastic supply of labour/full employment argument.** No longer as workers realise that they are few in number and their services are vital and the employers cannot lay off some and replace them with others they demand for high wages.
7. **Increased risky work argument/high risks involved in doing the job.** Workers doing risky jobs always demand for high wages as security for the life at the work place. For example in mining, heavy industrial operations and modern warfare.
8. **Failure by the employer to honour the earlier agreed upon periodical wage increases.** Workers keep demanding for high wages because they feel cheated by the employer.
9. **Failure by the employer to pay the minimum wage set by the government.** Where the current wage is lower than the government set minimum wage, employees demand for high wages to stop exploitation.
10. **High skills of offer by the workers.** Labour that had highly specialized skills to offer or is highly professional such workers demand for high wages.
11. **Increased work load/hours of work.** increase in activities done by workers forces them to demand for high wages so that the payment matches with the work done.

UNEB 2007

a) What is meant by the term collective bargaining? (04 marks)

b) When are employees justified to demand for wage increase? (16 marks)

UNEB 1998

a) Under what circumstances may workers demand for higher wages? (08 marks)

b) Examine the problems facing trade unions in your country. (12 marks)

CONDITIONS OR CIRCUMSTANCES UNDER WHICH DEMAND FOR INCREASED WAGES BY TRADE UNIONS OR EMPLOYEES HIGHER WAGES OR WAGE INCREASES

- **When** there is a rise in the cost of living, wages s as to cope with the increased cost of
- **In case** the productivity of labour has increase in output and revenue of the firm demand for higher wages.
- **When** the firm's profits have increased as is as a result of sweat of workers and have for higher wages.
- **When** workers of a similar job/skilled have workers through their trade unions for wages.
- **In case** the wage paid to workers is less than set by the government, trade unions as increases.
- **In case** there is an increase in risk/accident hazards, workers are justified to demand for their life.
- **When** labour is producing commodities workers are justified to demand for an
- **In case** there is an increase in skills labour are justified to demand for high skill.
- **When** the employer has failed to honour periodical wage increments, trade unions wage increase to fulfill their promises.
- **When** the number of hours of work has load implying high output which justifies high wages.
- **When** labour supply is inelastic/demand than supply (full payment) such labour wages since it is scarce.

UNEB 2004

a) What is meant by collective bargaining?

b) To what extent have trade unions objectives? (16 marks)

To a smaller extent, trade unions have Uganda.

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- they have tried to improve on working conditions of some workers for example provision of houses for workers such as doctors
- they have tried to improve on wages of some workers such as doctors, lawyers through collective bargaining
- They have tried to seek, promote and maintain human rights of workers
- They have tried to improve skills of members through training in seminars and workshops thus improvement in labour productivity
- They have tried to persuade the government to pass legislations and better working conditions for all government workers in the country

To a greater extent, trade unions have failed to achieve their objectives in Uganda

- They have failed to unite all members for a common cause i.e. they have failed to achieve unity among workers
- They have failed to convince the government to suppress workers demands such as implementation of a minimum wage
- They have failed to acquire and maintain substantial membership. They have failed to mobilize all rural workers to get actively involved in trade union activities
- They have failed to improve working conditions for all workers such as medical, housing and transport allowances
- They have failed to advise the government properly especially on proper man power planning and employment policy
- They have failed to protect all workers against treatment and dismissal from the jobs i.e. there is limited job security.
- They have not adequately improved worker's skills through training in all organizations
- They have failed to increase wages for all workers since most workers are still under paid

UNEB 2009

a) Explain the methods used by trade unions to obtain wage increase for their members

(08 marks)

b) What factors that limit the ability of trade unions to raise wages for their members in your country?

(12 marks)

UNEB 2013

State any four factors which limit the effective operation of trade unions in your country

(04 marks)

UNEB 2014

a) What is meant by a Trade Union? (04 marks)

b) Explain the challenges faced by Trade Unions in your country. (16 marks)

PROBLEMS/CHALLENGES FACED BY TRADE UNIONS IN DEVELOPING COUNTRIES.

(Reasons why trade unions have failed to achieve their objectives in developing countries /Uganda).

They are responsible for making trade unions weak and thus failure to achieve their intended objectives of agitating for higher wages and improved conditions of work.

1. **Shortage of adequate funds/financial difficulties.** Trade unions lack enough funds to finance their activities and maintain workers during periods of strikes because incomes of trade union members are very low.
2. **Weak and inefficient leaders/poor leadership skills.** Most leaders are incompetent and cannot give convincing reasons to justify demand for high wages on behalf of all members. Trade unions lack dedicated and professional leaders to push forward their objectives in a proper way.
3. **High level of unemployment in an economy.** It becomes easy for employers to replace workers who agitate for high wages as they fear to be replaced. There is open unemployment in LDCs and therefore trade unions fear to demand for high wages because of excessive labour ready to replace any striking workers.
4. **Increased government interference in trade union activities.** This is through influencing who their leaders should be and restricting trade unions from striking by demanding that they have to seek permission from state organs such as police, declaring their strikes illegal thus limiting their ability to agitate for higher wages.
5. **Disunity among trade union members.** This is due to tribal, religious, political and racial differences. This retards the performance of the trade unions since it makes them very weak which limits ability to demand for higher wages.
6. **High level of corruption and embezzlement of trade union funds.** Sometimes trade union leaders are bribed by employers and they end up betraying their fellow employees and resources meant for activities of the trade union are misused by few members thus limiting the amount of available to push their activities.
7. **Ignorance/apathy of workers about trade union activities/their rights.** In LDCs, most workers are less educated, unskilled and do not know their rights, therefore employers take advantage of this ignorance to exploit them and find it hard to accept trade union activities.
8. **Small size of membership/low level of unionization.** Most trade unions do not substantial numbers and this weakens their bargaining power for high wages. There are few salaried/wage earners to warrant the need for trade union activities.
   Rural workers do not mind about terms and conditions of service and many people are self employed in rural areas.

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9. **Poor/weak economic performance/low profitable of firms.** [illegible] to low productivity of firms which makes it [illegible] justify demand for high wages. This keeps trade unions weak.
10. **Poor transport and communication systems.** Limited infrastructure such as communication facilities make mobilization of members and coordination of trade union activities difficult thus hindering ability to demand for higher wages and better conditions of work.
11. **Use of trade unions by leaders to achieve higher political positions.** Most leaders of the trade unions use them as a stepping stone to attain top posts in government which undermines trade union objectives.
12. **Low demand for labour due to [illegible] industrial sector.** The industrial sector is still small thus few people are employed within the industrial sector thus a small percentage of the labour population which limits the ability of trade unions to expand and achieve their objectives.
13. **Low demand for products produced by members.** This implies that there is limited demand for services of some trade unions thus limiting their strength.
14. **Limited skills of members.** Trade union members do not have appropriate skills for employment and therefore cannot justify demand for increased wages.

FACTORS THAT INFLUENCE/DETERMINE THE STRENGTH OF TRADE UNIONS

NB. *Neutral points are presented and explained in two sides showing a favourable side that strengthens trade unions and unfavourable part that weakens trade unions.*

- **Amount of strike funds and financial strength of trade union.** Trade unions with a sound financial stand are able to finance their activities and therefore become strong compared to their counter peers with limited funds which remain weak.
- **Degree of organization of trade unions.** Highly organized trade unions are able to achieve their objectives, mobilize all members for a common cause and become strong while poorly organized trade unions remain weak. For instance Uganda law society is more organized than Uganda National Teachers Union.
- **Leadership skills/quality of management.** Competent and strong trade union leaders are able to agitate for given desired conditions of work on behalf of members which strengthens the trade union while weak trade union leaders are unable to agitate for given conditions on behalf of members which makes trade unions weak.
- **Level of unemployment and under employment.** High levels of unemployment and under employment weaken trade unions since trade union demands are likely not to be attained because unemployment may [illegible] work by hiring those under strike and have new labour [illegible] unemployment and under employment make trade unions [illegible]
- **Elasticity of supply of labour.** Where the supply of [illegible] trade unions become weak since demand for high wages achieved while inelastic supply of labour leads to high [illegible] since they are not easy to replace.
- **Size of membership/unionization.** Trade unions with [illegible] are unable to have high bargaining power and therefore [illegible] while trade unions with many members have high bargaining [illegible] become strong.
- **Level of government interference.** High level of [illegible] interference in the affairs of the trade unions such as [illegible] illegal weakens the trade unions while limited government [illegible] in the affairs of the trade unions is a basis of strong trade [illegible]
- **Prevailing economic performance.** Trade unions can [illegible] demanding for higher wages during an economic depression [illegible] profitability of firms which makes the trade unions weak [illegible] boom, they are able to succeed in demanding for high [illegible] therefore become strong.
- **Level of labour productivity of members.** Low level of [illegible] productivity of trade union members makes trade unions [illegible] high level of labour productivity of trade members [illegible] the employer which strengthens the trade unions.
- **Elasticity of demand for products produced by the** [illegible] Where trade union members produce [illegible] demand, such unions become strong because employers [illegible] inelastic demand for products weakens the trade unions [illegible] get revenue.

UNEB 2003

(i) *What is meant by the term collective bargaining?*

(ii) *Give any three features of trade unions in developing countries.* *(03 marks)*

Characteristics/features of trade unions in developing countries

- They lack membership on permanent structure. High mobility of workers.
- They attract a small number of members.
- They have weak leadership thus low bargaining power.
- Characterized by disunity among members based on [illegible] sectarianism and tribal difference thus weak organization.
- They are often politically motivated.
- They are mainly urban based.
- They are financially weak and members fail to pay [illegible]

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Chapter 12: INTERNATIONAL TRADE.

International trade refers to the exchange of goods and services between different countries. International trade is divided into two;

- **Bi lateral trade.** This is the exchange of goods and services between only two countries
- **Multi lateral trade.** This is the exchange of goods and services among more than two countries. Modern economies carry out international trade on multi lateral basis.

Visible trade. This refers to trade transactions carried out in intangible items/ services. For instance trade in coffee, cotton, tea, clothes, drugs, fish and cattle hides.

Invisible trade; this refers to trade transactions carried out in intangible items/ services. For instance trade in insurance services, financial and lodging services , banking services, legal services and security services, consultancy services

NEED FOR INTERNATIONAL TRADE/FACTORS GIVING RISE TO INTERNATIONAL TRADE.

- **Differences in natural resource endowments.** Different countries have different natural resources such as minerals, forests, water bodies and they are not transferable from one country to another unless international trade takes place.
- **Need to acquire necessary technology.** A country can acquire machinery in agriculture, machinery in industries through international trade
- **Need to acquire skills and experienced man power.** LDCs are able to acquire expatriates to run their key sectors through international trade.
- **Need to dispose of surplus output.** Production of excess output which cannot be absorbed by the domestic market is disposed off to other countries through international trade. For instance Uganda produces excess coffee which finds market in other countries.
- **Need to acquire revenue for national development.** This is through charging export and import duties.
- **Need to minimize production costs/comparative advantage argument.** A country may find it cheaper to consume imported commodities than producing them domestically. Production of one commodity in one country may be at a low cost than in another country.
- **Need to acquire foreign exchange.** Some countries trade with others because they want to acquire foreign currency essential for economic development
- **Need to acquire cooperant factors of production.** A country may get involved in international trade in order to acquire vital missing cooperant factors of production to exploit the existing natural resources such as attracting foreign entrepreneurs.

UNEB 2016

a) What is meant by "vent for surplus theory" as used in international trade? (04 marks)

b) Assess the role of international trade in the development of your country. (16 marks)

ADVANTAGES OF INTERNATIONAL TRADE.

- ***Enables a country to get what it does not produce.*** *Due to limited technology, man power and other essential resources, a country cannot produce all the requirements which are obtained through international trade and thus improves general welfare of nationals.*
- ***Enables a country to dispose off surplus output.*** *Output which could have been wasted due to limited market at home is disposed off to other countries.*
- ***Provides a variety of goods.*** *A variety of both consumer and non consumer goods are obtained through international trade thus increasing consumers' choice.*
- ***Promotes efficiency of domestic firms due to competition.*** *Importation of foreign goods forces home industries to become more efficient thus improved quality output on the market and exportation involves adding value to exports to meet standards of foreign market.*
- ***Promotes infrastructural development.*** *Infrastructure such as roads, pipeline, railways and airports are improved to coordinate international trade.*
- ***Leads to increased utilization of resources.*** *This is through the vent for surplus advantage of international trade because of widened market for output.*
- **Promotes international friendship and cooperation.** It strengthens political and economic ties between participating countries and this opens room for diplomatic missions between countries and increased trade.
- **Increases employment opportunities.** This arises from the expansion of import and export sectors.
- **Generates government tax revenue.** Government obtains revenue through imposing import and export duties which is necessary for public expenditure.
- **Promotes international specialization and its benefits.** Countries have different abilities in performing different activities and a country specializes in operations where output is maximized and where costs are minimized on the basis of comparative advantage.
- **Enables a country to acquire skilled labour from countries.** It facilitates movement of highly skilled labour from one country to another to engage in trade opportunities and working in key sectors as expatriates.

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- **Enables a country to acquire new ideas and values.** This is foundation of social change since it disseminates new ideas which
- **Promotes technological transfer/development.** This increases the level of production.
- **Increases output hence economic growth.** This results from a focus to produce for a wide foreign market.
- **Increased quality of output due to competition.** This improves standard of living among the population.
- **Enables a country to get supplies in times of emergences/supplements domestic output.** During emergencies in the domestic economy, commodities are imported to supplement the available limited output.
- **Promotes capital inflow.** This is important for increased domestic production due to very many foreigners attracted in trade and foreign exchange acquired from export.

VENT FOR SURPLUS.

Vent for surplus refers to a situation where international trade provides an opportunity for countries to utilize the formerly idle resources to produce surplus output for export markets.

NB. vent for surplus theory as *used in international trade states that international trade provides an opportunity for countries to utilize the formerly idle resources to produce surplus output for export markets.*

DISADVANTAGES OF INTERNATIONAL TRADE.

- **Leads to imported inflation.** There are chances of importing commodities from inflation prone economies thus negative effects if inflation in an economy.
- **Leads to importation of harmful/undesirable goods.** Undesirable commodities such as expired drugs, expired food stuffs, pornographic magazines and films which are socially undesirable are likely to be imported especially where there are weak trade restrictions thus reducing welfare.
- **Leads to over exploitation of domestic resources.** This happens especially where exports are highly demanded and marketable thus quick depletion of non renewable resources.
- **Worsens balance of payment problems in LDCs.** Developing countries get less foreign exchange earnings on exports and yet there is increased foreign exchange expenditure on imports.
- **Leads to collapse of domestic infant industries due to foreign competition.** International trade leads to increased importation of gods similar to what infant industries produce thus out competing such firms.

- ***Leads to dumping and its negative effects.*** It... up a ground for dumping and thus totally ... domestic infant industries where goods are dumped.
- ***Retards the development of local skills.*** Interna... country with most of its requirements, thus limited ... and skill acquisition. This kills the country's ... innovativeness.
- ***Increases external economic dependence/reduces ...*** This reduces the level of self reliance due to increased imports.
- ***Leads to poor terms of trade.*** This is due to low ... LDCs compared to highly priced exports from developed ...
- ***Leads to cultural erosion.*** This results from import ... undesirable commodities such as pornographic ... eating and dressing styles from foreigners ... undesirable.

BEGGAR MY NEIGHBOUR POLICY.

Beggar my neighbor policy is a government measure adopted ... benefit her own economy but which negatively affects ... that adopt counter to retaliate.

Or

It refers to an economic measure adopted by a country ... economic situation but has negative effects on her trading ... trading partners adopt counter policies to retaliate.

THE PRINCIPLE OF ABSOLUTE ADVANTAGE (BY ADAM ...

The principle of absolute advantages states that given two ... commodities, one country can produce both commodities ... another country using the same amount of resources.

Absolute advantage is the ability of a country to produce ... efficiently than another country. Given two countries and ... of resources (labour), a country which produces more ... than another at less input costs is said to have absolute ... production of those commodities.

For example, given equal units of labour and two commodities ... and rice, state the country with absolute advantage ... commodities.

Country	Coffee (Tonnes)	Rice (...
Uganda	20	30
Kenya	15	25

Table 12.1: Principle of absolute advantage

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Uganda produces 20 tonnes of coffee and 30 ... that it has an absolute advantage over Kenya in ... commodities.

... both coffee and rice more efficiently (at less ...

UNEB 2003

... between trade creation and trade diversion (04 marks)

... extent is the comparative cost theory applicable to developing ... (10 marks)

UNEB 1999

a) Distinguish between the principle of comparative advantage and absolute advantage in international trade. (04 marks)

b) What are the limitations of the principle of comparative advantage? (16marks)

LAW OF COMPARATIVE COST ADVANTAGE (BY RICARDO DAVID)

The law of comparative advantage states that given two countries, two commodities and same amount of resources, a country should specialize in producing a commodity where it has/ incurs the least opportunity cost than the other country.

$$\text{Opportunity cost} = \frac{\text{alternative foregone}}{\text{actual output (alternative undertaken)}}$$

A country has a comparative advantage in that product for which it has a lower domestic opportunity cost ratio than its competitor.

Even if a country is better off in the production of two commodities, it pays more than if that country specializes in the production of a commodity in which it incurs the least opportunity cost.

That's why a country may decide to import a commodity than producing it locally because it may be cheaper to import such a commodity than producing it locally.

Country	Coffee (Tonnes)	Rice (Tonnes)
Tanzania	40	10
Kenya	20	8

Table 12.2: Law of comparative cost advantage.

Tanzania has absolute advantage in the production of both commodities over Kenya. However it may not have comparative advantage in production of both commodities over Kenya. This implies that there is a need to calculate opportunity cost rations to find out in which commodity should each country specialize.

For Tanzania to produce 40 tonnes of coffee, it forgoes 10 tonnes of rice,

therefore to produce one tonne of coffee, Tanzania forgoes $\frac{10}{40}$ = 0.25 tonnes of rice

For Kenya to produce 20 tonnes of coffee, it forgoes 8 tonnes of rice,

therefore to produce one tonne of coffee, it forgoes $\frac{8}{20}$ = 0.4 tonnes of rice

Therefore, Tanzania has comparative advantage in production of coffee over Kenya because it forgoes less tonnes of rice (0.25) compared to Kenya which forgoes 0.4 forgoes 0.4 tonnes of rice.

For Tanzania to produce 10 tonnes of rice, it has to forego 40 tonnes of coffee, therefore to produce one tonne of rice it forgoes $\frac{40}{10}$ = 4 tonnes of coffee

For Kenya to produce 8 tonnes of rice, it has to forego 20 tonnes of coffee

therefore to produce one tonne of rice, it forgoes $\frac{20}{8}$ = 2.5 tonnes of coffee.

Therefore, Kenya should specialize in the production of rice because it has the least opportunity cost of 2.5 tonnes of coffee compared to Tanzania with 4 tonnes of coffee.

Examinable question

Given same units of labour and two countries, study the table below and answer the questions that follow.

Country	Commodities	
	Generators	Coffee
A	400	600
B	100	300

Table 12.3: law of comparative cost advantage.

a) State the country with absolute advantage in production of both commodities.

Country A has absolute advantage in the production of both commodities because it produced more output than country B.

b) Calculate the opportunity cost of producing each commodity in each country.

Opportunity cost for commodity A

400 generators = 600 coffee

Therefore, 1 generator = $\frac{600}{400}$ = 1.5 coffee i.e. 1 generator = 1.5 coffee

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600 coffee = 400

Therefore, 1 coffee = $\frac{400}{600}$ = 0.67 generators i.e. 1 coffee = 0.67 generators

Opportunity cost for commodity B

100 generators = 300 coffee

Therefore, 1 generator = $\frac{300}{100}$ = 3 coffee i.e. 1 generator = 3 coffee

300 coffee = 100

Therefore, 1 coffee = $\frac{100}{300}$ = 0.33 generators i.e. 1 coffee = 0.33 generators

c) In which commodity should each country should each country specialize?

Country A should specialize in production of generators while country B should specialize in production of coffee

UNEB 2009, 2002, 2011

a) Distinguish between comparative advantage and absolute advantage as used in international trade. (02 marks)

b) State any two assumptions underlying the principle of comparative advantage. (02marks)

ASSUMPTION OF THE LAW OF COMPARATIVE ADVANTAGE.

- Assumes only two countries. For instance Uganda and Kenya
- Assumes only two commodities produced and exchanged between two countries.
- Factors of production/units of labour are assumed to be homogenous and perfectly efficient.
- There are no transport costs incurred in the exchange of commodities between countries.
- There is perfect mobility of factors of production (labour) within a country/internally and perfect immobility of factors of production (labour) externally.
- Assumes the existence of barter trade system.
- Assumes full employment level of resources in both countries.
- Technology is assumed constant in both countries.
- Assumes similar and constant tastes and preferences among the two countries.
- Assumes constant returns to scale/the law of diminishing returns does not operate.
- Demand is assumed to be elastic.

RELEVANCE/APPLICABILITY OF THE PRINCIPLE OF COMPARATIVE ADVANTAGE IN DEVELOPING COUNTRIES.

To a smaller extent the principle of comparative advantage is relevant in developing countries.

- Developing countries import manufactured goods e.g. drugs, vehicles, computers, phones which is the comparative advantage which makes the law applicable.
- There are some cases of mobility of factors of production (industrial countries) in developing countries which is applicable
- There are some areas of free trade especially with regional integration in developing countries. This is mainly for reasons such as expanding market.
- In many developing countries, labour intensive techniques are used because of abundance of cheap labour as well as labour as the major input in production while to some extent technology has remained constant.
- There exists some areas of barter trade among the developing countries and the theory talks about the terms of trade in barter trade.
- Most developing countries have tended to specialize in agricultural products such as cotton, coffee, cocoa which have the lowest opportunity cost which makes the law

IRRELEVANCE/LIMITATIONS/CRITCISMS OF THE LAW OF COMPARATIVE ADVANTAGE IN LDCs.

To a larger extent, the principle of comparative advantage is irrelevant in developing countries.

- The theory assumes only two countries yet modern trade involves many countries, therefore it is based on unrealistic real life.
- The theory assumes conditions of full employment which do not exist in developing countries because it is difficult to achieve employment in LDCs.
- It does not favour developing countries because they are poorer since they specialize in primary products that are cheap and yet MDCs specialize in manufactured products which are expensive.
- It is unrealistic to assume only two commodities are exchanged between countries, yet there are many commodities exchanged between countries.
- The theory assumes of free trade which is unrealistic because there are various trade restrictions such as tariffs in international trade, therefore free world trade does not exist.
- It does not take into account changes in technology.

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increasing their supply in the long run. This occurs in developing countries.

- it does not take in account transport costs between two countries yet long distances are involved in which cause differences in costs of transport.
- it wrongly assumes that all factors of production/labour are equally homogenous and efficient and yet it is very difficult to find such a situation. Labour differs in skills and experience.
- assumes perfect mobility of factors of production within a country which is not possible, because they tend to be immobile for some reasons and even if factors of production can be international.
- it assumes barter trade and yet barter trade has become out dated since exchange of goods is monetary.
- it does not take into account the need for self reliance and diversification by countries which tend to disagree with specialization, yet modern countries aim at self reliance to reduce dangers of economic dependence.
- ignores existence of diminishing returns since it assumes constant returns which is unrealistic because diminishing returns cannot be avoided in production and this is likely to reduce output.
- Assumes that demand is elastic and yet demand for agricultural products in developing countries is inelastic.
- It ignores the possibility of absolute cost advantage (comparative advantage in production of both commodities) which limits specialization and exchange between countries.

UEB 2004

4. Given same units of labour, two countries, study the table below and answer the questions that follow.

Country	Commodities	
	Generators	Coffee
A	400	600
D	100	300

a) i) State the country with absolute advantage in production of both commodities. (01 mark)

ii) Calculate the opportunity cost of producing commodity in each country (04 marks)

b) In which commodity should each country specialize? (01 marks)

c) What are the limitations of comparative cost advantage theory in international trade? (14 marks)

UNEB 2000

a) What is meant by terms of trade? (01mark)

b) State any three reasons why the terms of trade of developing countries are deteriorating. (03 marks)

TERMS OF TRADE.

Terms of trade refers to the ratio of price index of exports to the price index of imports of a country.

Or

It is the relationship between the price index of a country's exports and the price index of her imports.

Or

It refers to the rate at which a country's exports are exchanged for imports. Both imports and exports should be valued in the same currency whose value does not fluctuate frequently.

$$\text{Terms of Trade} = \frac{\text{Index of exp ort prices}}{\text{Index of import prices}} \times 100$$

- If the ratio is equal to 100, then the price index of exports = price index of imports.
- If the ratio is greater than 100, it means favourable terms of trade.
- If the ratio is less than 100, it means unfavourable terms of trade.
- When terms of trade are increasing i.e. 100, 120, 130, 140, 150, 160 170, ... The country is said to be enjoying improving terms of trade.
- If terms of trade are declining i.e. 90, 80, 75, 60, 55, 45 ..... then such a country will be experiencing deteriorating terms of trade. This is when terms of trade become unfavourable year after year.

Unfavourable terms of trade.

This is a situation where price index of exports is relatively lower than the price index of imports of a country.

Favourable terms of trade.

This is a situation where the price index of exports is relatively higher than the price index of imports of a country.

Examinable question

Given 85 as a country's export unit value index and 120 as its import unit value index

(i) Calculate the terms of trade of such a country.

$$\text{TOT} = \frac{\text{Price of exports}}{\text{Price of imports}} \times 100$$

$$\text{TOT} = \frac{85}{120} \times 100$$

$$= 70.8$$

(ii) Comment on the state of terms of trade of such a country.

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...ms of trade are unfavourable because it is less than 100

... 2004

(i) Distinguish between barter terms of trade and income terms of trade. (03 marks)

(ii) State any two causes of unfavourable terms of trade in your country. (02 marks)

Terms of trade are two forms i.e.

- **Barter/commodity terms of trade;** this refers to the rate at which a country's exports are exchanged for imports. This shows the actual quantity of imports a country can purchase using a given volume of exports.

It measures the purchasing power of a unit of exports in terms of imports of a country. For instance how many sacks of Ugandan coffee in order to acquire one tractor from USA.

$$\text{Barter Terms of Trade} = \frac{\text{Price of a unit of exports (price index of exports) } PX)}{\text{Price of a unit of imports (Price index of imports) } PM}$$

If the ratio is greater than one, it means that one unit of exports buy more than one unit of imports hence favourable terms of trade

If the ratio is less than one, it means that one unit of exports cannot but one unit of imports hence unfavourable terms of trade.

- **Income terms of trade;** this is defined as the ratio of the value of exports to the price index of imports of a country. It shows the capacity of a county to import out of export earnings/income. It shows how much a country can import using from exports.

$$\textbf{Income terms of trade} = \frac{\textit{Value of exports } (PXQX)}{\textit{Price Index of Imports } (PM)}$$

Where;

PX = price of exports, QX = Quantity of exports, PM = Price of imports

UNEB 2007

a) Account for the existence of unfavourable terms of trade in your country. (10 marks)

b) Suggest measures that should be taken to correct unfavourable terms of trade in your country. (10 marks)

REASONS WHY TERMS OF TRADE ARE ... LDCs/CAUSES OF UNFAVOURABLE TERMS OF ... COUNTRIES.

The causes of unfavourable terms of trade in developing ... form factors that lead to low export prices and high ... developing countries experience such economic problems.

NB: explanation should show the element of falling / ... rising / high prices of imports

- **Exportation of semi-processed/primary ...** agricultural and mineral products such as coffee ... which do not command high prices on the world ... export prices compared to highly priced manufactured ...
- **Importation of expensive manufactured goods.** These include machinery, vehicles, ... command high import prices yet prices of exports ...
- **Increased competition of exports with synthetic substitutes by MDCs.** There is still competition ... the world market/ exploitation of LDCs products ... such as nylon, silk, plastic by developed countries ... for natural fibres such as sisal, raw wool and ... export prices compared to high prices of imports.
- **Market flooding of raw material products ... markets.** Almost all LDCs produce similar agricultural ... which leads to competition and high supply of ... low export prices yet prices of imports remain high.
- **Protectionist policies of developed ... products.** Developed countries use trade barriers ... sanitary ad hygiene requirements, total ban, and ... export prices export prices yet compared to high ...
- **Weak bargaining power on the world market.** ... agricultural commodity agreements and weak ... cannot bargain effectively for higher export prices ... imports remain high.
- **Discovery of raw material saving technology ... countries.** High technology by MDCs enables ... material saving innovations in production ... possible to increase output, thus less demand for ... low export prices yet import prices remain high.
- **Low quality exports.** These exports cannot ... world market and attract low prices compared to ... from developed countries.
- **Low income elasticity of demand for exports ...** developing countries are agricultural products ... even if world income, demand for primary products ... fast instead the increasing proportion ...

Scanned by CamScanner

...ufactured goods thus low price for exports yet prices of imports ...h high.

...g prices of exports.** This is due to their low demand abroad which ...leads to their low prices compared to highly priced imports.

- **Unfavourable exchange rates between LDCs and MDCs.** There is depreciation of currencies of LDCs and this makes developing countries to be in a poor position to negotiate for a high return from their exports leading to low export prices but makes imports relatively expensive leading to high import prices.
- **Increasing prices of imports.** I.e. increasing prices of oil petroleum products leading to reduce production and volume of exports thus low export prices and high import prices.

MEASURES TO IMPROVE TERMS OF TRADE IN DEVELOPING COUNTRIES/UGANDA

NB: *These measures should aim of either increasing export prices or reducing import prices.*

- **Establish import substitution industries** to produce the formerly imported expensive commodities. This helps to reduce reliance on imports which are highly priced hence reduced import prices.
- **Strengthen commodity agreements.** This is meant to increase bargaining power through formation of price fixing agreements so as to help in coordinating supply and marketing of products to increase export prices.
- **Processing primary exports to add value on exports.** Value addition on exports increase export prices and reduces dependence on primary products.
- **Imposition of trade restrictions on imports.** LDCs should impose trade barriers such as import quotas, total ban on the importation of expensive capital and luxuries commodities to reduce import prices.
- **Negotiating for removal of trade barriers in export markets.** This is done in order to avoid high tariffs and quotas imposed by MDCs which increases demand and export prices. For instance USA opened her market for Africa through Africa growth Opportunity Act, this increases export prices.
- **Diversifying products for export.** This can be done through producing a variety of manufactured products and diversifying agriculture instead of depending on a few export crops so as to increase export prices.
- **Diversifying of export markets.** Through strengthening economic integration so as expand export market leading to high export prices.
- **Encourage use of barter trade arrangements** which does not involve the use of currencies as a medium of exchange.
- **Encourage importation of goods from cheaper sources.** This leads to low import prices for instance from newly industrialization economies.

- **Improving the quality of exports.** This should be done through improving methods of production in order to increase export prices.

UNEB 2001

Mention any four effects of deteriorating terms of trade in your country (UGANDA)

EFFECTS OF DETERIORATING/UNFAVOURABLE TERMS OF TRADE IN LDCs.

- Leads to scarcity of basic inputs into the manufacturing sector because of limited foreign exchange to import.
- Contributes to debt crisis because LDCs earn less from exports hence heavy dependence on foreign aid.
- Leads to low incomes for peasant farmers.
- Hampers economic growth.
- Makes government planning difficult.
- Reduces the level of industrialization.
- Increases the level of dependence on developed countries.
- Reduces investment levels.
- Worsens balance of payment deficit.
- Leads to foreign exchange shortages.
- Results into currency depreciation as prices of exports continue to be low.
- Increases unemployment since the export sector cannot be expanded.

BALANCE OF PAYMENTS.

Balance of payments is a relationship between the country's transactions with the rest of the world in export and import of goods and services as well as capital flows for a given period.

Or

It is the difference between a country's receipts/earnings from abroad and its expenditure abroad during a given time.

Or

It is a difference between receipts from both visible and invisible exports and payments for both visible and invisible imports of a country, it includes capital inflows and outflows for a given period of time. Balance of payments is a difference between the country's foreign exchange earnings and her foreign exchange expenditure in a given period of time.

If a country's foreign exchange expenditure exceeds foreign exchange earnings, such a country is a said to be experiencing unfavourbale balance of payment/BOP deficit.

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A country's foreign exchange earnings are greater than foreign expenditure, then such a country is said to be experiencing balance of payment / BOP surplus.

differentiate between balance of trade and terms of trade (02 marks)

b) Suggest any two ways of improving terms of trade in your country (02 marks)

COMPONENTS OF BALANCE OF PAYMENT ACCOUNT/STRUCTURE OF BALANCE OF PAYMENT ACCOUNT.

1. **Current account**

This is a summary of all transaction of a country involving the exchange of goods and services with other countries (both visible and invisible trade). It is of two forms i.e

a) **Visible trade account;** this shows the record all receipts from abroad on export of goods and all expenditure abroad on import of goods. When these are compared, this is called balance of trade

Balance of trade refers to the difference between the value of visible exports and value of visible of imports of a country

When the value of visible exports exceeds the value of visible imports, it is called favourable balance of trade.

When the value of visible imports exceeds the value of visible exports, it is called unfavourable balance of trade.

When the value of visible exports is equal to the value of visible imports, it is called balance of trade equilibrium.

b) ***Invisible trade account;*** this shows the record of all earnings from intangible exports rendered abroad and expenditure on intangible imports. These services may include banking, insurance, hotel and lodging , travel and shipping, tourism.

2. **Capital account**

This is a record of all transactions arising from capital inflows and outflows. For instance purchase of stock, bonds, treasury bills in another country, repayment of foreign loans, direct foreign investment, creation of real physical assets in another country, borrowing from abroad, investing in industrial production in another country. It records capital inflows and outflows.

Uganda liberalized its capital account in 1997. This has seen increased inflow of capital by Ugandans abroad and foreign private investments.

3. **Monetary/cash account.**

This is called official financing account. This records all ... to the change in country's foreign exchange reserves ... official reserves in response to inflows and capital movements.

It has items that help to Balance of Payment surplus ... such as lending to other countries, investing abroad ... foreclose short term Balance of Payment deficit. ... such as borrowing from abroad, selling state enterprises ... reserves may be held in foreign commercial banks, the ... held gold and special drawing rights with IMF.

4. **Errors and omissions account.**

This caters for unaccountable shortages or surplus on balance ... account to ensure that there is a balance in BOP. If the balance ... records are completed both sides of balance payment ... balance, but in reality the two sides may not balance because ... collection in relation to imports and exports.

It ensures that the credits and total debits of the ... balancing, therefore in accounting sense the three main ...

UNEB 2005

a) *Distinguish between balance of trade and balance of pay... (04 marks)*

b) *Explain the causes of balance of payment disequilibrium ... (16 marks)*

UNEB 2001, 1999

a) *Account for balance of payment problems in develop... (10 marks)*

b) *What reasons should be taken to solve the problem of balan... deficit in an economy? (10 marks)*

UNEB 2012

a) *What is meant by the balance of payments?*

b) *Account for the persistent balance of payments deficit in ... (16 marks)*

CAUSES OF BALANCE OF PAYMENT DEFICIT/DISEQUILIBRIUM OR CAUSES OF UNFAVOURABLEBALANCE OF PAYMENT IN LDCs.

This occurs where foreign exchange expenditure exceeds ... earnings. Causes of balance of payment deficit/disequilibrium ... from factors that lead to high foreign exchange expenditure ... exchange earnings.

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However, if a country's foreign exchange earnings are greater than foreign exchange expenditure, then such a country is said to be experiencing favourable balance of payment / BOP surplus.

UNEB 2010

a) Differentiate between balance of trade and terms of trade (02 marks)

b) Suggest only two ways of improving terms of trade in your country.
(02 marks)

COMPONENTS OF BALANCE OF PAYMENT ACCOUNT/STRUCTURE OF BALANCE OF PAYMENT ACCOUNT.

1. **Current account**

This is a summary of all transaction of a country involving the exchange of goods and services with other countries (both visible and invisible trade). It is of two forms i.e

a) **Visible trade account;** this shows the record all receipts from abroad on export of goods and all expenditure abroad on import of goods. When these are compared, this is called balance of trade.

Balance of trade refers to the difference between the value of visible exports and value of visible of imports of a country.

When the value of visible exports exceeds the value of visible imports, it is called favourable balance of trade.

When the value of visible imports exceeds the value of visible exports, it is called unfavourable balance of trade.

When the value of visible exports is equal to the value of visible imports, it is called balance of trade equilibrium.

b) ***Invisible trade account;*** this shows the record of all earnings from intangible exports rendered abroad and expenditure on intangible imports. These services may include banking, insurance, hotel and lodging , travel and shipping, tourism.

2. **Capital account**

This is a record of all transactions arising from capital inflows and outflows. For instance purchase of stock, bonds, treasury bills in another country, repayment of foreign loans, direct foreign investment, creation of real physical assets in another country, borrowing from abroad, investing in industrial production in another country. It records capital inflows and outflows.

Uganda liberalized its capital account in 1997. This has seen increased inflow of capital by Ugandans abroad and foreign private investments.

3. **Monetary/cash account.**

This is called official financing account. This records all transactions relating to the change in country's foreign exchange reserves in cash. It shows the official reserves in response to interest and capital accounts.

It has items that help to balance of payment Surplus (autonomous items) such as lending to other countries, investing abroad and items that help reconcile short term Balance of payment deficit (accommodating items) such as borrowing from abroad, selling state enterprises. Foreign exchange reserves may be held in foreign commercial banks, the central bank may hold gold and special drawing rights with IMF.

4. **Errors and omissions account.**

This caters for unavoidable shortages or surplus on balance of payment accounts to ensure that there is a balance in BOP. If the balance of payment records are completed both sides of balance payment statement would balance, but in reality the two sides may not balance because imperfect data collection in relation to imports and exports.

It ensures that the credits and total debits of the three accounts are balancing, therefore in accounting sense the three must always balance.

UNEB 2005

a) *Distinguish between balance of trade and balance of payments.*
(04 marks)

b) *Explain the causes of balance of payment disequilibrium in your country.*
(16 marks)

UNEB 2001, 1999

a) *Account for balance of payment problems in developing countries.*
(10 marks)

b) *What reasons should be taken to solve the problem of balance of payment deficit in an economy? (10 marks)*

UNEB 2012

a) *What is meant by the balance of payments?* *(04 marks)*

b) *Account for the persistent balance of payments deficit in your country.*
(16 marks)

CAUSES OF BALANCE OF PAYMENT DEFICIT/DISEQUILIBRIUM OR CAUSES OF UNFAVOURABLEBALANCE OF PAYMENT POSITION IN LDCs.

This occurs where foreign exchange expenditure exceeds foreign exchange earnings. Causes of balance of payment deficit/disequilibrium originate from factors that lead to high foreign exchange expenditure and low foreign exchange earnings.

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nation should be connected to the element of either ... change expenditure or decreasing/ low foreign exchange earnings

- **urable natural factors which reduce agricultural output for export.** This leads to fluctuations in the volume of exports. Export volume tends to reduce due to natural calamities such as drought which affect agricultural output for export hence low foreign exchange earnings.
- **Excessive profit and income repatriation.** High capital outflow in form of profit, dividends and income repatriation by foreign investors and expatriates hence storage of foreign exchange and increased expenditure abroad.
- **Protectionist policies of developed countries/trade restrictions on exports.** Developed countries tend protect their economies by use of tariff and non tariff barriers. This reduces LDCs export volume hence low foreign exchange earnings.
- **Persistent political instabilities leading to increased imports of military hardware.** Political unrest characterizing most LDCs leads to excessive government expenditure on imported military hardware defence equipment leading to high foreign exchange expenditure and limited investment to expand export volume.
- **Excessive government expenditure on diplomatic missions and travels abroad.** Excessive expenditure on bureaucrats and big delegations that travel abroad and foreign missions waste the scarce foreign exchange leading to increased foreign exchange expenditure.
- **Increased debt servicing problems due to constant borrowing.** LDCs are ever suffering with high external debt burden and its servicing leads to high capital outflow which leads to high foreign exchange expenditure.
- **Heavy dependence on exportation of primary products.** Due to low prices that such exports attract such as coffee and cotton because of low value added, there is limited foreign exchange earnings from such exports.
- **Limited markets for exports leading to flooding of international markets.** This is because LDC produce similar primary school-products, they sell in similar world markets thus flowing of international markets with agricultural products which leads to low export prices and limited foreign exchange earnings.
- **Increased importation of expensive capital and consumer goods.** Heavy importation of machinery drugs and vehicles against low priced exports due to limited import substitution industries increases foreign exchange expenditure.
- **Weak bargaining power of LDCs on the world market.** Prices of LDCs' exports are dictated by major external buyers who fix them at a lower level leading to low foreign exchange earnings.

- **low quality exports.** Exports are of low quality due to ... production and are less competitive on the world ... and low foreign exchange earnings.
- **Limited variety of exports/dependence on a few ...** Uganda rely on a few export crops such as coffee, ... price fluctuations on the world market, limited export ... goods hence low foreign exchange earnings.
- **Heavy reliance on expatriate manpower.** This is ... of expatriates who are highly paid using the foreign ... foreign exchange expenditure.

UNEB 2008, 2005

Mention any four effects of balance of payment deficit in an ... (04 marks)

EFFECTS OF BALANCE OF PAYMENT DEFICIT IN AN ...

- Reduces volume of imports.
- Results into disinvestment.
- Leads to high taxation on the citizens.
- Limited prospects of employment opportunities.
- Leads to currency depreciation.
- Increases shortage of foreign exchange/leads to deplet... scarce foreign exchange reserves.
- Leads to limited level of savings and investment.
- Retards economic growth.
- Inflationary tendencies may result.

UNEB 2014

a) *Account for the persistent balance of payments defici... (10 marks)*

b) *Suggest measures that should be taken to reduce ... deficits in your country.* (0...

MEASURES TO REDUCE BALANCE OF PAYMENT DEFIC...

NB. *These measures should aim at either increasing ... reducing foreign exchange expenditure and this should ... explanation.*

- **Establishment of export promotion industries.** ... establish industries to increase production for export ... what they cannot produce. This will in the long run ... of exports hence high foreign exchange earnings.
- **Devaluation of domestic currency.** This makes exp... makes imports expensive which increases foreign exch... reduces foreign exchange expenditure

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...sity export markets. This should be done through ...tion so as to increase the bargaining power on the world market, ... market for exports which increases foreign exchange earnings.

- **...et up import substitution industries.** Industries to produce the ...formerly imported goods should be established which reduces the volume of imports in the long run and encourage consumption of locally produced goods hence reducing expenditure abroad.
- **Proper manpower development/training.** This helps to reduce heavy expenditure on expatriates which reduces foreign exchange expenditure.
- **Promote political stability/create a conducive political climate.** Emphasis should be put on creation of a peaceful, stable and conducive political climate to reduce the huge expenditure on military hardware and encourage domestic investments to reduce importation hence less foreign exchange expenditure.
- **Use of trade restrictions on imports.** Tariff and non-tariff barriers should be imposed by LDCs to restrict imports such as high import duties on imported luxurious commodities. This will help to discourage some imports hence reduction in foreign exchange expenditure.
- **Strengthen international commodity agreements.** These help to set and fix favourable prices for LDCs' exports which increasing bargaining power leading to high export prices hence increasing foreign exchange earnings.
- **Reduce external borrowing and use of proper debt servicing methods.** External public debt burden should be reduced through debt rescheduling, debt negotiation for debt relief and debt cancellation leading to reduced foreign exchange expenditure.
- **Encourage use of barter trade arrangements.** This involves absence of money hence reduced expenditure abroad thus stabilizing balance of payment position by minimizing the use of foreign exchange.
- **Restructure foreign missions and diplomatic travels/limit expenditure on diplomatic travels and foreign missions.** Excessive expenditure by government bureaucrats on foreign travels and diplomatic missions should be limited so as to reduce capital outflow and save the scarce foreign exchange thus reduced foreign exchange expenditure.
- **Diversify products for export.** This involves production of a variety of exports and reduce over reliance on a few exports which expands export base thus increase in foreign exchange earnings.
- **Encourage liberalization of the economy.** This favourable trade policy increases production which leads to supply for exports which helps to increase foreign exchange earnings.

UNEB 2000

a) Explain the different forms of protectionism. (10 marks)
b) What are the implications of protectionism in an economy? (10 marks)

PROTECTIONISM IN INTERNATIONAL TRADE.

Protectionism refers to a commercial policy of restricting trade between countries through methods such as total ban, tariffs, quotas and foreign exchange control.

It is aimed at reducing dangers of international trade on an economy. It involves trade restrictions used by economies in international trade. The usually imposes trade barriers to the free movement of goods and services across its borders.

TOOLS OF PROTECTIONISM.

(Methods / ways of trade restrictions).

Tools of protectionism are instruments that are used to control foreign trade in an economy. They are of two categories;

- **Tariffs**

These are taxes imposed on either imports of exports. High import tariffs discourage importation and low tariffs encourage importation.
High export tariffs discourage exportation intended satisfy local demand and low export tariffs encourage exportation.

A tariff barrier is an international restriction involving the use of taxes.

Objectives of tariff barriers in an economy.

- To generate government tax revenue.
- To discourage dumping.
- To improve Balance of Payment position.
- To act as a beggar my neighbor policy.
- To protect domestic infant industries form foreign competition.
- To discourage importation of harmful and undesirable commodities.
- To reduce imported inflation.

- **NON TARIFF BARRIERS.**

These are restrictions employed in international trade which don't involve the use of taxes.
These may include;

a) ***Import quotas.*** This is the physical amount of goods that are permitted to be imported into a country in a given period of time. For instance a country may decide to import only 200 tonnes of sugar in a particular period. This is intended to control the volume of imports.

b) ***Total ban / trade embargo.*** This is where a country completely stops the importation of certain commodities for given reasons. For instance importation of marijuana was completely banned for health reasons.

c) ***Import licenses.*** This is where the government requires every importer to have a license. The government becomes selective and gives licenses to importers of essential commodities. This is intended to control the nature of imports.

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d) **Devaluation of the local currency.** This is used as a measure to reduce on importation since it makes imports very expensive and increase exportation since it makes exports relatively cheaper.

e) **Direct intervention.** This is where the government takes over importation of certain commodities and prohibits importers to clearly control the volume of imports and encourage local production.

f) **Direct administrative controls/regulations.** These are long administrative formalities aimed at discouraging direct importers for instance filling several forms, delay to clear items out of a bonded ware house. This is intended to control the volume of imports

g) **Subsidization of domestic industries.** This is done so as to enable infant industries grow, produce at a low cost internally and therefore charge low prices and will compete imported commodities and export cheaply.

h) **Quality control requirements.** Commodities to be imported are required to satisfy a certain quality standard. The government through bureau of standards recommends certain sanitary and health requirements to be met by the imported commodities and once they are not met the product cannot be traded.

i) **Special import deposits.** Importers are asked to deposit a certain amount of forex with the central bank before they are allowed to import certain commodities. This limits their ability to import and helps volume imports.

j) **Rationing of foreign exchange among importers.** The government reduces foreign exchange that is allocated to some importers or provide foreign exchange cheaply to some importers. The government through the central bank controls or allocates foreign exchange to be used in importation of particular commodities. This makes the government to have control over which commodities should be imported.

UNEB 2006, 2011

(i) What is meant by the term a tariff? *(01 mark)*

(ii) Mention any three non tariff barriers in your country. *(03 marks)*

FORMS OF NON TARIFF BARRIERS THAT UGANDA HAS IMPLEMENTED.

- Total ban.
- Subsidies to local industries.
- Use of Quotas.
- Administrative controls such as tight bureaucratic procedures.
- Manipulation of exchange rates.
- Qualify control measures.
- Licensing.

UNEB 1997, 2003

'protectionism rather than free trade should be adopted ... benefit from international trade' discuss

ADVANTAGES OF PROTECTIONISM IN AN ECONOMY

- **Protects domestic infant industries from unfair foreign goods.** Infant industries need to be protected ... of foreign improved cheap commodities until they ... they are large enough to enjoy economies of scale ... duties and improve quality.
- **Discourages dumping.** High import duties are imposed ... dumping because such cheap commodities destroy ... industries in countries where they are dumped and ... prices and supply since they are not constant thus ... industries to expand.
- **Creates and maintains employment opportunities ... economy.** Domestic jobs are created and maintained ... industries are subsidized and protected from foreign ... can lead to closure of some industries leading to ... and employment creation.
- **A source of government tax revenue.** Tariffs impose ... a major source of revenue to the government for natio...
- **Reduces foreign dependence on imports and ensures ...** leads to attainment of self reliance where import substi... are developed and imports are reduced through high im... ban thus promoting self reliance.
- **Guards against imported inflation.** This is done by ... of imports from countries suffering from inflation thro... import duties and total ban on goods from such countr...
- **Improves the country's Terms of Trade.** Restrictive ... quotas, total ban and high special import duties ... imports reduce their demand hence improving ter... country.
- **Improves on Balance of Payment position.** Trade re... reduce the volume of imports hence reducing ... expenditure which results into improvement in BOP po...
- **Discourages importation and consumption of harmf...** It prevents the importation of expired drugs and harm... high import duties, total ban hence protecting the ... living.
- **Encourages the use of domestic/local resources.** ... imported raw materials increase demand for local ra... their increased utilization
- **Acts as a retaliation measure towards trading par...** retaliate against tariffs imposed by other countri...

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countries as a way of retaliation/a beggar my neighbor policy in international trade.

- **Promotes innovations and creativity in the domestic economy.** Because commodities from abroad are restricted, entrepreneurs in the country devise means to modernize production to satisfy domestic demand which leads to technological development.
- **Reduces political domination and influence from abroad.** Protectionism reduces the influence of foreigners in the politics of the domestic economy thus encouraging independence while making political decisions.

UNEB 2008

(a) What is meant by term protectionism? (01 marks)

(b) Give any three reasons why there is need for protectionism in your country. (03 marks)

WHY IS THERE A NEED FOR PROTECTIONISM IN AN ECONOMY/REASONS FOR PROTECTIONISM IN AN ECONOMY/WHY IS IT NECESSARY TO ADOPT PROTECTIONISM IN AN ECONOMY.

NB: These are given as reasons but not as effects of protectionism.

- To improve the country's Balance of Payment.
- To guard against imported inflation.
- To promote employment opportunities at home.
- To minimize political influence from abroad.
- For retaliation purposes.
- To promote innovations and creativity at home.
- To provide government revenue through tariffs.
- To guard against importation and consumption of undesirable commodities.
- To encourage dependence on foreign goods and attain self sufficiency.
- To protect local infant industries form foreign competition.
- To discourage dumping.
- To improve on terms of trade.

DISADVANTAGES/NEGATIVE IMPACT OF PROTECTIONISM IN AN ECONOMY.

- **Leads to creation of monopoly in the domestic economy.** Local producers become monopolists due to limited competition, thus negative effects of monopoly on an economy such as consumer exploitation.
- **Increases government expenditure/costly for government to implement.** It increases supervisory costs, subsidizing domestic industries and other enforcement agencies thus budgetary deficits.
- **Leads to retaliation/beggar of neighbor policy form trading partners.** Other countries can also impose tariff and non tariff barriers on exports of the country and this retards trade between countries thus reducing benefits of international trade.
- **Encourages trade malpractices.** Increases smuggling/illegal trade and corruption especially at border posts. This occurs as people try to avoid high tariffs imposed on imports.
- **Some tools of protectionism reduce government tax revenue.** Various non tariff barriers such as import quotas, total ban and preferential treatment reduce tax revenue since they do not involve the use of taxes.
- **Reduces foreign exchange earnings.** This results from limited volume of exports which limit the level of development. The country may not enjoy all the benefits of international trade, therefore loss of item for surplus and reduced earnings from abroad.
- **Leads to persistant infancy of protected local firms.** Firms protected form foreign competition may not grow so as to benefit continuously form government support through subsidies thus limited industrial expansion which is very costly and dangerous to the economy.
- **Subjects nationals to highly priced goods.** Creates shortage of commodities at home hence consumption of highly priced commodities due to increase in costs of production in running domestic industries, in case of structural break down at home and due to limited imports, shortages are likely to occur hence inflation.
- **Subjects nationals to poor quality goods.** Low quality products are produced because domestic industries are protected from foreign competition thus poor standard of living.
- **Encourages international specialization and its advantages.** It becomes difficult for a country to get involved in what it can produce better and leave other commodities to be produced by other countries since countries may use tools such as total ban and export quotas thus limited benefits of comparative cost advantage.
- **Limits variety of goods.** Protectionism limits importation of various commodities which reduces consumers which reduces consumer's choice.

FREE TRADE.

Free trade refers to unrestricted exchange of goods and services between countries through absence of any form of government interference such as of tariffs, import quotas, total ban and foreign exchange control.

Or

It is a situation where there is absence of any form of government interference in form trade barriers such as quotas, import licenses, total ban in the flow of international trade. Free trade implies no intervention of the government in the flow of international trade which implies that importing and exporting of commodities is free.

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ADVANTAGES OF FREE TRADE IN AN ECONOMY.

- **Stimulates fair utilisation of resources/promotes a peak for surplus.** Domestic resources are put to use to benefit from the expanded world market.
- **Relieves the government of high expenditure on protectionism.** Protectionism is not necessary in free trade thus reduced expenditure on subsidies to local firms.
- **Encourages international specialisation and its benefits.** This reduces costs of production because a country can easily acquire what it does not produce efficiency.
- **Encourages more inflow of foreign exchange and resources.** This is because of limited control in acquiring foreign exchange and transferring of resources from one country to another.
- **Eliminates trade malpractices.** Since trade is free between countries there are no chances of spending on anti smuggling activities.
- **Widens market for a country's output.** The entire world becomes a market place for all produced commodities.
- **Encourages stiff competition in production hence high quality products are produced.** Competition is created between domestic industries and foreign products thus efficiency of local firms.
- **Discourages local monopoly tendencies.** Free trade leads to increase inflow of substitutes which limits growth of monopoly powers thus reduced dangers of monopoly.
- **Facilitates easy technology and development.** New and efficient methods of production are transferred from developed economies to developing economies due to absence of barriers in their transfer.
- **Increases international cooperation and mutual understanding between countries.** Trading countries enjoy international relationships and understanding which promotes more trade and inflow of foreign aid.
- **Eliminates possibility of beggar my neighbor policy/retaliation.** Free trade means no protectionist policies implying that chances of retaliation among countries in trade are reduced.
- **Expands employment opportunities.** Increased production to enjoy the opportunities of expanded market helps to create more job opportunities.

DISADVANTAGES OF FREE TRADE IN AN ECONOMY.

- **Promotes external dependence.** This results from high level of specialization and a country will be importing from other countries.
- **Results into damping.** Free importation leads to damping which retards the development of local industries.
- **Leads to consumption of harmful and undesirable imported products.** This is because there are no taxes to discourage their importation.

- **Encourages high capital outflow.** This arises in repatriation, desire to invest abroad by rich nationals.
- **Leads to collapse of domestic infant industries by competition.** Local firms are not competent by foreign producers in low costs and charge low prices.
- **Results into imported inflation.** Since there are no trade in high inflation prone economies, there are possibilities of such economies.
- **Leads to over underutilization of domestic resources.** National resources are over utilized to enjoy benefits of leads to their quick depletion.
- **Reduces government tax revenue.** Free trade does not imports and exports leading to loss of customs duty.
- **Worsens unfavourable balance payment position.** expenditure observed in most developing countries exchange earnings due to limited volume of exports imports.
- **Leads to political and economic domination by foreign** leads to increased dependence on MDCs by LDCs domination which undermines political sovereignty of

UNEB 2010

(i) What is meant by dumping?

(ii) State any three effects of dumping in the recipient country.

DUMPING.

Dumping is the selling of commodities in foreign markets than those charged in the local market.

Positive Effects Of Dumping In The Recipient County.

- Cheap goods are availed to consumers.
- A variety of goods are availed to consumers.
- Increases government tax revenue when dumped goods

Disadvantages Of Dumping In The Recipient County.

- Local producers are out competed thus collapse of
- Inferior goods are sold to consumers.
- Promotes external dependence.
- Leads to underutilization of local resources where
- Discourages local initiatives/investment.
- Leads to employment.

DEVALUATION.

Devaluation is a legal/official reduction of the exchange currency in terms of value of other currencies. It is reduce Balance Payment defici. It can be carried out fixed exchange rate system with the purpose of

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...ncing imports. When a currency is devalued, it becomes cheaper in terms ...f other currencies.

...evaluation increases the domestic currency price and reduces the foreign ...currency price.

...evaluation increases the value of exports by making them cheaper and ...ncourages the volume of imports by making them more expensive which ...roves balance of payments deficit of a country. Between 1981 and 1986 ...he government repeatedly devalued the Uganda shilling in an effort to ...stabilise the economy.

...or instance in order to make national exports cheaper and more ...competitive on the world market, the Uganda shilling was devalued in 1987 ...y frequent mini devaluations in the previous years.

...n May 1987, Uganda devalued the currency by 77% and in July 1988, it ...was devalued by 60%. With current liberalisation of foreign exchange market ...this end is no longer used in Uganda.

UNEB 1999

(a) *What is meant by devaluation?* (01mark)

(b) *Given that the exchange rate is 1£ = 1000 shillings. Calculate the new exchange rate after devaluation of the shilling by 20%.* (03marks)

New exchange rate = 1,000 + (20,000 x 1,000)
1000 + 200

New exchange rate = 1£ = 1,200 Ug shillings

This implies that after devaluation, a shilling becomes cheaper compared to a pound and a Ugandan importer finds it difficult to import from countries where pounds are used but it becomes easy for those countries using pounds to import from Uganda.

Devaluation therefore makes exports of the devaluing country cheaper and imports expensive. This helps to increase foreign exchange earnings form exports and reduces foreign exchange expenditure on imports which helps to reduce balance of payment problems.

Worked example

If the country's current exchange rate is US$ 1 = 1800 Ug shillings, and if there is a 40% devaluation of the shilling. Calculate the new exchange rate.

New exchange rate = 1800 + (40/100 x 1800)

New exchange rate = $1 = 2520 Ug shillings

After devaluation, with a few dollars, foreigners can buy more quantity of exports of the devalued currency but with the same amount of the devalued currency, people can import less quantity from where dollars are used.

Reasons/Objectives Of Devaluation.

- To reduce imports since they become expensive.
- To reduce BOP problems in the long run increasing foreign exchange earnings and reducing foreign expenditure.
- To encourage domestic production by attracting both local and foreign investments.
- To increase foreign capital inflow.
- To increase government revenue by expanding tax base.

CONDITIONS/REQUIREMENTS NECESSARY FOR SUCCESSFUL DEVALUATION IN AN ECONOMY.

- ***Demand for exports should be price elastic in order to increase foreign exchange earnings.*** This implies that a small decrease in the price of exports resulting from devaluation should lead to a very big increase in quantity demanded for exports and increase the volume of foreign exchange earnings.

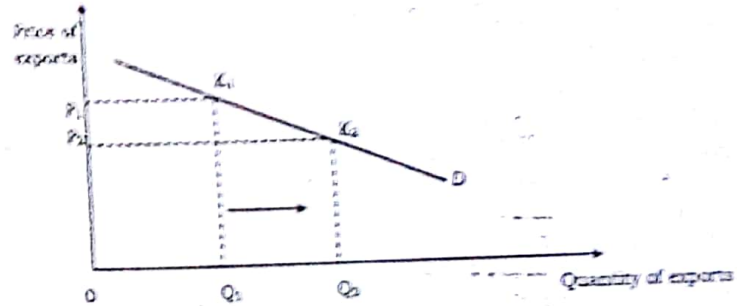

Figure 12.1: effect of devaluation on exports and foreign exchange earnings

Before devaluation, the country's foreign exchange earnings from exports are $OP_1K_1O_1$. After devaluation that caused the fall in price of exports from OP_1 to OP_2, more exports are demanded thus generating more foreign exchange income to $OP_2K_2Q_2$

After devaluation, price of exports reduces from OP_1 to OP_2 implying that quantity demanded for exports increases from OQ_1 to OQ_2 leading to increased foreign exchange earnings from $OP_1K_1Q_1$ to $OP_2K_2Q_2$.

- **Demand for imports in the devaluing country must be price elastic in order to reduce foreign exchange expenditure.** In this case, a small increase in the price for imports resulting from devaluation leads to a big decrease in the quantity demanded for imports.

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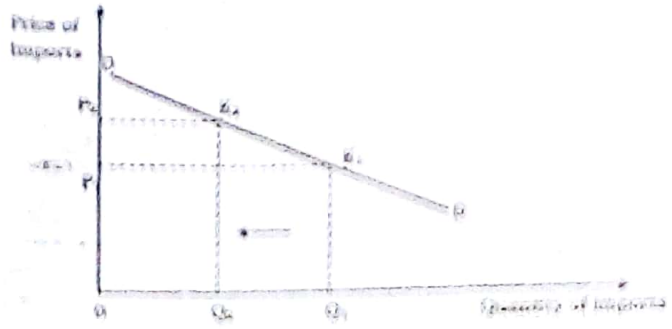

Figure 12.2: effect of devaluation on imports and foreign exchange expenditure

Before devaluation, a country was spending foreign exchange on imports equivalent to $OP_2K_2Q_2$ which is a large expenditure.

After devaluation, foreign exchange expenditure on imports reduces because of a rise in price of imports from OP_2 to OP_1 and so a country only spends $OP_1K_1Q_1$ which is a less expenditure.

- **Supply of exports in the devaluing country should be price elastic.** This implies that as demand for exports increases, the country must have the capacity to respond very quickly and increase supply of exports to increase foreign exchange earnings.
- **There should be absence of competitive devaluation.** Other countries in the same region producing the same commodities should not devalue at the same time because this does not make exports cheaper than those of competitions. There should be retaliation by other trade partners in devaluing their currencies.
- **The country devaluing should be free from inflation.** This is because inflation makes exports expensive and hence less attractive in the foreign market. This is intended to increase foreign exchange earnings.
- **The exchange rate in the devaluing country should be a fixed exchange rate.** This is because it is stable and predictable and hence encourages long term transactions to take place and it does not encourage speculation in the exchange rate system so as to increase supply of exports.
- **The devaluing country should be producing at excess capacity.** It should be producing at excess capacity so that production and supply of exports increase when demand increases thus increased foreign exchange earnings.
- **There should be absence of trade restrictions on exports of devaluing country** to increase export volume. In other words there should be no trade barriers between trading partners so as to increase the volume of exports and foreign exchange earnings.

REASONS WHY DEVALUATION FAILS TO ACHIEVE ITS ...

LDCs (Why does the use of devaluation policy fail to ... payment problem in developing countries.)

Devaluation in most developing countries has failed to ... objectives. This is due to the following reasons:

- **Exports of LDCs have inelastic demand.** Even if the ... reduce by a very big percentage, the demand for ... increase by the same percentage because of price ... quality which does not increase foreign exchange earnings.
- **Supply of exports of LDCs is price inelastic.** This is ... of exports whenever demand increases which limits ... earnings.
- **Demand for imports of most LDCs is price inelastic.** ... if prices for imports increase by a very big margin for ... reduce by the same margin because of high prices ... import which may not reduce foreign exchange expenditure.
- **Persistent inflation in most LDCs.** This increases ... which leads to high prices for exports and reduces ... earnings.
- **Competitive devaluation.** Where competing countries ... devalue at the same rate makes devaluation unsuccessful.
- **There are various trade restriction on exports** ... import quotas, total ban and this limits the ... countries' exports and reduces foreign exchange earnings.
- **Exportation of same poor quality primary products** ... countries export the same poor quality products and ... cannot compete favourably on the international market ... prices reduce.
- **High marginal propensity to import in most LDCs.** ... for the essential commodities and capital goods because ... produce them locally. This increases foreign exchange ... fails devaluation policy.
- **Most developing countries have liberalised the ... rate/system** and yet devaluation works successfully ... exchange rate system. Unstable exchange rate in LDCs ... term planning.
- **Weak administrative machinery to coordinate ... devaluation policy** i.e. incompetence of policy makers ... failure to effectively implement devaluation and increase ... export.

UNEB 1998

a) *Distinguish between devaluation and currency depreciation.*

b) *Why may devaluation fail to achieve the objectives ... economy? (10 marks)*

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REASONS WHY THE USE OF DEVALUATION MAY FAIL TO SOLVE BALANCE OF PAYMENT PROBLEM IN AN ECONOMY.

- There may be weak administrative machinery in the devaluing country to coordinate and implement devaluation policy.
- Consumers in the devaluing country may be having high marginal propensity to import.
- Exports of the devaluing country may be of poor quality and various get enough market abroad.
- Exchange rate in the devaluing country may be unstable.
- The devaluing country may have reached full payment level of resources which may limit supply of exports to meet high demand in external markets.
- Demand for exports of the devaluing country may be price inelastic.
- Demand for imports of the devaluing country may be inelastic.
- There may be existence of competitive devaluation between competing countries.
- Supply of exports in the devaluing country may be price inelastic.
- The devaluing country may be affected by inflation which increases cost of production.
- There may be use of trade restrictions on exports of the devaluing country.

UNEB 2000

(i) Distinguish between devaluation of a currency and depreciation of a currency. (02 marks)

(ii) State any two merits of currency devaluation in an economy. (02 marks)

UNEB 2001

(i). Distinguish between deflation and devaluation. (02 marks)

(ii) Mention any two effects of devaluation in an economy. (02 marks)

EFFECTS OF DEVALUATION IN AN ECONOMY

- **Increases volume of exports.** It is an instrument of commercial policy which expands on the demand for a country's exports and creates a large market.
- **Increases foreign capital inflow/foreign investors.** Foreign investors undertake greater investments because of a large market created for exports.
- **Increases foreign exchange earnings.** It earns greater exchange to the country which is used to import the required capital equipments and facilitate the overall development programmes.
- **Improves on balance of payment position.** This is affected by increasing foreign exchange earnings from exports and reducing foreign exchange expenditure on imports.
- **Reduces the volume of imports.** There is reduced importation due to increases prices of imports.
- **Increases domestic production.** Export promotion industries are expanded to produce high output for export.
- **Leads to retaliation by trading partners.**
- **Causes inflation in the domestic economy.**

EXCHANGE RATE SYSTEM

Exchange rate system is the rate at which a country's currency is exchanged for other currencies in a foreign exchange market. This is the price of a country's currency in relation to other currencies in a foreign exchange market.

Some currencies are easily converted into other currencies and are readily acceptable for use in international transactions such as US dollars, British pound sterling, Japanese yen and such currencies are called **hard currencies/convertible currencies.**

Other currencies are not easily convertible into other currencies because they are not accepted in many countries in international transactions for instance Uganda shilling.

Countries involved in international trade use currencies other than their own and therefore exchange rate is necessary because countries must be paid in their own currency when trading together.

International trade makes it necessary for one country to demand for foreign currency. For instance the Ugandan importer of vehicles form United States of America would need dollars.

UNEB 2007

(i) Distinguish between a managed exchange rate and a floating exchange rate. (02 marks)

(ii) State any two advantages of adopting a floating exchange rate in your country. (02 marks)

TYPES OF EXCHANGE RATE SYSTEM

1. Floating/flexible/free exchange rate system

This is one where the rate at which the local currency exchanges for other currencies is determined by market forces of demand and supply in foreign exchange market.

It is the one in which the price of the domestic currency in terms of other currencies is determined by the interaction of the forces of demand and supply in foreign exchange market. There is no intervention form monetary authorities.

The value of the currency in terms of other currencies is determined by the operation of market forces in the foreign exchange market.

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Usually a flexible exchange rate system results into an equilibrium exchange rate by forces of demand and supply.

An equilibrium exchange rate is where the demand for a currency is equal to its supply.

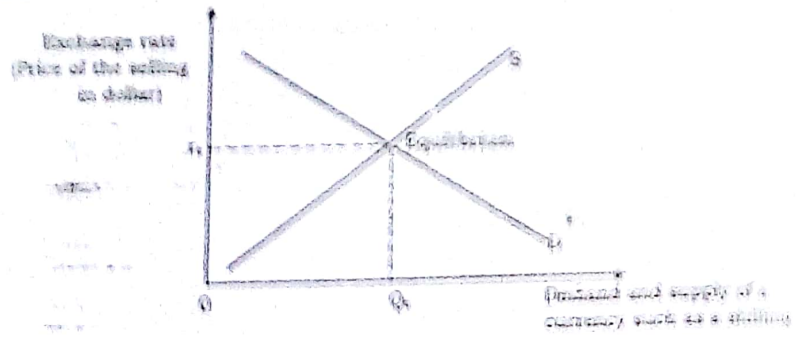

Figure 12.3. A flexible exchange rate system

e_0 is the equilibrium exchange rate

forces of supply of a shilling interact with forces of demand for a shilling to determine the equilibrium exchange rate e_0

Q_0 is the equilibrium quantity demanded and supplied of a currency

Advantages Of A Flexible Exchange Rate.

- Enables a country to generate adequate amount of foreign exchange from transactions, grants and loans.
- Enables a country to pursue an independent monetary policy which is not influenced by external forces.
- Provides an automatic mechanism for reducing balance of payment problems and does not require official administration.
- It is cheaper to administer. Does not required the country to maintain a large foreign exchange reserve to correct any imbalance if foreign exchange rates are moving freely.
- Encourages investments into the country because they can trade freely.
- Gives a more realistic value of the domestic currency in relation to the value of other currencies.

Disadvantages Of A Flexible Exchange Rate.

- Encourages speculation in the foreign exchange market because people keep idle waiting for capital gains.
- Makes planning difficult especially the quantities to be exported because of constant instability in exchange rates.
- Creates economic instability in the value of the currency because of constant fluctuations.
- Fails to correct Balance of Payment deficit when the demand for imports is greater than the demand for exports.
- It leads to currency depreciation.

- Leads to imported inflation.

CURRENCY DEPRECIATION.

This refers to a fall/decrease in the exchange value of a currency in relation to foreign currencies as a result of the forces of demand and supply in foreign exchange market.

Or

It refers to a fall/decrease in the exchange value of a currency in relation to foreign currencies under a flexible exchange rate system when its demand falls relative to its supply leading to its depreciation under a floating exchange rate.

UBSB 2002, 2011

(i) Distinguish between currency devaluation and currency depreciation. (02 marks)

(ii) Give any three effects of currency depreciation in your economy. (03 marks)

Merits Of Currency Depreciation In An Economy.

- It makes exporters recover higher local currency amounts.
- Encourages foreign investment / increases foreign capital.
- Export produces prices increase hence stimulating production.
- Increases the volume of exports which reduces balance of payment problems.

Negative Effects Of Currency Depreciation In An Economy.

- Leads to inflation/rise in prices of goods and services in the economy.
- Projected planning is made very difficult.
- Worsens external debt burden because the government has to pay more foreign loans since foreign currencies become more expensive.
- Causes a lot of speculations in foreign exchange markets as people expect further rise in prices of foreign currencies the more the currency depreciates the more.
- Makes imports expensive thus unfavourable terms of trade.
- Discourages investment.

CURRENCY APPRECIATION.

This refers to a rise in the exchange value of a country's currency in relation to other currencies under a floating exchange rate system when its demand increases relative to its supply leading to its shortage.

2. Fixed/pledged exchange rate

This is one where the rate at which the local currency is exchanged for a particular foreign currency is fixed by the central monetary authority.

Or

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is one which is determined by monetary authorities in relation to a ticular foreign currency. No one is therefore supposed to sell below or e it. The central bank intervene in the foreign exchange market exchange rate is normally fixed in terms of hard currencies such as nd sterling

EB 2000, 2004

Distinguish between a fixed exchange rate and a managed exchange rate (02 marks)

Mention only two merits of a fixed exchange rate (02 marks)

rits Of A Fixed Exchange Rate.

- Discourages speculation in foreign exchange market and minimizes exchange rate uncertainties.
- Stabilizes incomes of exporters. It is stable and predictable and hence encourages trade transactions to take place since it exporters certainty and confidence.
- It is used to control inflation/ stabilizes price in an economy.
- Stabilizes the value of domestic currency/reduces currency depreciation.
- Encourages long term planning.
- Minimizes capital outflow.
- Encourages production and investment which promotes economic growth.

emerits Of A Fixed Exchange Rate System.

- It is very expensive to administer. Requires serious administrative network in monitoring and supervision and this is costly to the government.
- Does not show the actual purchasing power of the domestic currency in terms of other currencies.
- Discourages foreign investment which increases unemployment because it limits high inflow of foreign investors.
- Results into overvaluation of the domestic currency. Sometimes the exchange rate may be overvalued by the central bank.
- It is bureaucratic and causes delays in trade.

URRENCY REVALUATION.

t refers to a legal/official increase in the exchange value of a country's currency in terms of other currencies.

Or

This refers to an increase in the exchange value of a country's currency in terms of other currencies fixed exchange rate system.

Worked example

a) Given that the exchange rate in a country is 1US dollar = 1000 shillings. Calculate the new exchange rate after revaluation of a shilling by 20%.

1000 – (20/ 100 x 1000)
1000 – 200
= 800 shillings
New exchange rate = 1 Us dollar = 800 shillings

b) Given that the exchange rate in a country is €1 = 3000 shillings. Calculate the new exchange rate after revaluation of a shilling by 40%

New exchange rate = 3000 – (40/ 100 x 1000)
3000 – 1200 = 1800shillings
New exchange rate € 1 = 1800 shillings

CURRENCY OVERVALUATION.

This is the fixing of the exchange value of a country's currency by the central monetary authority above the equilibrium exchange rate.

Or

This is where the exchange rate of a currency is fixed by the central monetary authority above the exchange rate determined by interaction of forces of demand and supply of a currency.

Demerits Of Currency Overvaluation.

- Reduces volume of exports.
- Worsens balance of payment problems.
- Discourages domestic production.
- Increases imports.
- Reduces capital inflow.

CURRENCY UNDERVALUATION.

This refers to the fixing of the exchange value of a country's currency by the central monetary authority below the equilibrium exchange rate.

UNEB 2008

(i) Distinguish between currency revaluation and currency undervaluation. (02 marks)

(ii) State any two effects of currency undervaluation. (02 marks)

Effects Of Currency Undervaluation.

- Improves balance of payment position.
- Reduces volume of imports.
- Increases exportation of goods.
- Increases foreign capital inflows.

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- Encourages domestic production

UNEB 2001

(i) Distinguish between managed exchange rate system and floating exchange rate system. (03 marks)

(ii) State any two advantages of a managed exchange rate system. (02 marks)

3. Managed or Dirty float exchange rate.

This is one in which the exchange rate is allowed to fluctuate within certain limits determined by the central monetary authority.

Or

This is one in which forces of demand and supply are left to determine the rate which the local currency exchanges for other currencies but within certain limits set by central monetary authority.

The exchange rate is not fixed at one point but simply fluctuates between certain rates.

Advantages Of Managed Exchange Rate.

- It safeguards importers and exporters from rapid and unfavorable fluctuations in earnings.
- It controls the actions of speculations.
- Ensures a favourable exchange rate on the market.
- Enables monetary authorities to maintain control over exchange rate.

4. Dual exchange rate.

This is one where two exchange rates for priority and non priority imports operate side by side in the foreign exchange market.

A high exchange rate is always fixed for the importers of luxurious commodities and a lower exchange rate is fixed for importers of essential commodities. For instance Obote II government introduced window I for priority importers and window II non priority importers but later merged the two exchange rates.

Advantages Of A Dual Exchange Rate.

- Encourages importation of priority goods.
- Provides foreign exchange to different forms of importers.
- Promotes growth of infant industries.
- Promotes investment in the domestic economy.

NB. In July 1990, Uganda liberalized foreign exchange markets and the exchange rates over the period have been deteriorating in relation to US dollar. For instance in 1995 Ug shillings per us dollar was shs 988.6 and in 2011 it reached at shs 2675.3 (general rates).

The exchange rate system in Uganda has come from a highly regulated one to one that is highly market oriented. This has led to establishment of a wide variety of forex bureau and increased role of commercial bans in trading foreign currency.

UNEB 2005

Mention any four factors that determine demand for currency in your country. (04 marks)

FACTORS THAT DETERMINE/INFLUENCE DEMAND FOR FOREIGN CURRENCY.

NB: Neutral points must be presented

- Price of imports.
- Debt servicing requirements.
- Volume of exports.
- Level of capital out flow.
- Degree of speculation in foreign exchange market.
- Volume of imports.
- Price of exports.
- Need to accumulate foreign reserves.
- Central bank interventions.

FOREIGN EXCHANGE RATE CONTROL.

This is where the central monetary authority regulates local currency exchanges for foreign currencies. It controls the factors that determine the rate of exchange in a system. It can either be full or partial exchange rate control. The government fixes the exchange rate and controls transactions involving foreign currencies. The central bank is chief controller of foreign exchange.

UNEB 2011

(i) What is meant by the term "foreign exchange rate"

(ii) Mention any three objectives of foreign exchange rate

Objectives Of Foreign Exchange Control In a Country

- To check on capital outflow or flight.
- To control the importation and consumption of certain goods.
- To control speculative activities in foreign exchange.
- To protect domestic infant industries against foreign competition.
- To acquire foreign exchange for servicing the country's debts.
- To encourage and facilitate long term planning.
- To encourage investment.
- To control inflation/ensure price stability.
- To correct unfavourable balance of payment position.
- To raise revenue for government.
- To ensure availability of foreign exchange so as to import.
- To stabilize exchange rates/to iron out temporary fluctuations in exchange rates.

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UNEB 2003

a) Distinguish between a floating exchange rate and a fixed exchange rate. (04 marks)

b) Explain the events and elements of foreign exchange rate control in an economy. (16 marks)

Merits Of Foreign Exchange Rate Control In An Economy.

- Ensures stability in the value of domestic currency by controlling inflation.
- Encourages investment because of stability and easy accessibility of foreign exchange.
- Minimizes capital outflow through encouraging investors especially in the long run.
- Encourages long term planning since the value of domestic and foreign currencies tends to be stable.
- Ensures stability in the incomes of exporters by safeguarding exports from constant price fluctuations.
- Helps to prevent importation and consumption of undesirable commodities.
- Protects domestic infant industries from foreign competition. This is because restriction of forex to import foreign goods.

Demerits Of Foreign Exchange Rate Control In An Economy.

- Reduces the volume and value of international trade especially due to ability to restrict imports and exports.
- Breeds black marketing in foreign exchange market. This arises when there is hoarding of foreign currency in order to create shortages and raise profit margins.
- It is expensive to enforce. This is because it normally requires the central bank to have large amount of reserves which may not be available.
- Promotes retaliation in foreign trade and this discourages production.
- Causes delays in trade because it is very bureaucratic in its operation.
- Causes inefficiency and corruption among the people concerned with its administration.
- Discourages foreign investments because of unnecessary bureaucracy in securing foreign exchange.

UNEB 2005

a) Distinguish between a managed rate and a free exchange rate. (04 marks)

b) Explain the factors which determine the exchange rate in a money market. (16 marks)

FACTORS THAT INFLUENCE/DETERMINE/AFFECT EXCHANGE RATE IN A MONEY MARKET.

NB. These are presented as political factors and explained in two sides showing a positive side which strengthens the value of the currency and a negative side which weakens the value of the domestic currency in relation to other currencies.

- **Level of capital outflow and inflow.** The higher the rate of capital outflow the weaker the currency because it leads to depreciation of the domestic currency and the higher the rate of capital inflow the stronger the currency because it leads to appreciation of the domestic currency.
- **Rate of inflation in other economies.** The higher the rate of inflation in foreign economies the stronger the domestic currency and the lower the rate of inflation in other economies the weaker the domestic currency.
- **Volume of imports.** The higher the volume of imports the weaker the currency and the lower the volume of imports the stronger the currency.
- **Volume of domestic output.** The higher the volume of domestic output the stronger the currency and the lower the volume of domestic output the weaker the currency.
- **Rate of domestic money supply.** The higher the rate of domestic money supply the weaker the currency and the lower the rate of domestic money supply the stronger the currency.
- **Volume of exports.** The higher the volume of exports the stronger the currency and the lower the volume of exports the weaker the currency.
- **Level of foreign exchange reserves.** The higher the foreign exchange reserves, the stronger the currency and the lower the foreign exchange reserves the weaker the currency.
- **Demand and supply of foreign exchange.**
- **Government policy on exchange rate.** For instance in case of pegged exchange rate.
- **Political climate**

UNEB 2003

a) Define the term commercial policy. (01 mark)

b) State any three instruments of commercial policy in your country. (03 marks)

COMMERCIAL POLICY.

This refers to the deliberate attempt by the government to influence, control and direct the value and volume of both internal and foreign trade in an economy.

Commercial policy refers to a set of measures taken by the government to influence, control and direct the volume and value of both internal and foreign trade in an economy.

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OBJECTIVES OF COMMERCIAL POLICY.

- To increase gains from trade.
- To maintain balance of payment equilibrium.
- To achieve rapid industrialization and accelerate employment opportunities.
- To attract foreign investors into a nation.
- To encourage exports.
- To discourage given imports.
- To stabilize exchange rates.

Instruments of commercial policy.

- Taxation/tariffs especially on substitutes.
- Licensing.
- Total ban banning substitutes.
- Quality controls.
- Devaluation.
- Subsidization.
- Import quotas.
- Direct administrative control regulations.
- Trade agreements.
- Manipulation of exchange rates/foreign exchange control.

FOREIGN RESERVES/FOREIGN EXCHANGE RESERVES.

This refers to total value of all gold, dollars and special drawings rights held by a country as both a reserve and a fund from which international payments can be made. For instance in form of US dollars, gold reserves and special drawing rights from IMF, bonds and treasury bills bought from abroad.

Foreign reserves are made of gold or specific currency, marketable securities in foreign currency such as treasury bills, government bonds, equities and foreign currency loans.

***NB. Special drawings rights** are financial assets created by IMF which give holders unconditional drawing rights.*

Or

Special drawings rights are financial assets created by IMF and are held by member countries as part of the international reserves meant to increase international liquidity of member countries.

Sources of foreign reserves/how are foreign reserves acquired.

- Selling of government property abroad.
- Private foreign investments abroad.
- Foreign aid in form of grants and external borrowing.
- Capital inflows from IMF, foreigners wishing to buy shares and bonds within the country.

Importances of foreign exchange reserves in an economy.

- Used to pay debts/payment of external debts.
- Used to import goods.
- Used in importing capital goods.
- Paying salaries of expatriates.
- Financing diplomatic missions and travels abroad.
- Used to establish investments abroad.
- It is used to make contributions to international agencies such as United nations.
- Used for lending to other countries, provision of grants and donations.

ECONOMIC INTEGRATION / COOPERATION.

Refers to the joining together of two or more countries in a given region to the aims of mutual economic benefits of all member states. It aims at increasing benefits of international trade and later result into political cooperation. It involves several countries agreeing to have a number of economic and other activities in common that can later result into political cooperation. Two or more countries agree to cooperate with each other by removing obstacles or restrictions in their trading relationship to maximize benefits from trade.

Examples of economic integration (economic blocs) in the world include;

1. **COMESA;** *Common Market for Eastern and Southern Africa.* This is the successful economic cooperation in Africa with a proven trade record achievements with member countries such as Uganda, Egypt, Sudan, Zambia, Sudan, DRC, Kenya, Tanzania, Burundi among others.
2. **EAC;** East African Community
3. **ECOWAS;** *Economic Community of West Africa States*
4. **EEC;** European Economic Community

UNEB 2004

State any four conditions necessary for the success of regional economic integration (04 marks)

CONDITIONS NECESSARY FOR SUCCESSFUL ECONOMIC INTEGRATION.

- Intending countries should be relatively at the same level of development to avoid resource distribution imbalances. This enables them to share benefits and costs equally.
- Intending countries should be geographically close to each other (share common borders) so as minimize costs of transport and other barriers.
- All member countries have the same or related political and economic ideologies i.e. either capitalist or socialist so as to avoid conflicts.
- There should be well developed infrastructural network connecting the countries so as to facilitate easy movement of goods, telecommunications, roads and railways.

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- All member countries should be ready to maintain good political ties between themselves. There should be good political ties and working relations among member countries.
- All member countries should preferably be of the same population size / market size in order to share equally the benefits of integration.
- Comparative advantage must exist among trading partners to allow specialisation on different products. There should be differences in resource endowments to have different production capacities which helps to produce different goods.

STAGES/TYPES/FORMS OF ECONOMIC INTEGRATION

Economic integration is classified according to its level of development as follows:

1. **Preferential trade area (PTA)** this occurs where member countries reduce tariffs among themselves on some selected commodities. Countries give preferential treatment in regard to tariffs charge on given commodities.
2. **Free Trade area.** This occurs where member countries eliminate all tariffs between themselves but continue to charge different tariffs on goods from non member countries.
3. **Customs Union.** This is where is free trade among member countries and adoption of common/ similar tariff structure on goods from non member countries. At this stage, in addition to eliminating all the tariffs between themselves, countries adopt common or uniform tariff n all goods from non member countries.
4. **Common Market.** this is where there is free trade among member states with a common/ similar tariff structure on goods from non member states plus free movement of factors of production among member states.
   This occurs when all countries abolish all tariffs among themselves adopt a common tariff against non member countries and there is free movement of factors of production.
5. **Economic Union or Community.** This is where there is free trade among member states with a common/similar tariff structure on goods from non member states plus free movement of factors production among member states and joint running of common services.
   At this stage, all the elements of the common market are in place and in addition there is joint economic planning, joint ownership of certain enterprises and facilities such as industries, roads, postal services.
6. **Monetary union.** This is where there is free trade among member states with a common/similar tariff structure on goods from non member states plus free among movement of factors of production among member states, joint running of common services and adopting a single currency for the region.

A common currency is [illegible] the value of [illegible] but with the same exchange rate or value for [illegible] Economic Community use [illegible] as their currency.
Member countries adopt and harmonize monetary and [illegible]

CHARACTERISTICS/FEATURES OF AN ECONOMIC UNION

- Sharing of common services/joint ownership of certain [illegible] facilities.
- Use of a common currency hence a monetary union.
- Joint economic planning/harmonized economic policies [illegible] problems are dealt with jointly.
- Common external tariff structure.
- Free movement of goods and services/free trade within the [illegible]
- Free movement of factors of production with the region.
- Strong regional institutions.

UNEB 1998, 2010

a) What is meant by regional economic integration? (2 marks)
b) Examine the merits and demerits of economic integration. (8 marks)

UNEB 1998

a) Distinguish between the following:

- *Preferential trade area and free trade area*
- *Customs union and common market*

b) Examine the merits of regional economic integration. (Please)

UNEB 2014

(i) Distinguish between a customs union and a common [illegible] (02 marks)
(ii) State any two benefits of economic integration to your country. (0[illegible]

ADVANTAGES OF ECONOMIC INTEGRATION/COOPERATION

- **Leads to trade creation effect.** Trade creation is when [illegible] integration results into a shift of trade from high cost member [illegible] to low cost member countries. This increases benefits of [illegible] economic integration, trade shifts from inefficient and high [illegible] member country to efficient and low cost member country [illegible] a change in tariffs and non tariff barriers which enable [illegible] acquire cheap commodities within the union compared [illegible] form non member countries.
- **Stimulates establishment and expansion of [illegible] industries.** manufacturing sector expands because [illegible] resource base and expanded market thus promoting industrialization.
- **Better quality products are produced.** Increases competition production among member countries especially where [illegible] commodities are produced hence improved quality of output.

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- **Leads to easy access to foreign resources/aid.** Bilateral and multilateral donors prefer lending to integrated countries than to a single country thus increased benefits of foreign aid.
- **Leads to market expansion/creation of a wider market which increase investment.** Market for goods and services expands when trade restrictions are removed hence increasing gains from trade.
- **Encourages joint research at a cheaper cost/leads to sharing costs of research.** Research and collection of information jointly is possible as a result of which leads to innovations and inventions in production which increases production levels.
- **Increases bargaining power of member countries on world market.** This leads to fair trade policies with non member countries thus high export prices and increased earnings from exports.
- **Leads to joint provision of common services/infrastructure.** Countries share common services such as roads, railways, postal and telecommunication services. It leads to joint sharing and running of such services hence infrastructure development.
- **Eases trade by use of the same currency.** When countries start using the same currency, trade goes on smoothly since there are no problems/complications of converting currencies.
- **Promotes political cooperation and mutual understanding among member states.** This promotes peace and harmony and inter-state cooperation within the region necessary for economic development.
- **Increase employment opportunities.** This arises from the fact that factors of production can freely move within the region and this enhances mobility in the region especially labour which redistributes income.
- **Opens room for specialization among member states.** This is because each member country is supposed to specialize in certain industries and later exchange for what they do not produce on the basis of comparative advantage.
- **Provision of low priced goods.** Member countries enjoy cheaper priced goods due to abolition of taxes and other unnecessary expenses on borders hence reduced general price level.
- **Reduces costs of duplication of goods/resources.** One industry is established in one country to serve the whole region and this increases gains from international trade reduced resource wastage.
- **Increases volume of output leading to economic growth.** More output is realized due to joint production leading to increased economic growth.
- **Increases resource utilization thus vent for surplus.** This results from expanded market and combined development efforts among member states leading to exploitation of formerly idle resources.

- Increases in the volume of trade within the region.
- Widens choice from a variety of commodities produced.
- Saves scarce foreign exchange for importing goods experiencing trade (the region).
- Employment creation/high among member countries.
- Expands employment opportunities.
- Promotes investment within the region where factor inputs are more than outside the region.

(iii) What is meant by economic integration?
(iv) Examine the merits and demerits of economic integration.

DISADVANTAGES OF ECONOMIC INTEGRATION.

- **Leads to trade diversion.** Trade diversion is where customs integration results into a shift of trade from low cost non member countries to high cost member countries. This reduces benefits of trade. After economic integration, trade shifts from efficient and low cost non members states to inefficient and high cost member states who produce cheap goods from non member states.
- **Leads to production of poor quality goods.** Member countries are compelled to buy commodities of poor quality from member states instead of importing better ones from non member countries. This reduces welfare.
- **Leads to uneven distribution of industries.** This leads to unequal benefits from integration. For instance during the former E.A.C in the 1977, many industries were located in Kenya due to transport ease and other member countries were losing.
- **Leads to loss of government tax revenue.** This is because taxes (customs duties) are removed on trade between countries thus reduces government revenue.
- **Results into surplus of similar goods.** This occurs where similar commodities in developing countries are produced thus results into wastage.
- **Involves loss of political sovereignty among member countries.** The formation of strong economic community involves sacrifice of some political interests at the expense of member countries and a country does not pursue independent political policies.
- **Leads to quick resource depletion.** Natural resources are exhausted because of high market created and increased rate of utilization thus over utilization of such resources.
- **High costs in its establishment i.e. staffing.** These are in terms of administrative costs in financing secretariats and commissions. The labourforce of the union can be transferred to fare places.

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- **Sacrifice of national interest at the expense of members states.** Members countries especially those at low levels of development have to act the interest of other member states.
- **Leads to movement of goods and services in one direction.** This leads to imbalances in trade because strong members countries dominate trade. This leads to unfair distribution of benefits from the integration.
- **Leads to retaliation by other economic blocs.** Other countries impose restrictions on exports of the economic bloc leading to rival trade blocs and thus reduces benefits of international trade.

UNEB 2004, 1999

(a) Distinguish between trade diversion and trade creation. (03 marks)
(b) Mention any two disadvantages of trade diversion. (03 marks)

Effects Of Trade Diversion

- Consumptions of poor quality products due to limited competition.
- Members countries are forced to buy highly priced goods.
- Reduced government tax revenue from import and export duties.
- Home industries remain small in nature.
- Limited variety of goods.
- Leads to regional self reliance.
- Leads to growth of inefficient industries in member.

UNEB 2011

a) Explain the benefits of regional economic integration. (10 marks)
b) What factors have undermined the achievement of regional integration in developing countries? (10 marks)

UNEB 2012

a) What are the features of an economic union? (06 marks)
b) Explain the factors that limit regional economic integration among developing countries. (14 marks)

LIMITATION OF ECONOMIC INTEGRATION IN LDCs/FACTORS THAT UNDERMINE THE SUCCESS OF ECONOMIC INTEGRATION AMONG DEVELOPING COUNTRIES.

NB: *These are given as one sided factors which undermine/limit the intensified efforts of ensuring successful economic integration especially in developing countries.*

- **Production of similar primary products thus limited market.** this leads to resource wastage. Most LDCs produce similar primary products such as coffee, cotton which makes specialization different and this implies a need to interact with developed countries for foreign exchange to buy most of imports.

- **Limited political will.** Some countries do not subject their individual interests of common objectives.
- **Political instabilities in some member states.** Political trade between countries and free mobility of factors of region. For instance the military coup of 2971 in Uganda collapse of the former EAC due to political tension.
- **Poor infrastructure among countries.** There are limited because railways, air and road transport are not fully most cases existent, thus difficulty to achieve integration network to facilitate trade.
- **Differences in levels of development of member** leads to unfair benefits from integration. For instance in EAC, Kenya was developed than Uganda and Tanzania resources were moved to Kenya.
- **External interference/sabotage.** In most cases developed and international financial institutions hinder successful to unfavourable economic policies. For example the former EAC was partly due to influence of Britain and were main trading partners.
- **Differences in social factors.** These include differences language barrier and religion which hinder trade and difficult to forge unity among member countries.
- **Differences in political ideologies.** Different countries conceptions as to how the goals of economic integration fulfilled. For instance in 1967 EAC, Tanzania was pursuing while Kenya and Uganda were pursuing capitalism ideologies are incompatible.
- **Limited geographical proximity/closeness between** Member countries are located far away from each other and the benefits of trade thus increasing transport costs.
- **Differences in economic policies of member countries** privatization, trade liberalization and taxation policies. Such policies are difficult to incorporate for mutual benefits of all
- **Unfair distribution and sharing benefits from the (Failure to share benefits equality).** For instance the due to failure to share benefits equally. This causes member states.
- **Fear of loss customs revenue.** Some countries are others in regional groupings in fear of losing tariffs on exports.
- **Differences in currencies.** Member countries have and this limits the ability of member countries to and makes trade less profitable and tiresome thus of trade.

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- **Conflicts among leaders in integrating countries.** This creates unnecessary disagreements on key issues meant for enhanced economic integration.
- **Differences in the size of the market/population.** This leads to conflict on how to share the benefits of integration among member states.

THE EAST AFRICAN COOPERATION (EAC).

The East African Cooperation is a regional intergovernmental organization of the Republic of Kenya , Uganda, United Republic of Tanzania, Republic of Rwanda and Burundi. It was originally founded in 1967 and later collapsed in 1977.It was officially revived on July 7th 2000.

The East African Cooperation aims at widening and deepening economic, social and political opportunities to improve the lives of people of East Africa. The total population in the region is estimated at 133 million people (July 2009). The headquarters of EAC are found in Arusha Tanzania. The total GDP of the region was US$ 79 million in 2010.

Motto: One people One destiny.

Some of the objectives of East African integration include.

- To promote peace, security and stability among member states
- To ensure sustainable use of natural resources.
- To attain sustainable growth and development of all member states.
- To strengthen political, social and economic cooperation in research and technology development.

The East African Cooperation has to some extent registered some social, political and economic achievements such as;

- Harmonized immigration forms at border posts.
- easing cross border movement of people.
- use of temporary travel documents.
- Easing the movement of capital among member countries.
- Easing conversion of local currencies of member countries.
- Harmonized budget preparations and presentation by the ministers of finance and central banks.
- Use of preferential tariff discounts on given commodities.
- Intensified cross border disease by member countries.
- Reduction in trade barriers among member countries.
- Cooperation in defence for political stability in all member countries.
- Abolition of students Visas for East Africa.

Economic development planning is a deliberate effort by the government to influence, direct and control major economic variables so as to achieve pre determined objectives of development over a given period of time.

Or

It is a deliberate government attempt to formulate decisions so that production resources shall be allocated among different uses in order to achieve targeted objectives of development such as economic growth in a given period of time.

Or

It is a deliberate government effort or attempt to influence, direct and control economic activities to achieve targeted making of major economic decisions and all forms of government intervention in the operations of the economy.

Economic decisions are made on principle variables such as consumption, savings, investment, employment, infrastructure development and trade necessary for economic development.

An economic plan is defined as a set of quantitative economic targets to be reached in a given period of time using a stated strategy.

NB. Development Planning

Development planning is a deliberate government attempt to achieve pre determined economic, social and political goals of development for the whole country in a specific period of time.

Development planning is the planning for the whole society so as to achieve various economic, social and political objectives. Development planning is wider than economic planning.

Development planning aims at removing obstacles that might hinder economic, social, political and national progress.

UNEB 2012

(i) Distinguish between a sectoral plan and a comprehensive plan. (02 marks)

(ii) State any obstacles to the effective implementation of ecorum development plans in your country. (02 marks)

TYPES OR CLASSIFICATION OF PLANS.

a) CLASSIFICATION OF PLANS ACCORDING TO COVERAGE.

(i) Partial plans are plans that cover one part or one sector or a few sectors of the economy.

Partial planning refers to planning for one part of a few sectors of the economy.

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A partial plan can categorised as project by project plan, integrated public investment plan and regional plan.

A partial plan can be a **sectoral plan** which covers only one a specific sector of the economy.

A sectoral plan is one which covers one/a specific of the economy. For instance agricultural sector, industrial sector.

ii) Comprehensive plans are plans that cover all sectors of the economy. They cover the whole economy and consider inter sectoral linkages. It takes into account sectoral interdependence and priorities. Such as cover public and private sectors issues such as agriculture, industry services, poverty eradication plans.

Comprehensive planning refers to planning being aimed at covering all sectors of the economy.

UNEB 2002, 2000

(i) Distinguish between a partial plan and a comprehensive plan. (02 marks)
(ii) Mention any two merits of a comprehensive plan. (02 marks)

Advantages Of A Comprehensive Plan.

- Reduces regional imbalances in development.
- Promotes inter-sectoral linkages.
- Facilitates fair and efficient utilisation of all resources.
- Widens the tax base.
- Expands employment opportunities.

Disadvantages Of Comprehensive Plan.

- Requires experienced manpower to draft and implement.
- Requires a lot of resources which are relatively scarce in LDCs.
- In case of plan failure, the country loses a lot of resources.
- Does not favour the development of leading sectors.

UNEB 2015

(i) Differentiate partial planning and perspective planning. (02 marks)
(ii) Mention any two elements of partial planning in an economy. (02 marks)

Advantages Of A Partial Plan/A Sectoral Plan.

- Easy to manage especially with scarcity of skilled labour.
- Easy and cheap to implement with limited resources.
- Encourages competition between sectors leading to efficiency.
- Limited losses and resource wastage in case of plan future.
- Becomes effective where there is regional imbalance in development
- Promotes development of leading sectors.

b) CLASSIFICATION OF PLANS BY TIME.

1. ***Short term plans.*** These are plans that cover a short period of time. For instance annual plans that cover a period of one year.

2. ***Medium term plans.*** These are plans that cover a period of 2 to 5 years. They act as a link between short term plans and long term plans.
3. ***Long term / perspective plans.*** These are long term plans that cover a period of 10 years or above. They are majority plans for long term projects of the government.

Perspective planning. Refers to long term planning in which long term targets are set in advance for a period of ten years or above. For example planning which covers 20 years or 25 years such as current development plan for northern Uganda, Poverty Eradication Action Plan.

UNEB 1999

(i) Define the term "a perspective plan". (01 mark)
(ii) State any three problems faced in formulation of a perspective plan. (03 marks)

Problems Faced In Formulating A Perspective Plan.

- Limited statistical information.
- Limited skilled man power.
- Heavy dependence on foreign resources.
- Inadequate capital / finance.

NB. ***Project planning.*** Refers to planning meant to cover a specific project for instance dam construction, power supply project.

D) CLASSIFICATION ACCORDING TO SOCIO-ECONOMIC SYSTEM.

(i) ***Socialist/administrative/directive plan.*** This is one where resources are owned and allocated by the state using administrative directives.

(ii) ***Indicative plan.*** This is one where government identifies appropriate investment areas, provides incentives and supplies information to individual economic units to achieve pre-determined targets.

Or

Is a plan where the government identifies priority areas for resource allocation and provides incentives and conducive atmosphere to the private sector but without directing their decisions.

UNEB 2007

(i) Distinguish between partial planning and comprehensive planning. (02 marks)
(ii) State any two constraints to economic development in your country. (02 marks)

THE PROCESS OF PLANNING.

Planning is a comprehensive and continuous process and it involves the following steps;

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- **Plan identification, goals and objectives.** It involves defining what is to be done and what is to be achieved in a given period of time.
- **Plan formation.** This is the setting of plans where ways of achieving the objectives are formulated and estimations of costs and benefits of the plan.
- **Plan implementation.** This is transforming the plan into actual work. It is the practical part of the planning process where programmes and projects are started.
- **Plan evaluation and assessment.** This is an attempt to find out whether the plan is fulfilling the intended objectives. Evaluation takes place even at implementation stages.

WAYS/SOURCES OF FINANCING DEVELOPMENT PLANS

- Borrowing from internal and external sources.
- Use of foreign aid in form of grants and donations.
- Use of accumulated savings.
- Use of revenue from taxation.
- Sale of state enterprises.
- Profits from government bodies and investments.

UNEB 2001

a) Why is there a need for development planning in your country? (10 marks)
b) What factors that limit the effective implementation of development plans in plans country? (10 marks)

UNEB 1999

a) What is economic development planning? (04 marks)
b) Why does your country carry out economic planning? (16 marks)

UNEB 2010

a) Distinguish between partial planning and decentralized planning (04 marks)
b) Why is development planning necessary in an economy? (16 marks)

UNEB 1998

a) Why is it necessary to carry out development planning in your country? (10 marks)
b) Examine the problems encountered in the formulation of development (10 marks).

RATIONALE/REASONS/NEED/OBJECTIVES FOR ECONOMIC PLANNING IN AN ECONOMY/ WHY IS IT NECESSARY TO CARRY OUT ECONOMIC PLANNING.

These must be given as reasons but not as role or importance of economic planning.

- **To correct deficiencies of price mechanism.** Prices of commodities associated with defects and those requiring government planning to solve problems especially in the periods of rapid structural changes for instance in periods of natural disasters.
- **To ensure proper allocation of resources.** Resources are scarce and therefore a need for proper allocation in productive projects so as to get as much output as possible in therefore budget to identify suitable areas where surplus resources can be used most productively.
- **To ensure equitable distribution of income.** Resources and income need to be distributed between regions and individuals to a fair way and this requires systematic planning by the government such as the use of progressive taxation.
- **To achieve pre-determined rate of economic growth.** Systematic planning helps to utilize available resources and increase output in all sectors of the economy through favourable investment climate.
- **To reduce inflation and attain price stability.** This requires systematic planning for the use of monetary and fiscal policies to influence production levels and attain price stability. For instance reducing government expenditure and increasing direct taxes to reduce demand pull inflation.
- **To reduce unemployment problem.** This is possible through planning for economic expansion of areas that create employment where the private and public investments are encouraged to produce job creating, proper manpower planning and promote resource utilization and development to absorb the abundant unemployed labourforce.
- **To mobilize foreign resources/aid.** Plans must be presented first to both multi-lateral and bi-lateral donors before any financial assistance is given to guarantee how such resources are to be used. Development plans act as "begging lists" to attract foreign resources for proje implementation for national development.
- **To identify areas suitable for both private and public investment.** Projects that benefits the entire society are less profitable and essentia are fit for public investment such as roads , power supply, railway which benefit the entire society are undertaken by the public sector an others which are highly profitable are left to private sector.
- **To correct balance of payment problems/improve balance o payment position.** This is through systematic planning to increa exports by setting up export promotion industries and reduce impor thus increasing foreign exchange earnings and reduce foreign exchang expenditure.
- **To reduce external economic dependence/promote self reliance.** Planning helps tin promoting a self-sustaining integrated economy b setting up import substitution industries through suitable plans raise enough revenue locally, increased training of local manpower to reduc dependence on expatriates.

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- **To encourage public participation in development/solicit for political support.** The government uses economic plans to highlight benefits of the plan which helps to win support and makes it possible for members of the public to be involved in process and development of a national economy. Its intended course of action and activities it opts to achieve are shown in a plan in order to win political support and participation of the public in nation building.
- **To relate present performances to future economic trends and targets.** Future economic opportunities for national development are revealed basing on present economic activities that may change in future. For instance drawing a relevant education plan basing on current educational system. Current projects are therefore implemented to suit future needs of the country.
- **To ensure harmonious and consistent use of resources.** This is to ensure that resources are properly used in line with development programmes to avoid resources wastage, avoid duplication of projects and achieve high rates of development.

UNEB 2005

a) Distinguish between a sectoral plan and a comprehensive plan. (04 marks)
b) Explain the importance of economic development planning in an economy. (16 marks)

UNEB 2004

a) Distinguish between a comprehensive plan and a partial plan. (04 marks)
b) Examine the role of planning in an economy. (16 marks)

IMPORTANCE/POSITIVE ROLE OF ECONOMIC DEVELOPMENT PLANNING IN AN ECONOMY.

NB: *These should not be given as reasons for economic planning*

- Corrects deficiencies of price mechanism.
- Ensures efficient mobilization and utilization of resources.
- Ensures equitable distribution of resources and incomes.
- Achieves pre-determined rate of economic growth.
- Reduces inflation and ensures price stability.
- Reduces unemployment and under employment problems.
- Makes it easy to mobilize foreign resources.
- Ensures harmonious and consistent use of resources.
- Identifies areas suitable for both private and public resources.
- Corrects balance of payment problems/improves balance of payment position.
- Reduces external economic dependence.
- Relates present performance to future economic trends and targets

DISADVANTAGES/NEGATIVE ROLE OF ECONOMIC DEVELOPMENT PLANNING IN AN ECONOMY.

- **Limits consumer sovereignty/ reduces the role of price mechanism.** Centralized planning leads to misallocation of resources. This freedom of choice by consumers is violated. Planning does not allocate resources according to the needs of consumers according to the objectives of the state hence ignoring the price mechanism.
- **Encourages bureaucracy.** There are delays in decision making and implementation of plans by the government especially under centralized planning. Planning requires a lot of consultations at different levels which leads to slow and unnecessary delays in decision making.
- **Discourages private individual initiatives.** This is especially where centralized planning is undertaken where chances of private individuals to take action in economic decisions regarding production are limited. This limits creativity and innovativeness among private individuals.
- **Breeds corruption and embezzlement.** Planning involves a lot of corruption during plan formation and implementation by those responsible which limits success of plans.
- **Promotes inefficiency in production.** This is especially where a high level of centralized planning is undertaken where there is lack of competition in plan implementation leading to misallocation of resources and production of low quality goods.
- **Promotes political dictatorship.** Sometimes, there is no room for all democratic institutions especially during centralized planning. The public may oppose such plans. Politicians in now case may resort to dictating certain plans in order to achieve their objectives which may not be supported by the public.
- **Plan formulation and implementation is a very expensive process.** It needs a lot of resources in monetary form and man power which are not easy to mobilize on part of government.
- **Encourages wastage of resource due to over production.** It fails to assess accurately what is needed by consumers especially under centralized planning. Resources may be allocated to units whose output is not demanded by the public.

UNEB 2002

a) Differentiate between centralized planning and [illegible] (04 marks)
b) What are the factors that influence the effectiveness of [illegible] development planning in developing countries? [illegible]

UNEB 2013

(i) What is meant by economic development planning? [illegible]
(ii) Give any three factors that affect the implementation of [illegible] plans in your country. [illegible]

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UNEB 2010

a) What are the benefits of economic development planning? (08 marks)

b) Explain the factors that influence the implementation of economic development plans in your country. (12 marks)

FACTORS THAT INFLUENCE/DETERMINE THE EFFECTIVENESS OF ECONOMIC PLANNING IN AN ECONOMY.

NB: These must be presented as neutral points and each point should be explained fully in both sides catering for effective / successful economic planning and ineffective/unsuccessful economic planning.

- **Rate of inflation/general price level.** High rate of inflation makes economic planning unsuccessful while economic stability in form of low rate of inflation leads to effective economic planning.
- **Population growth rate.** High population growth rate affects the limited resources for successful economic planning which hinders effective economic planning whereas a low population growth rate makes economic planning more effective.
- **Availability statistical data.** Availability of enough statistical data about economic variables encourages effective economic planning while limited statistical data about economic variables hinders effective economic planning.
- **Efficiency of the implementation machinery/quality of administrative staff.** Presence of efficient administrative machinery in planning sections leads to successful economic planning while inadequate efficient administrative machinery in planning unit limits economic planning.
- **Availability of financial resources/funds from within and abroad.** Availability of enough financial resources makes enough planning more effective which inadequate financial resources limits effective economic planning.
- **Level of corruption and embezzlement in planning process/level of accountability.** High level of corruption and embezzlement in planning process hinders effective economic planning while low level of corruption and embezzlement in planning process leads to effective economic planning.
- **Political climate.** Poor political climate limits effective economic planning whereas favourable political climate encourages effective economic planning.
- **Level of infrastructure development.** High level of infrastructure development leads to successful economic planning but underdeveloped infrastructure limits successful economic planning.
- **Level of dependence on nature/level of occurrence of natural calamities.** Frequent occurrence of natural calamities hinders effective economic planning while lack of occurrence of natural calamities leads to successful economic planning.
- **Political will and support of the masses.** Good political will and support from masses in planning process leads to successful planning while limited political leads to unsuccessful economic planning.
- **Availability of trained manpower in planning/skills of planners.** Increased supply of trained manpower in planning leads to successful economic planning while limited supply of skilled manpower in planning limits successful economic planning.
- **Degree of responsiveness of the private sector.** A rapidly growing and purposive private sector limits successful planning compared to where the private sector is weak and responsive.
- **Degree of dependence on external resources/aid for planning.** High degree of dependence on external resources limits successful economic planning while limited degree of dependence on external resources in planning leads to successful economic planning.

UNEB 2011

a) What are the features of a good economic development plans? (08 marks)

b) Explain the challenges faced during the implementation economic development plans in your country. (12 marks)

UNEB 2002

a) Describe the features of a good economic development plan. (10 marks)

b) Account for the failure of developing countries to effectively imple economic development plans. (10 mar

CHARACTERISTICS/QUALITIES/FEATURES OF A GOOD ECO PLAN.

- **A good economic plan should be economically feasible.** It sh achievable and not too ambitious in relation to the available reso planned programmes exceed the available resources, the objec the plan cannot be fully achieved.
- **It should be as comprehensive as possible.** It should cover the sectors of the economy taking into account linkages betwee sectors.
- **A good economic plan should be consistent in nature.** Sh line with the country's development goals for easy implementa
- **It should be internationally relevant.** It should be in li international or word economic policies and programm policies of financing bodies, world prices since they affect ac objectives of the plan.
- **A good economic plan should be socially relevant.** The address the social needs and aspirations of the society public participation.

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- **A good economic plan should sequential.** It should enable the establishment/implementation of projects in an orderly/logical manner. Projects should be set up step by step procedure. For instance improving transport as a basic factor expanding the mining sector.
- **The plan should be politically acceptable.** It should be in line with the political systems of the country and in the interest of majority of the public to reduce political sabotage in plan formulation and implementation.
- **A good economic plan should ensure compatibility.** It should fit in other relevant plans or support other plans to ensure linkages between plans in different sectors of the economy.
- **A good economic plan should ensure proportionality.** Allocating resources to various projects or sectors according to some degree of priority.
- **A good economic plan should ensure optimality in the use of resources.** It should ensure full utilization of planned resources to ensure maximum social welfare.
- **It should ensure simplicity.** It should be easy to understand by the general population to encourage participation.

CONDITIONS/REQUIREMENTS NECESSARY/PRE-REQUISITES FOR SUCCESSFUL ECONOMIC PLANNING.

- **Availability of enough reliable statistical information.** Statistical data should be available and up to date about various variables such as population, GDP, income levels, employment and foreign trade to enable fixing priorities in suitable investment programmes for successful plan implementation.
- **Clearly stated objectives of planning.** Realistic priorities and objectives of planning should be set in that they are specific, measurable, achievable, realistic and time bound such as ensuring price stability reducing income inequality, annual rate of job creation.
- **Availability of enough capital resources.** These can be mobilized from both internal and external sources for financing the plans in both formulation and implementation stages.
- **Efficient administration which is not corrupt.** Strong, efficient and incorrupt administrative staff as a major pre-requisite for successful economic planning since it helps to allocate resources properly during plan implementation.
- **Availability of enough skilled labour in planning process.** There should be a planning authority or machinery such as economists, engineers, accountants, planning committee of cabinet and central planning agency which are necessary to collect reliable statistical data.
- **Adequate political will or political good will.** The government should be committed to implement the plans and degree of political sabotage should be low for easy plan implementation.

- **Enough public participation** [illegible] from the masses who should actively participate in plan [illegible] and plan implementation.
- **Political stability.** This is necessary to allow easy [illegible]

UNEB 2014

a) Why is it necessary to formulate an economic development [illegible] country? (06 marks)
b) Explain the factors that limit successful implementation [illegible] development plans in developing countries. (12 marks)

UNEB 2009

a) Define the term perspective planning. (04 marks)
b) Explain the factors limiting economic development planning [illegible] countries. (16 marks)

UNEB 2005

a) Distinguish between centralized planning and decentralized [illegible] (04 marks)
b) Explain the factors that limit the successful implementation [illegible] development plans in developing countries. (16 marks)

LIMITATIONS/CHALLENGES /CONSTRAINTS OF ECONOMIC [illegible] IN LDCs.

These are given as one sided factors which undermine/limit the [illegible] plan identification, formulation of goals/objectives [illegible] implementation of plans and evaluation of plans leading to [illegible] economic planning.

- **Limited reliable statistical data/information.** The [illegible] quantity of data about performance of different sectors [illegible] variables is limited which does not allow accurate planning [illegible] to poor record keeping, many people are not willing to give [illegible] information thus plan future.
- **Limited control over natural factors/unfavourable natural [illegible]** Natural calamities such as climatic changes, floods, [illegible] landslides are unpredictable and make planning difficult since [illegible] diverted from financing various plans to rescue the situation.
- **Inefficient implementation/administrative machinery.** [illegible] poor coordination between planners and implementers. [illegible] suitable institutions to implement plans at both local and [illegible] leading to poor coordination in planning.
- **Inadequate capital/limited funds.** LDCs lack adequate [illegible] effective planning process because of low tax revenue and [illegible] secure loans. Planning in LDCs s only on papers but not in [illegible]

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most plans are not translated from paper into actual practice/ practical implementation while others are partially implemented.

- **Failure to identify viable or worthwhile projects/priorities.** This leads to resource wastage because projects which are profitable and income generating are hard to find out due to limited skilled personnel.
- **High dependence on foreign aid.** Most LDCs depend on foreign resources to implement their plans because of low tax revenue and other domestic revenue sources but foreign aid is inconsistent/uncertain and that's why some plans are never implemented due to adequate funds from donors.
- **Drawing of over ambitious plans.** Over government plans are drawn sometimes unrealistic and therefore are not cast to achieve since they aim at achieving too many objectives in a short time and end up failing.
- **External influence and pressure from developed countries.** For instance IMF unrealistic conditionalities of liberalization, cost sharing, privatization and restricting of public sector. There is external pressure from donor countries and agencies which normally dictate on the type of projects to sponsor or be undertaken that may not a priority to LDCs' development.
- **Corruption and embezzlement of funds in planning process.** This is especially on the part of plan formulators and implementers and therefore false accountabilities are presented thus failure of plans thus leaving certain plans never implemented.
- **Non responsive growing private sector.** The government may not have direct control over given activities of the private sector in the process of planning. Some plans are supposed to be implemented by the private sector which may be non responsive towards plan implementation.
- **High inflation rates.** Most LDCs experience persistent inflation which makes plan implementation difficult since the value of money is reduced overtime. This leads to plan failure since it will be difficult to complete projects being implemented since the cost of plan implementation goes high.
- **Political sabotage/interference by politicians.** Because of differences in political motives among politicians, some plans which would have been good are sabotaged, stopped to meet their political interests and plan implementation becomes very difficult.
- **Political instabilities and insecurity.** Political insurgencies in LDCs make economic planning difficult since most of the resources are diverted for suitable plans to stabilize political climate and restore peace. Frequent military coups and popular uprising have left many plans on paper since investment is discouraged.
- **High population growth rate which affects limited resources for planning.** Most LDCs have high population growth rates which increase dependence burden and high expenditure on provision of social services, which limits resources to implement plans leading to plan failure.

- **Limited political will and full support by the people/ communities.** People do not have full support for governmental programmes such as poverty reduction, controlling diseases and plans tend to remain on paper. There is limited support of the plans from the people and be a source difficulty during plan implementation.
- **Poorly developed infrastructure.** Poor road network and telecommunication services limit coordination of various plans during plan implementation thus plan failure since some areas cannot be accessible by planners.
- **Limited supply of qualified planners/ skilled manpower who are de nationals.** There is too much over reliance on expatriates who lack limited knowledge about planning in developing countries which limit plan process. There are limited economists and statisticians to formulate plans and implement them.

PRINCIPLES OF ECONOMIC PLANNING.

- **Comprehensiveness.** Planning should cover all the sectors and regions of the economy so as to achieve the various elements of development and promote linkages among sectors.
- **Sequencing.** Activities of economic plans should be established with secondary projects for example establishment of roads with industries.
- **Optimality.** Planning should ensure utilization of available resources more efficiently so as to ensure maximum welfare.
- **Feasibility.** The objectives of planning should be SMART. Plans need to be economically achievable in line with the available resources. It should clearly show the time period the projects are supposed to be completed.
- **Proportionality.** Resource allocation and zoning should be according to some degree of priority and resources should be allocated between different sectors according to their importance on the economy.
- **Consistency.** It should be in line with the country's economic development goals for easy financing. This is meant for easy implementation.
- **Compatibility.** Various plans should be related and bale to support one another to ensure maximum linkages between sectors such as agriculture and industry. Objectives of the plan should not conflict with the already existing objectives.
- **Simplicity.** Plans should be easily understood by planners themselves implementers and the general population for successful implementation.
- **Acceptability.** A good economic plan should be accepted by the masses and politically acceptable among politicians to ensure their full participation in implementation.

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UNEB 1998

(i) Distinguish between centralized planning and decentralized planning (04 marks)

(ii) Account for the existence of decentralized planning in your country (10 marks)

DECENTRALIZED PLANNING AND CENTRALIZED PLANNING

Decentralized Planning

This is sole/planning where economic decision making and implementation of plans in line with set targets are undertaken by local governments/local authorities instead of central government or authority for instance planning at district level.

Planning activity begins from the grass root/regional/district level and the plans made are incorporated or integrated in the central government plan. Such plans must be in line with attainment of national objectives.

REASONS WHY THERE IS DECETRALISED PLANNING IN LDCs/WHY IS DECENTRALIZED PLANNING NECESSARY IN DEVELOPING COUNTRIES

- **To encourage use of local resources for efficient utilization.** Local resources are utilized fairly since suitable local plans are made to utilize them on the grass root level.
- **To reduce bureaucratic tendencies of central planning.** There is high level of bureaucracy in centralized planning which makes decentralized planning suitable. This leads to quick decision making and plan implementation since there are limited consultations to be made.
- **To promote division of labour central and local government.** Regions plan for their own development and the central government plans for other sectors which reduces the burden to the central government.
- **To promote regional balance in development.** Local opportunities in each region are maximumly tapped if there is suitable planning and such region develop equally thus promoting regional development.
- **To ensure fair distribution of employment opportunities to local people.** It provides employment to local people through increased utilization and identification of various rural opportunities increases employment opportunities.
- **To ensure efficient tax revenue collection.** Taxes and other forms of revenue are easily collected by local authorities since they can easily be identified to increased government tax revenue and better service delivery is offered.
- **To favour interests by involving local people in plan implementation.** This enables each region to take advantage of its priorities.
- **To reduce rural urban migration.** Decentralized planning helps to expose local opportunities and local projects are set up which increases employment to rural labour.

- **To promote a sense of belonging and participation in development among citizens.** Decentralized planning enables the people participate in policy making and implementation and feel part of development process.
- **To promote equitable distribution of income.** Decentralized planning enables every region to utilize its resource potentials and provide employment to local people, therefore a tendency of each region to develop equitably.
- **To ensure that each region takes full advantage of its potentials.** This helps to cause meaningful development in each region.
- **To suit poor countries with limited capital to plan for the whole country at ago.** There is limited capital to cater for all regions at the same time which leaves each region to suffer on its own and to mobilize resources for development.
- **To suit large countries.** Decentralized planning breaks a large country into small units which are effectively controlled and planned for as resources are effectively controlled.

UNEB 2002

(i) What is meant by decentralized economic planning?

(ii) State only three merits of decentralized economic planning.

Merits Of Decentralized Planning

- Reduces bureaucratic tendencies of centralized planning.
- Promotes a sense of belonging and participation in development by local people.
- Reduces rural urban migration.
- Enables each region to take full advantage of its priorities.
- Promotes fair distribution of employment opportunities.
- Promotes regional balance in development.
- Encourages use of local resources.
- Promotes equitable distribution of income.
- It promotes division of labour between central and local government.
- It ensures efficient tax revenue collection.
- It is appropriate for large country.

Demerits Of Decentralized Planning.

- Promotes regional imbalance in development because some regions have enough resources develop than others with inadequate resources.
- Leads to duplication of development projects which leads to resource wastage. This is due to lack of coordination in project implementation among districts therefore; similar projects are developed at the same time.
- Promotes corruption at local levels. This leads to plan failure.

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- Creates conflict between local and national interests. This is because local interests may differ from national interests hence limiting development.
- Worsens imbalance between sectors due to poor coordination while developing different sectors.
- It promotes nepotism and discrimination. This is because jobs tend to be given to some local people even without necessary qualifications.
- Leads to over taxation at local levels. Local people are normally over taxed by local governments to raise more revenue for project implementation.

CENTRALISED PLANNING.

This is planning by the central authority which determines resource allocation in the whole economy and directs implementation of plans in line with the set targets/objectives. Planning is made by the central authority (central government) by addressing the concerns of different regions and sectors.

Planning is done at the national level to cover all the economic activities within the whole country. The central planning authority formulates a central plan, lives objectives, priorities and targets for every sector of the economy.

UNEB 2012

a) *What is meant by centralized planning.* (04 marks)

b) *Explain the rationale for centralized planning in an economy.* (16 marks)

RATIONALE/REASONS/NEED FOR CENTRALIZED PLANNING IN AN ECONOMY.

- For easy mobilisation of resours.
- To achieve a pre-determined rate of economic growth.
- To identify areas suitable for public and private investment.
- To relate present to future economic trends and targets.
- To reduce unemployment problem.
- To solicit for foreign aid.
- To ensure proper coordination in sectoral developmet since the private sector is still weak.
- To correct deficiencies of price mechanism especially during the periods of rapid structural changes.
- To promote self reliance.
- To fight income inequality/ensure equitable distribution of resources.
- For proper sequencing of operations of the economy.
- For political support.
- To ensure economic stability.
- To reduce the problem of shortage of manpower at local levels.
- To protect national interest.

- To ensure consistency of plans to coordinate previous ones with the available resources.
- To ensure proportionality and complementarity of plans.
- To eliminate duplication of development projects.

INDICATIVE PLANNING.

Indicative planning is planning where government identifies appropriate investment areas and provides incentives and interest adjustments to individual economic units to achieve pre-determined targets. This is planning where the government identifies priority areas for resource allocation and provides incentives and disincentives to the private sector without directing their decisions to achieve pre-determined targets. The government identifies priority areas for resource allocation and provides necessary incentives such as subsidies, tax exemptions and favourable atmosphere to private sector to achieve the pre-determined targets. The government influences the level of economic activity activities through fiscal and monetary policies.

HOW TO EXCEL IN ECONOMICS EXAMINATION.

Economics is among the subjects offered by many students at 'A' level in Uganda's different education system.

Currently, it is highly competitive and therefore not easy to be highly successful in the many students who excel in economics. It is a vast subject which almost touches every aspect of human life.

In the past, economics used to be purely a theoretical subject and most of the ancient economics text books were not in any way different from the bible.

Economics forms the basis of most courses offered in higher institutions of learning such as universities especially in the department of economics and other related fields. This implies that one must have passed economics to be able to be offer such related courses.

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demand for money is low but when the interest rate is low on assets, the demand for money is high.

When the rate of interest is expected to fall, speculators convert their bonds / securities into cash but when the rate of interest is expected to increase, speculators convert their cash into bonds/ securities. This is illustrated by the liquidity

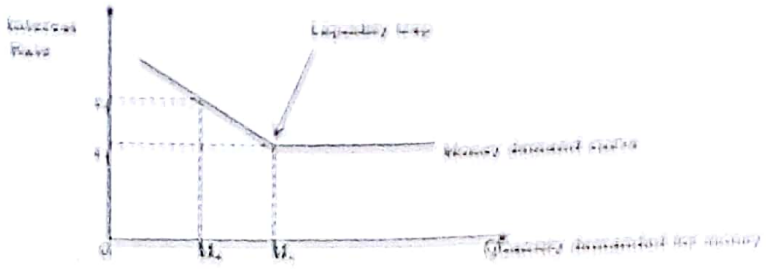

Figure 10.1 Liquidity trap

If the of rate of interest is high, at r_2, speculators buy bonds and demand less money M_2.

If the interest rate is low at r_1, speculators convert bonds into cash and demand more money M_1 to avoid capital loss.

Liquidity trap is a point below which the interest rate is too low to encourage speculators to invest in bonds and hence people have an infinite desire to hold cash.

Or

It is a point below which the interest rate is too low such that speculators do not buy bonds and thus their wealth is trapped in liquid form.

It is a point below which speculators will no longer for assets for speculative purposes.

It is a low interest rate that forces speculators to prefer holding money in their hands other than converting it into assets.

At this point liquidity preference is high.

LIQUIDITY PREFERENCE/DEMAND FOR MONEY.

Liquidity preference refers to the desire by individuals to hold wealth/assets in cash or near form. Liquidity preference in many developing countries is very high because f high marginal propensity to consume, poor banking habits, underdeveloped financial institutions which leads to low level of investment.

UNEB 2014

(i) Differentiate between liquidity ratio and liquidity preference (02 marks)

(ii) Mention any two reasons for the high liquidity preference in developing countries. (02 marks)

UNEB 2006, 2009

(i) What is meant by liquidity preferen (01 mark)

(ii) Mention three factors which determine liquidity preference in (03 marks)

DETERMINANTS OF LIQUIDITY PREFERENCE.

- **Level of transactions in an economy.** High levels of transa... high level of liquidity preference while low levels of transactions ... liquidity preference.
- **Interest rate on deposits.** Low interest rate on deposits ... liquidity preference while high interest rate on deposited fund... low liquidity preference.
- **Level of income.** High level of income implies high liquidity p... since individuals require money to transact businesses while hi... income leads to low liquidity preference.
- **Level of prices of goods and services.** High price level leads ... liquidity preference while low price level leads to low liquidity pref...
- **Level of development of financial institutions.** Low ... development of financial institutions leads to high liquidity pre... while well developed financial institutions help to mobilize deposi... the public hence low liquidity preference.
- **Knowledge of banking facilities.** Poor banking habits imply ... liquidity preference while high level of use of commercial banks ... public implies low liquidity preference.
- **Degree of uncertainty.** High degree of uncertainty leads to high liq... preference while low level of uncertainty in an economy leads to lo... liquidity preference.
- **Investment climate.** Favourable investment climate leads to ... liquidity preference while unfavourable investment climate leads to ... liquidity preference.

Liquidity refers to ease with which an asset can be turned into cash ... as a medium of exchange.

MONEY SUPPLY.

Money supply refers to the quantity/amount of money which is ... circulation in a particular country/economy at a given period of time.

It refers to the total cash in circulation outside banks plus bank deposits ... a particular country at a given period of time.

It is the volume or stock of money circulating in an economy both in ... hands of the public and on demand deposits in a given period of time.

It excludes money in treasury, central bank, government and commercial ... bank deposits with the central bank. Money supply in Uganda has been ...

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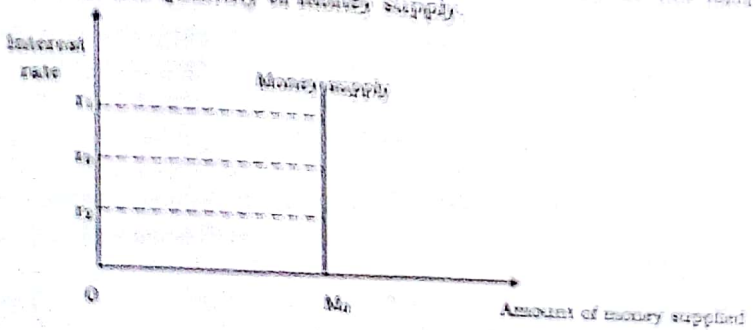
increasing year because of frequent printing of new and more currency into circulation to finance government activities.

Demand deposits are deposits withdrawn by the customers from the banks any time on demand and do not earn interest.

Time deposits are deposits withdrawn by the customers on giving notice to the bank and they earn interest.

TYPES OF MONEY SUPPLY.

1) **Exogenous money supply.** This is money supply determined and fixed by the central monetary authority regardless of the level of interest rate and economic activity. This money supply is not influenced by the interest rate and it is determined by the minting authority. This means that changes in interest rates and economic activity do not have any influence on the quantity of money supply.



2) **Endogenous money supply.** This is money supply that is directly influenced by the interest rate and depends on the level of economic activity in an economy i.e. the level of output, interest rate and employment.

Aggregate money demand refers to total amount of money held in cash by all income earners for various motives.

UNEB 2005

(i) *Distinguish between money supply and demand for money. (02 marks)*
(ii) *Mention any two determinants of money supply in an economy. (02 marks)*

DETERMINANTS OF MONEY SUPPLY IN AN ECONOMY.

These factors are both endogenous and exogenous

1. **Level of financial accommodation.** The government may direct the central bank to print more money so as to finance government programmes, assist the declining key sectors of the economy. This is called financial accommodation. This influences the level of government expenditure.
2. **Level of liquidity preference.** High level of liquidity preference implies high money supply while low level of liquidity preference leads to low money supply.
3. **Level of monetization of the economy/size of subsistence sector.** A large size of monetary sector leads to high money supply while subsistence sector dominated economy leads to low money supply.
4. **Volume of foreign exchange reserves.** When foreign exchange reserves are in abundance, money supply becomes high while foreign exchange reserves are in short supply money supply becomes low.
5. **Level of economic activity/level of investment.** High investment economic activity implies high output hence high money but low investment economic activity leads to low money supply.
6. **Level of capital inflow and outflow.** High level of capital inflow implies low money supply while high capital inflow exports implies increase money supply.
7. **Level of operation of monetary policy.** A contractionary monetary policy through increasing bank rate, selling securities to the public, selective credit control, high special deposits reduce money supply while expansionary monetary policy through reducing bank rate, buying securities from the public, reducing legal reserve requirements increase money supply.
8. **Interest rates.** High interest rates on borrowed money reduce money supply while low interest rate on borrowed money increases money supply.

NB. Financial accommodation refers to where government directs central bank to print more money to finance its undertakings that run out of money.

CONSTITUENTS/COMPONENTS OF MONEY SUPPLY.

- Coins
- Foreign exchange reserves
- Bank notes
- Instruments of credit
- Bank deposits

UNEB 2009

(i) *What is meant by the term value of money? (01 mark)*
(ii) *Mention any three factors that influence the value of money. (03 marks)*

VALUE OF MONEY

Value of money is the purchasing power of a unit of money.

Or

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It refers to the amount of goods and services a unit of money can purchase.
The value of money is categorized into two;

a) **Nominal value of money**. This is the face value indicated on bank notes and coins irrespective of the quantity of goods and services that money can purchase.

b) **Real value of money**. This is the quantity of goods and services that can be purchased using a given amount of nominal value of money.

It is mainly determined by the price level and services and the size of nominal value of money itself.

DETERMINANTS OF VALUE OF MONEY

- General price level for goods and services
- Quantity of money in circulation/monetary policy of the country
- Velocity of circulation of money. High velocity of money implies low value of money while low velocity of money in circulation leads to high value of money.
- Level of output/quantity of goods and services available in an economy
- Government policy in relation to devaluation and revaluation. Devaluation reduces the value of money while revaluation increases the value of money.

Relationship Between Value Of Money And General Price Level.

An increase in money supply increases general price level and this reduces the value of money while a decrease in money supply reduces general price level which increases the value of money. This relationship between money supply and value of money is explained by **the quantity theory of money**

UNEB 2004, 2000, 1997

a) Explain the quantity theory of money *(06 marks)*
b) What are the limitations of quantity theory of money? *(14 marks)*

UNEB 2001

a) Given that the quantity of money in an economy is 1,000,000 dollars, its velocity of circulation is 20, and the numbers of transactions made are 250. Calculate the general price level in the economy.
(04 marks)

b) Explain the limitations on Irving Fisher's quantity theory of money.
(16 marks)

UNEB 2013

a) Given that the volume of money in an economy is €20 billion, total level of transactions is €250 million and the transactions velocity of money is 20; calculate general price level in an economy.
(04 marks)

b) Explain the limitations of Irving Fisher's quantity theory of money.
(16 marks)

THE QUANTITY THEORY OF MONEY BY IRVING FISHER.

The quantity theory of money was advanced by an economist Irving Fisher. It states that the general price level (P) of goods and services in an economy is determined by quantity of money in circulation (M) provided velocity of circulation of money (V) and number/ level of transactions (T) are constant.

The theory is expressed by Irving Fisher's equation of exchange;

$PT = MV$ or $P = MV/T$

Where;

P = general price level for goods and services
M = quantity/ amount of money in circulation
T = volume/ level of transactions
V = velocity of circulation of money.

NB. A change in money supply (M) in an economy will lead to equal change in general price level (P) of goods and services provided the velocity of circulation of money (V) and number/ level of transactions (T) remain constant.

If the quantity of money in circulation doubles, the general price level will also double with V and T remaining constant.

Velocity of money refers to the number of times a unit of money is used in transactions. According to Irving Fisher, by holding V and T constant, an increase in M will lead to an increase in P and a decrease in M will lead to a decrease in P.

Velocity of circulation of money refers to the number of times in which a unit of money is used in transactions in a given time. It is the speed with which a unit of money changes hands.

Worked example.

(i) Given that the quantity of money in an economy is 1,000,000 dollars its velocity of circulation is 20, and the number of transactions made are 250. Calculate the general price level in the economy

General Price level = Quantity of money in circulation x velocity of circulation of money / Level of transactions

P = MV/T
P = 1000,000 x 20/250
General Price level = 80,000 dollars

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(b) Given that the volume of money in an economy is ₦20 billion, level of transactions is ₦250 million and the transactions velocity of money is 20. Calculate the general price level in an economy.

General Price level = Quantity of money in circulation x Velocity of circulation of money / Level of transactions

P = MV/T or MV = PT

20,000,000,000 x 20 / 250,000,000

General Price level = ₦1600

UNEB 2012

(a) *State Irving Fisher's equation of exchange.* *(02 marks)*

(b) *How is the value of money determined in Fisher's equation of exchange?* *(02 marks)*

HOW IS THE VALUE OF MONEY DETERMINED IN FISHER'S EQUATION OF EXCHANGE.

- Quantity of money in circulation
- Velocity of circulation of money
- Level of transactions./volume of production
- General price level

Assumptions of the quantity of money.

- All businesses are affected by use of money as a medium of exchange. No barter trade transactions.
- Money is only demanded for transaction motive.
- V and T are assumed to be constant in the short run.
- General Price level is only affected by changes in money supply.
- Assumes no hoarding of money. All the money is spent on transactions.
- The theory is only operational in the long run.

CRITICISMS/LIMITATIONS OF THE QUANTITY THEORY OF MONEY.

1. The theory assumes that velocity of circulation of money (V) and level of transactions (T) are constant, but this is not the case because a change in one induces a change in the other.
2. The theory ignores a system of barter trade which does not involve the use of price and money supply and yet not all transactions are carried out through the use of money.
3. The theory attempts to attempt to explain changes in the value of money but does not clearly explain how it is determined since it only how changes in the value of money are brought about by a change in quantity of money in circulation.
4. This is not enough to explain the value of money.
5. It ignores the rate of interest on capital and yet this also influences supply of money. The theory cannot be complete without relating it to interest rate.
6. Low interest rate implies high borrowing hence investment and high output hence low price level but this is ignored by the theory.
7. The theory ignores demand for money and only considers supply of money in the equation and yet demand for money is also very important and may either increase or reduce general price level.
8. There is nothing like the general price level which the theory talks about but rather a series of price levels for goods and services in an economy.
9. Price changes take place at different time periods due to changes in money supply.
10. The theory does not work in case there is high marginal propensity to save since high savings reduce velocity of circulation of money leading to a reduction in general price level.
11. The theory does not consider price control where minimum or maximum prices are fixed by the government; the theory becomes irrelevant since changes in money supply will not lead to changes in general price level.
12. The theory does not explain other causes of changes in general price level such as changes in cost of production, shortages in supply apart from money supply.
13. The theory ignores possibilities of haggling/bargaining between buyers and sellers which determines an aggregate price level. The price may reduce due to bargaining even if money supply increases.
14. The theory considers only the transaction motive of holding money and ignores other motives for holding money such as precautionary and speculative motives.
15. The theory is a truism, it merely says that M,V,P and T are related but there is no clear explanation about how they change.
16. It ignores the fact that where a country has many unemployed resources, an increase in money supply increases output of goods and services which causes a fall in general price level or no change at all.

INTEREST RATE.

Interest rate is a reward/payment/price for the use of capital as a factor of production. It is therefore a change for securing capital i.e. cost of borrowing and price for lending. It is the price at which money is borrowed and lent usually expressed in percentage. In Uganda, commercial banks charge interest rate on loans of between 22-30% and less that 6% on deposits (September 2011).

There are two types of interest rate i.e.

- Interest rate on loans
- Interest rate on deposits.

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POSITIVE EFFECTS OF TRADE UNIONS.

- **Trade unions encourage fair income distribution.** This helps to reduce income inequalities by increasing wages for low paid workers.
- **Help in designing government policies on employment.** For example wage policy thus proper man power planning.
- **They encourage increased savings.** This is because of social security benefits provided to workers.
- **They promote industrial peace** because disputes are settled peacefully. This promotes continuous production.
- **Increase labour productivity and efficiency.** This is due to increased training offered to members and high wages offered.
- **Reduce exploitation of workers by employers.** This increases morale at work.
- **They improve working conditions of workers.** Hence better welfare of workers.
- **Stabilise employment by increasing job security.** They protect members against unfair dismissal from their jobs.
- **Increase purchasing power of members through high wages.** This improves their standard of living.
- **Reduce entry of unqualified staff into given occupations.** For instance legal occupation, teaching, nursing. This leads to provision of better quality services.
- **They create unity among workers** in different regions and occupations.

NEGATIVE EFFECTS OF TRADE UNIONS.

- **Lead to unemployment.** This is due to frequent demand for high wages which limits demand for more labour by employers.
- **They increase income inequality.** This is between trade union members and non trade union members.
- **Discourage investment** due to high wage demand by workers. This reduces demand for more labour to increase investment.
- **They cause wage push inflation.** High wage demands increase cost of production which is shifted to consumers in form f high prices for commodities.
- **Cause decline in production levels.** This is especially during periods of sit down strikes where output levels reduce.
- **Encourage political unrest/they are used by political opponents to cause instability politically.** This causes poor climate.
- **Cause destruction of property and loss of life in case of violent strikes.** This limits further production.
- **Increase rural urban migration by labour.** They are highly functional in urban areas which leads to congestion, development of slums.

Chapter 10.

Money refers to an asset that is generally acceptable as a medium of exchange for goods and services/settling any financial obligations. It is a legal meaning that everybody in the country concerned must accept by law in the settlement of debts or other financial obligations.

FEATURES/QUALITIES OF GOOD MONEY.

1) ***Universal acceptance.*** *Good money must be acceptable by everybody in the country for financial obligations.*
2) ***Portability.*** *Good money should be easy to carry in relation to its value or right to transfer from one place to another.*
3) ***Divisibility.*** *It should be divisible into smaller units to allow small transactions to take place without any difficulty.*
4) ***Durability.*** *Good money should last for longer periods without depreciating in its face value.*
5) ***Homogenity.*** *One piece of money should be as good as others means that it should be the same in all features of a particular currency to any body.*
6) ***Relative scarcity.*** *Good money should be relatively scarce / limited supply, otherwise it would lose value if it is in its plenty since it may cause inflation.*
7) ***Stability in value.*** *It should not frequently fluctuate in its value for purposes of smooth transactions to take place.*
8) ***Good money should be convenient and relatively cheap to print.***
9) ***good money should be difficult to forge by counter feiters.***

FUNCTIONS OF MONEY.

- ***Money is used as a medium of exchange.*** *It makes it possible to determine the value and quantities of commodities to be exchanged.*
- ***It is a unit of account.*** *Money is used when carrying out business transactions and accounting particularly through record keeping.*
- ***Money is a store of value/wealth.*** *It can be used to store wealth because it is not bulky and perishable, so having money is like having any other form of wealth.*
- ***It is used as a standard of deferred payments.*** *Money facilitates payment of debts and transactions to some future time. One can enter transactions without immediate payments for them.*
- ***It is a measure of value.*** *It helps to measure the value of goods and services in terms of their prices in the market.*

BARTER TRADE SYSTEM.

Barter trade refers to exchange of commodities directly for other commodities. This is the earliest form of exchange where commodities were exchanges directly for other commodities. This implies that it does not

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involve the use of money as a medium of exchange. The system requires double coincidence of wants between the seller and the buyer.

ADVANTAGES OF BARTER TRADE.

- Overcomes problems of currency difference and exchange rates between countries which are very costly.
- Encourages friendship and cooperation among traders.
- Avoids negative effects of price fluctuations in an economy.
- Eliminates the problem of black marketing.
- Reduces imported inflation.
- Makes transactions quicker compared to the use of money.
- Reduces balance of payment problems especially in LDCs.
- Encourages diversification of exports in order to meet foreign demand.

PROBLEMS/OBSTACLES OF BARTER TRADE.

1. **Lack of double coincidence of wants.** For instance if one has maize and wants rice, he must get somebody with rice who wants maize which is very difficult.
2. **Perishability problem.** Most commodities are perishable and difficult to store for exchange in near future.
3. **Difficulty in determining the relative value of goods being exchange.** There is no measure of value.
4. **Problem of bulkiness of some commodities.** Which affects transportation of such commodities from one market area to another.
5. **Indivisibility of commodities.** Some commodities are difficult to divide into smaller units to allow smaller transactions to take place.
6. **Lack of standard of deferred payments/credit transactions cannot be made.**

UNEB 2003

(i) *Distinguish between fiduciary issue and fiat money.* (02 marks)
(ii) *State the Irving Fisher's quantity theory of money* (02 marks)

TYPES OF MONEY.

1) **Fiduciary issue.** This is money issued by the central bank on its discretion and it is not backed by gold or foreign reserves. The central bank may simply increase money supply into circulation to meet government obligations and this money is over and above gold reserves kept by the central bank. For instance if the central bank has gold worth 400 dollars but increases coins and bank notes equivalent to 500 dollars then 100 dollars will be fiduciary issue.

2) **Fiat money.** This is money printed by the central bank on the orders of government. It is issued irrespective of the level of economic activities and gold reserves.

3) **Deposit money.** This is the money held by the public in form of deposits in commercial banks that can be withdrawn on demand.

4) **Hard to convertible currency.** This is a currency a suitable value of its international recognition and can easily be exchanged for other currencies. It can easily be exchanged for other international currencies such as US dollars, Euro and British pounds.

5) **Token money.** This refers to coins whose intrinsic/metered value is less than the face value. It is meant to discourage people from melting coins to sell the metals.

6) **Convertible currency.** This is the currency that cannot easily be exchanged for other currencies in international transactions and its value is unstable. For instance Uganda shillings.

7) **Quasi or near money.** These are basically assets that are held in form that can easily be converted into cash without loss of value. For instance cheques, bank drafts, bonds, treasury bills and shares.

MOTIVES FOR HOLDING MONEY.

There are generally the Keynesian motives of demand for money.

a) Transaction motive.

According to Keynes, money is demanded to facilitate the day to day transactions of the business. For instance buying goods and services, paying wages, rent and interest. This is the most important motive of demand for money in the modern world. During the era where there was barter trade system, there was no transaction demand for money.

b) Precautionary motive.

People demand for money in order to prepare for unforeseen future uncertainties or problems in future. Money is demanded to meet unpredictable/unforeseen circumstances. For instance sickness, accidents, academics and death. It is a result of providing for contingencies or unplanned expenditure. People foresee uncertainties into the future and tend to save money to meet the unexpected expenses.

c) Finance/investment motive.

Money is needed to finance the ongoing projects where fixed capital has been invested. The desire to hold money is meant to finance the existing and on going investments.

d) Speculative motive

This is demand for money for the purpose of making gains in the near future through speculation. Money is kept in form of assets, bonds, treasury bills in order to make profits out of if in the near future in a financial market.

The demand for money for speculative reasons depends on the interest rate charged on bonds or assets *when the interest rate is high on assets*

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UNEB 2004

(i) What is meant by interest? (01 mark)

(ii) Mention any three determinants of interest rates. (03 marks)

UNEB 1999

(i) Different between interest and rent. (02 marks)

(ii) Mention any two determinants of interest rate in your country. (02 marks)

DETERMINANTS OF INTEREST RATE

- Amount of money supply in an economy
- Level of inflation/economic climate/general price level
- Policy of individual lenders or commercial banks
- Demand for loanable funds/investment capital
- Period of loan repayment
- Monetary policy of the central bank in relation to bank rate charged on commercial banks
- Number of banking institutions/level of development of banking sector
- Supply of loanable funds/investment capital

FINANCIAL INTERMEDIARIES

Financial intermediaries are financial institutions which bring borrowers and lenders together. A bank is an institution specialized in business of providing monetary services to the public. Banks trade in money as a commodity and charge a price called interest on loans and also give interest on deposits from customers.

TYPES OF FINANCIAL INTERMEDIARIES.

Banking financial intermediaries

These are financial institutions that receive deposits from the public, give out loans and create credit.

They are basically commercial banks which bring together deficit lending individuals and surplus lending individuals.

These are financial institutions that engage in provision of short term loans, receive short term deposit from the public and are involved in the process of credit creation.

Characteristics of Banking Financial intermediaries.

- They operate money markets
- They pay low interest rate on deposits from customers
- They lend on short-term basis
- They keep short-term deposits.
- They create credit through the process of credit creation.

UNEB 2004

(i) *What are non banking financial intermediaries?* *(02 marks)*

(ii) *State any two functions of these intermediaries in your country.* *(02 marks)*

NON BANKING FINANCIAL INTERMEDIARIES.

These are financial institutions which perform similar functions as commercial banks but do not create credit.

Or

These are financial institutions which receive deposits, give out loans but do not create credit. They receive deposits from the public and give out long term loans but do not create credit.

Examples of non banking financial intermediaries are;

- Development banks such as East African Development Bank, Uganda Development Bank
- Insurance companies
- Stock exchange markets/capital market Authority
- Post office savings Bank.

Characteristics of Non Banking Financial Intermediaries.

- They operate capital markets where long term securities are traded.
- They give long term loans mainly for development purposes.
- They normally undertake risky and long term investments.
- They charge high interest rate on loans.
- They do not create credit through credit creation.
- They pay high interest on initial deposits
- They are mainly owned by government for instance development banks.

Functions of Non- Banking financial intermediaries.

- They finance long term investment
- They promote savings
- They provide compensation in case of insurance companies
- They encourage trade
- They ensure social security for instance NSSF, life assurance.

CAPITAL MARKET

A capital market is one where long term securities/financial assets are traded. It is market which deals in debentures of companies, bonds and long term government security shares. A capital market is opened by non-banking financial intermediaries.

UNEB 2009

(i) *Distinguish between a money market and a capital market.* *(02 marks)*

(ii) *State any two functions of capital markets in your country.* *(02 marks)*

Functions of capital markets.

- To mobilize savings
- To encourage investments
- To promote easy conversation of assets from near cash to cash

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- To regulate prices of traded securities/financial assets

MONEY MARKET.

A money market is one where short term securities/financial assets are traded/exchanged. It is market for short term loans made up of borrowers and lenders. It is operated by banking intermediaries. Commercial banks operate such a market.

UNEB 2007

(i) *Distinguish between a money market and a capital market.* (02 marks)
(ii) *State any two characteristics of money in developing countries.* (02 marks)

Features of money markets in developing countries.

- They are mainly urban based.
- They charge mainly high interest rates.
- They mainly operate on a small scale.
- There are few participants in the market.
- Deal mainly in limited variety of financial assets.

UNEB 2012

a) Distinguish between banking financial institutions and non banking financial institutions. (04 marks)

b) Explain the functions of banking financial institutions in your country. (16 marks)

FUNCTIONS OF COMMERCIAL BANKS/BANKING FINANCIAL INTERMEDIARIES.

1. **They receive deposits from the public** and keep them in safe custody until they are required. With ATM commercial banks can receive huge deposits and make payments o a 24-hour basis. This helps to mobilize savings for future investment.
2. **They advance loans to individuals and companies.** For instance commercial banks advance over drafts to customers, cash credit and discounting bills of exchange. This helps to increase production.
3. **They issue various forms of instruments of credit/provide easy means of payment.** Travelers' cheques which can be cashed anywhere other than the country of origin, drafts, and credit cards are all offered. This minimizes risks of carrying large sums of money.
4. **They safe guard valuable items/assets for their clients.** For instance land titles, wills, certificates which are kept in strong rooms.
5. **They trade in foreign currency/exchange currencies of different countries.** They operate foreign exchange bureaus where they buy and sell different currencies of several countries. They provide facilities for foreign transfer of money. They make payments abroad on behalf of their customers such as bankers money transfer offered by several commercial banks. This promotes international trade.
6. **They help to implement monetary policies.** They act as agents of the government in sale and purchase of securities. Such as treasury bills and bonds. Both expansionary and contractionary monetary policies such as interest rate control, moral suasion are implemented through commercial banks. This helps control money supply.
7. **They act as advisors for potential investors/to their clients.** They act as credible advisors for their customers in local and foreign trade because they issue letters of credit, financial cards. This makes possible to increase the level of investment.
8. **They offer advice to potential investors and customers on business and financial matters.** This helps to set up profitable projects. They provide advice and guidance to their customers on how to use to correct loans for profitable investments.
9. **They create credit through granting loans** from the initial received from the public. This is through the process of credit creation.
10. **They act as trustees and executors of property of the customers.** They are entrusted with the property of clients when they die. This is because they can guarantee continuous existence than an other organization.

CREDIT CREATION.

Credit creation is a process by which commercial banks create new deposits out of initial deposit by customers through repeated lending.

Money lent out by commercial banks out of initial deposit using the cheque facility expands to result into greater volume of credit than the amount originally lent out.

The process happens without receiving any new deposits which implies repeated lending. The credit created from the process is usually on current account and is in form of book entry.

ASSUMPTIONS OF CREDIT CREATION.

- Assumes many banks or one bank with branches in the banking system.
- The public must be willing to deposit money to the bank/initial deposit must be made to the bank.
- A certain cash ration is known and fixed by the bank such as 0.2, 20% 10%
- The borrowers must have accounts in different banks.
- There should be a low cash ratio and high initial deposits for credit creation to be effective.
- There should be use of cheque facility and never to withdraw cash.
- The public must be willing and able to demand for loans from the bank.
- Commercial banks should be willing to lend money to the public.

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Total credit created = Initial deposit x Credit multiplier

Where Credit multiplier = $\frac{1}{cash\ ratio}$

For instance, if cash ratio is 20%, the credit multiplier $\frac{1}{20/100} = 5$

Assuming the initial deposit was Ug shillings 10,000 and cash ratio of 20%
Calculate the total deposit created
Total deposit created = Initial deposit x Credit multiplier
10,000 x 5
Total deposit created = Ug Shs 50,000

UNEB 2004

a) Given that, the cash ratio is 0.1% and initial deposit is shillings 250,000
Determine the;
(i) Total credit created (02 marks)
(ii) Credit multiplier (03 marks)

Examinable questions
UNEB 2007

a) Given the cash ratio of 0.2 and total deposit created is Ug shillings 200,000,000, calculate the initial deposit that was available at the bank.

Initial deposit = Total deposits x cash ratio
200,000,000 x 0.2
Initial deposit = Ug. Shillings 40,000,000

Or

Initial deposit = Total deposit / credit multiplier

Where credit multiplier = $\frac{1}{cash\ ratio} = \frac{1}{0.2}$

Initial deposit = Ug shillings 40,000,000.

b) Given that, the cash ratio is 0.1% and initial deposit is shillings 250,000
Determine
(i) Total credit created
(ii) Credit multiplier

Total credit created = Initial deposit/credit multiplier

Credit multiplier = $\frac{1}{cash\ ratio} = \frac{1}{0.1\%} = \frac{1}{0.001}$

= 1000 times

Total credit created = 250,000 x 1000

Shillings 250,000,000

Credit multiplier = $\frac{1}{cash\ ratio}$

a) Given that the cash ratio is 0.2% and initial deposit is shillings 500,000
Determine
• Total credit created
• Credit multiplier

Total credit created = Initial deposit / credit multiplier

Credit multiplier = $\frac{1}{cash\ ratio} = \frac{1}{0.2\%} = \frac{1}{0.002}$

Credit multiplier = 500 times

Total credit created = 500,000 x 500
Shillings 250,000,000

Credit multiplier = $\frac{1}{cash\ ratio} = \frac{1}{0.2\%} =$

Credit multiplier = 500 times

d) Given that the initial deposit in a bank is shilling 10,000,000 and the cash ratio is 20%. Calculate the total amount of credit that will be created in a multi-bank system.

Total credit created = Initial deposit / credit multiplier

Credit multiplier = $\frac{1}{cash\ ratio} = \frac{1}{0.2} = 5$

Total credit created = 10,000,000 x 5
Total credit created = shillings 50,000,000

UNEB 2011

(i) What is meant by the term credit multiplier?
(01 mark)

(ii) Given that the initial deposit in a bank is shillings 10,000,000 and the cash ratio is 20%. Calculate the total amount of credit that will be created in a multi bank system. (03 marks)

Credit multiplier or bank deposit multiplier

This is the number of times initial bank deposit multiplies and give/generate a final deposit/total credit created.

Credit multiplier has no units; it simply shows the number of times

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Assuming the initial deposit in a multi banking system is Ug shillings 10,000 and cash ratio is 30%. Calculate total credit created when four banks are involved in the banking system

Bank(s)	Initial deposit new	Cash ratio (30%)	New loan advance
L	10,000	3,000	8,000
M	8,000	1,600	6,400
N	6,400	1,280	5,120
P	5,120	1,024	4,096

Table 10.1: Credit creation

Total credit created after four banks = 10,000 + 8,000 + 6,400 + 5,120

Total credit created after infinity = 10,000 + 8,000 + 6,400 + 5,120 + ... If the process was to continue total deposit created will be much more.

From the above information, a given customer deposited shillings 10,000 to bank L

Cash ratio i.e. shillings 2,000 was kept for him

The remaining balances i.e. shillings 8,000 was lent out to another customer as a new loan who deposits it bank M.

Bank M keeps part of the deposit as cash ratio i.e. shillings 1,600 and lending out shillings 6,400 as new loan. The process continues for all banks until the deposit is defuses in the system.

NB. *At each singe, the amount lent out reduces because the cash ratio remained by the bank is constant.*

Worked example.

Given that the initial deposit among four commercial banks 1,2,3 and 4 is shillings 10,000 and the cash ratio is 5%. Determine the total deposit created

Banks	Initial deposit/new deposit	Cash ratio (5%)	New loan advance
1	10000	500	9500
2	9500	475	9025
3	9025	451.25	8573.75
4	8573.5	428.69	8145.06

Table 10.2: Credit creation

- Total deposit created = 10000 + 9500 + 9025 + 8573.75
- Total deposit created = shillings 37098.75

UNEB 2003

a) How do commercial banks in your country create credit? (08 marks)

b) Explain the factors which influence the process of credit creation in your country (12 marks)

UNEB 2010

a) How do commercial banks create credit? Illustrate your answer. (08 marks)

b) Explain the factors which limit credit creation by commercial banks in your country (12 marks)

UNEB 2015

a) Describe the process of credit creation by Commercial banks (10 marks)

b) What factors limit the ability of Commercial banks to create credit in an economy? (10 marks)

HOW DO COMMERCIAL BANKS CREATE CREDIT?

- Commercial banks create credit by receiving initial cash deposit from customers by a given bank. For example bank K receives shillings 1,000,000 as initial deposit.
- Retaining/keeping a percentage of the deposit as cash ratio. For instance 20% (Shs 200,000).
- Lending out the remaining balance to another customer i.e. Shs 800,000 who deposits it to another bank.
- Accepting money lent out as new deposit in another bank such as bank L i.e. Shs 1,000,000 – 200,000 = shs 800,000 which becomes the new deposit in bank L.
- Keeping a percentage of deposit in form of cash ratio by bank L i.e. 20% of Shs 800,000 which is Shs 160,000 is kept as cash ratio.
- The process continues until the initial deposit defuses in the system.
- At the end of the process, total deposit created = initial deposit x credit multiplier

$$\text{Total deposit created} = \text{Shs } 1{,}000{,}000 \times \frac{1}{20\%} = \text{Shs } 5{,}000{,}000$$

UNEB 2007

a) *Given a cash ratio of 0.2 and the total deposit created is Ug shillings 200,000,000. Calculate the initial deposit that was available at the bank. (04 marks)*

b) *Explain the factors that influence the process of credit creation. (16 marks)*

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DETERMINANTS OF CREDIT CREATION OF BANK DEPOSIT MULTIPLIER.

(Factors that influence/affect the process of credit creation in a multi banking system)

NB. Neutral points are presented showing high capacity to create more credit and limited capacity

to create more credit by commercial banks.

- **Size of initial bank deposit/availability of funds for lending.** The bigger the size of initial deposit, the higher the credit creation and the smaller the size of initial deposit, the lower the process of credit creation.
- **Size of the cash ratio.** High cash ratio implies less credit creation while a low cash ratio increases the process of credit creation.
- **Level of central bank interference through monetary policy/government monetary policy.** Use of expansionary monetary policy by the central bank through reducing bank rate, reducing legal reserve requirements increases credit creation while use of a contractionary monetary policy lowers the process of credit creation.
- **Interest rate on loanable funds.** High interest rate on borrowed funds scares away potential borrowers thus low rate of credit creation while low interest on borrowed capital borrowers from the public which increases the capacity of commercial banks to create credit.
- **Availability of valuable collateral security.** Presence of valuable collateral securities such as stocks, bills and bonds. Commercial banks expand their lending activities thus high power of credit creation while limited valuable collateral security limits the level of lending by commercial banks thus low rate of credit creation.
- **Level of liquidity preference.** The higher the liquidity preference, the lower the rate of credit creation since money is not taken to banks and the lower the level of liquidity preference, the higher the rate of credit creation.
- **Number of banks in the system and their distribution/level of development of banking sector.** Presence of many banks in the system which are evenly distributed increases credit creation while limited commercial banks and which are urban based limit credit creation.
- **Level of liquidity preference.** The higher the liquidity preference, the lower rge rate of credit creation since money is not taken to banks and the lower the liquidity preference, the higher the rate of credit creation.
- **Number of banks in the system and their distribution/level of development of banking sector.** Presence of many banks in the system which are evenly distributed increases credit creation while limited commercial banks and which are urban based limit credit creation.
- **Economic climate/rate of inflation in an economy.** Mild inflation encourages people to undertake economic activities and banks lend out more money to facilitate such activities which leads to high power to

create more credit while hyper inflation discourages investment and banking which lowers the rate of credit creation.

- **Level of investment/availability of investment opportunities.** The higher the level of profitable investments, the higher the rate of credit creation since individuals are encouraged to borrow while lower investments lower the capacity of commercial banks to create credit.
- **Level of awareness of people about the banking system.** High level of awareness of the public about banking system increases willingness to borrow and deposit money with commercial banks which increases credit creation while low level of awareness of the public about banking system limits credit creation.
- **Degree of accountability/corruption within the banking system.** Low level of corruption and embezzlement of funds among bank officials increases credit creation while high level of corruption and embezzlement of funds among bank officials limit the capacity to create more credit.
- **Level of monetization or size of subsistence sector of the economy.** If the use of money in an economy is high, credit creation increases but a large subsistence sector limits credit creation.
- **Level of demand for loanable funds/people's knowledge and popularity of loans.** High popularity of loans increases borrowing and credit creation while limited popularity of loans limits credit creation.

UNEB 2005

a) *Given that a micro finance bank has initial deposit of shillings 1,000,000 and the required cash ratio of 25%. Calculate the;* *(12 marks)*

(i) *Credit multiplier*

(ii) *Total deposit that will be created in a multi bank system.(12 marks)*

b) *Explain the factors which limit credit creation in an economy.*

(16 marks)

FACTORS THAT LIMIT CREDIT CREATION AMONG COMMERCIAL BANKS IN AN ECONOMY

NB These are given as unfavourable factors and one sided in nature that retard the capacity of commercial banks to create more credit.

1. **Poor distribution of commercial banks.** Few and poor distribution of banks mainly concentrated in urban areas limit credit creation in rural areas since potential customers for loans are reduced.
2. **High cash ratio maintained by commercial banks.** A high cash ratio within commercial banks reduces the amount of loanable funds as well as the rate of credit creation.
3. **High interest rate on loanable funds.** High interest rate charged on loans by commercial banks discourages borrowers hence limiting credit creation process.

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4. **Poor political climate.** This increases uncertainty which discourages potential investors leading to low demand for loanable funds which limits credit creation.
5. **High level of liquidity preference.** High desire by the public to hold cash limits the volume of deposits and savings in the banks hence less credit is created.
6. **Restrictive monetary policy by the central bank.** The use of restrictive monetary policy by the central bank reduces the capacity of commercial banks to create more credit. Power of the central bank through increasing bank rate, increasing legal reserve requirement which reduces amount of money for lending.
7. **Low demand for loans/unpopularity and limited knowledge of loans.** Limited demand for loans because of poor investment climate leads to low investment and limited use of commercial banks and credit creation reduces.
8. **Economic instability/uncertainty in form of inflation.** This leads to constant fluctuations in the value of the currency and discourages lending and credit creation as well.
9. **Limited valuable collateral security among the public.** This is because of wide spread poverty which limits the rate of borrowing and credit creation as well.
10. **Low level of monetization/large subsistence production.** Low level of monetization limits the rate of borrowing due to limited commercial transactions which limit credit creation.
11. **High rate of corruption and embezzlement of funds by bank officials.** Misuse of deposited funds in the banking sector and lending to only those who bribe them halts the process of credit creation.
12. **Small size of initial deposit.** Where the initial deposit is small, credit creation is lowered. This is due to low savings among the public.
13. **Limited credit worthy bank borrowers.** Bank customers who default on loans hinder successful credit creation in commercial banks.
14. **Low level of investment.** Limited investment levels reduce the ability of entrepreneurs to demand for loanable funds which limits the process of credit creation.

UNEB 2002

a) What are the assets and liabilities of a commercial bank? (06 marks)

b) How are commercial banks able to achieve both liquidity and profitability? (14 marks)

ASSETS AND LIABILITIES OF A C OMMERCIAL BANK.

1) Assets of commercial bank.

Assets of commercial bank are possessions of the bank plus its claims on other institutions. It refers to what the commercial bank owns.

Examples of assets of a commercial bank

- Cash at hand. This notes and coins within the bank
- Deposits with other banks and non banks
- Loans, advances and overdrafts to customers and other banks
- Special deposits with the central bank
- Reserves with the central bank
- Fixed assets such as buildings, land
- Long term investments in other institutions
- Profits and income from discounting bills of exchange

2) Liabilities of a commercial bank

Liabilities of a commercial bank are claims against the assets of the bank by creditors and depositors. It is what the commercial bank owes.

Examples of liabilities of a commercial bank are

- Customers' deposits. Money on current, fixed and savings accounts which belong to bank customers. Government funds deposited in the bank.
- Deposits by other banks and non banks with the commercial bank
- Bills discounted with the central bank
- Dividends payable to share holders of the bank
- Reserves payable to the central bank
- Share capital.

A **cheque** is a written order by the drawer to his bank o pay on demand a specified sum of money to the person named on it.

A **drawer** is the person who writes out a cheque i.e. the account holder.

A **drawee.** This is the bank in which the cheque is drawn.

Payee is the person to whom the cheque is made payable.

CONFLICTING OBJECTIVES OF COMMERCIAL BANKS.

These objectives contradict each other when it comes to lending. For instance long term loans are profitable but risky, therefore commercial banks are faced with the problem of achieving these objectives. Commercial banks are basically aimed at achieving these objectives;

- Liquidity
- Profitability
- Security

How do commercial banks reconcile the three conflicting objectives?

1) Liquidity objective. The bank must reserve liquidity/cash/liquid asset to meet the daily demands of customers. This is necessary to gain public confidence. Commercial banks achieve liquidity objective.

- Through maintaining a cash ratio. Keeping part of deposits in cash in cash ratio to meet the daily demands of customers.
- By keeping some near liquid assets such as treasury bills and bon which can easily be converted into cash.

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known as Bank of Uganda. It was formally established in Uganda on July 14 1966.

UNEB 2010

a) *Explain the functions of a central bank.* *(08 marks)*

b) *How does a central bank control credit in a multi bank system?* *(12 marks)*

(Give tools of monetary policy and employ the phrase THROUGH at the beginning of every tool). This is mainly done through manipulation of monetary policy tools.

FUNCTIONS OF THE CENTRAL BANK.

1. **Issues out the country's currency.** No bank other than the central bank is legally authorized print new currency notes and minting coins. The central bank enjoys the monopoly of the issue of country's currency in accordance with the rate of economic activities.
2. **It is a banker to the government.** The central bank keeps the accounts, deposits of the government and it is charged with the custody of government foreign exchange reserves or gold reserves.
3. **It is fiscal agent and financial advisor to the government.** The central bank helps the government in devaluation and revaluation matters, advises the government during an economic depression, formulation of annual budgets and modes of expenditure.
4. **It is a banker to commercial banks.** The central bank accepts deposits from commercial banks such deposits are liabilities to the central bank.
5. **A lender of last resort to commercial banks.** Commercial banks always borrow from the central bank in case they are in financial difficulties to meet their obligations as the last resort.
6. **Manages country's monetary policy/controller of credit.** The central bank controls credit by use of various monetary tools such as ban rate, moral suasion, open market operation by regulating the buying and selling of government securities, legal services requirements to either increase or reduce money supply on behalf of the government.
7. **Manages the country's public debt.** Both internal and external public debts are managed by the central bank through various methods such as setting a sinking fund, selling government securities to the public deficit financing, debt conversion and debt rescheduling.
8. **Banker to all international institutions working in the country.** For instance international Monetary Fund, World Bank, DANIDA and Red cross. It provides banking services to such institutions.
9. **Controls and inspects all commercial banks operating in the country.** This is meant to ensure that they control with the monetary policy.

10. **It controls foreign exchange** which the local currency exchanges for foreign currencies is controlled by the central bank.
11. **It is a clearing house for all commercial banks.** Commercial banks settle all their indebtedness through the central bank.

UNEB 2010

(i) *What is meant by monetary policy?* *(02 marks)*

(ii) *Give any three tools of monetary policy in your country.* *(12 marks)*

MONETARY POLICY.

Monetary policy is a deliberate governmental attempt through the central bank to regulate/control supply so as to achieve objectives of development (such as price stability, stable economic growth rate, full employment and balance of payment of stability.)

Therefore concerned with either increasing or reducing money supply in an economy to achieve various objectives of development.

TYPES OF MONETARY POLICY.

1) **Expansionary monetary policy** refers to a deliberate government attempt through the central bank to employment, stable economic growth rate.
2) **Contractionary/restrictive monetary policy** is a deliberate attempt through the central bank to reduce money supply in an economy so as to achieve objectives of development such as price stability, full employment, and stable economic growth rate.

UNEB 2009, 2006

a) *State the objectives of monetary policy in your country.* *(04 marks)*

b) *Explain the factors which limit the effective operation of monetary policy in your country.* *(16 marks)*

UNEB 2013

a) *Outline the objectives of the monetary policy in your country.* *(06 marks)*

b) *Examine the factors that limit the success of the monetary policy in your country* *(14 marks)*

OBJECTIVES OF MONETARY POLICY.

- To ensure price stability by controlling inflation through adopting restrictive monetary policy so that the value of money is stable over time.
- To influence the rate of economic growth in an economy by providing credit to private sector which helps to increase more investment.
- To influence the level of employment by stimulating investment through favourable interest rates which increases investment and job creation.

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- To influence balance of payment position through maintaining a stable foreign exchange rate system. This is through devaluation of the local currency in order to encourage exports and increase foreign exchange earnings
- To influence the level and nature of investment by controlling interest rates to attract more investors. This helps to attain balanced growth and development of the economy through selective credit control
- To encourage the growth of financial sector. This increases the rate of borrowing for increased investment
- To ensure stability of foreign exchange rates by strengthening the value of the currency in terms of other currencies.

UNEB 1999

a) What is meant by tools of monetary policy?
b) What factors limit the application of monetary policy in your country? (06 marks) (12 marks)

Tools of monetary policy are guidelines/weapons/instruments employed by the government through the central bank to regulate/control money supply so as to achieve objectives of development such as price stability, full employment, and stable economic growth rate.
Then give the tools of monetary policy and explain them.

UNEB 2015

a) What are the objectives of the monetary policy in your country? (06 marks)
b) Explain the methods used by the central bank to regulate money supply in your country. (14 marks)

UNEB 2008

a) Define the term monetary policy. (04 marks)
b) Explain the tools of monetary policy used in your country. (16 marks)

UNEB 1998

a) Explain the term monetary policy. (04 marks)
b) Examine the tools used by the central bank to regulate money supply in your country (16 marks)

TOOLS/INSTRUMENTS OF MONETARY POLICY IN AN ECONOMY

(How does a central bank control credit in a multi-bank system?)

Tools of monetary policy are guidelines or weapons or instruments employed by the government through the central bank to increase or reduce money supply in circulation so as to achieve objectives of development such as stability, high levels of employment, stability in foreign exchange. These tools are basically methods of credit control.

The central bank uses a number of tools or instruments that can help to control credit (money supply) in an economy and achieve the main objectives of monetary policy. These tools are basically methods of credit control. Each tool can either be contractionary / restrictive or expansionary monetary policy.

NB. State the tool, define it and clearly explain how it works both contractionary and expansionary

1. **Bank rate.** This is the rate of interest that the central bank charges commercial banks when they borrow from it. An increase in bank rate reduces money supply since it increases interest rate on loans for commercial banks while a decrease in bank rate increases money supply as it reduces interest rate on loans.
2. **Open market operation.** This involves buying and selling of government securities to the public such as treasury bills and bonds in an open market. Selling of government securities to the public withdraws cash from money and reduces money supply while buying of securities from the public increases money supply.
3. **Legal reserve requirements (reserve ratio).** This is a compulsory deposit by commercial banks which by law must be kept with the central bank. Increase in legal reserve requirements reduces money supply as commercial banks with enough liquidity.
4. **Special deposits/supplementary legal reserve requirements.** This is where the central bank instructs commercial banks to make a special deposit which is over and above legal reserve requirements. Lowering special deposits by the central bank increases money supply while increasing special deposits reduces money supply.
5. **Moral suasion.** This is the issuing of persuasive instructions by the central bank to commercial banks soliciting their cooperation in making its monetary policy effective. During inflation, the central bank asks commercial banks to increase lending thereby increasing money supply.
6. **Selective credit control.** This is where the central bank instructs commercial banks to favour or disfavour certain sectors when giving out loans. Credit is given to many sectors to increase money supply and lending is restricted to few to reduce money supply.
7. **Margin requirement.** This refers to the monetary difference between the value of the collateral security mortgaged for a loan and the value of the loan advanced to the borrower. Margin requirement is raised to reduce money supply since it discourages borrowing while it is reduced to increase money supply since it encourages borrowing.
8. **Currency reforms/conversion.** This is where changes in the country's national currency are made especially during inflation. This helps to control money supply. It occurs when there is excess liquidity in the economy which lowers the value of currency and the central bank may

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3. **They out compete local banks.** They create unnecessary competition which results into domestic banks leaving the banking sector.
4. **Lead to regional imbalances in development.** This is because they mainly operate in urban areas with necessary infrastructure.
5. **They are difficult to control by the central bank.** This is because at times they work under the direction of large banks in their countries of origin. They interfere with government and central bank policies which limits effective operation of monetary policy.
6. **They have discriminative lending policies.** They discriminate against local industries enterprises and charge them high interest rates. They show little concern to small-scale savers and are more interested in big depositors such as international firms, foreign embassies and government and mainly extend loans to foreign owned enterprises.
7. **Promote external economic dependence.** This exposes Uganda to dangers of external dependence such as unfavourable balance of payment position.
8. **They lead to low mobilisation of domestic savings.** This is due to high minimum account balance requirements which local people may not easily manage.

PROBLEMS FACED BY COMMERCIAL BANKS.

Commercial banks in Uganda face various challenges which limit their capacity to mobilize enough deposits from the public and give out enough loans. This implies that they are unable to successfully achieve profitability and liquidity objectives.

- **Low savings among people.** Majority of bank customers have low incomes and this implies low deposits from the public hence poor performance of commercial banks.
- **Limited skilled manpower to manage and supervise the banks efficiently.** Limited supply of highly skilled bank managers, tellers, supervisors limit the performance of commercial banks since it reduces efficiency.
- **Poor distribution of commercial banks/commercial banks are mainly urban based.** Most commercial banks are located in urban areas which have access to supporting infrastructure such as power supply, roads and this makes it difficult to get large number of customers and mobilize rural savings.
- **Limited credit worthy bank customers or borrowers.** Some of the bank customers normally default on loans which negatively affects the liquidity of the banks.
- **Persistent inflation /economic instability.** Uganda normally experiences hyper inflation, this discourages lending and leads to loss of real value of money thus limited investment.
- **Poor political climate in some parts of the country.** Political instabilities curtail economic activities that would create savings in the

banking sector. This also leads to loss of money and people uncertain to borrow for investment.

- **Government interference through the central bank.** For example increasing bank rate, increasing special deposits, regulations on the level of borrowing, increasing legal reserve requirement, selective credit control and through nationalization of commercial banks.
- **General ignorance of people about banking services.** Most people are ignorant about banking services provided by commercial banks due to low level of education thus poor banking habits and limited demand for loans.
- **High level of liquidity preference among people.** Many individuals prefer to hold wealth in cash form and they are unwilling to save in commercial banks. This limits the level of deposits with commercial banks from the public.
- **Corruption and embezzlement of funds among bank employees.** This negatively affects liquidity of the bank and discourages potential borrowers and depositors of the bank.
- **Stiff competition in the banking sector/business.** This is from commercial banks themselves, competition from non-banking financial intermediaries and other money lending institutions such as pension schemes, SACCOs, micro finance, telecommunication companies which have assumed the role of handling money. This limits mobilization of savings by commercial banks, increased operational costs and reduces profitability.
- **Limited collateral security form customers for lending and borrowing purposes.** Many bank borrowers lack valuable assets such as land, shares, buildings, investments to guarantee access to loans.
- **Existence of a large subsistence sector.** The level of monetary transactions is still low since there is high production for own use and limited borrowing for commercial activities. This limits deposits and demand for loans.
- **Poor infrastructure.** For instance roads and other communication facilities which reduces efficiency of the bank since it limits coverage of activities.

THE CENTRAL BANK.

A central bank is a government financial institution that helps to control amount and use of money in order to implement a certain monetary policy of the country.

It is a central monetary institution responsible for management of the system of the country. It is non-profit motivated and controls other banks and financial institutions operating in a country and it is responsible for ensuring economic stability in a country. In Uganda, the central bank

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- Through maintain a high minimum balance on deposit accounts
- By lending out short term loans so as to reduce the risk liquidity / avoiding long term lending
- By adopting a policy of credit squeeze

Credit Squeeze refers to a deliberate policy adopted to limit lending by commercial banks to maintain enough liquidity for the bank

2) **Profitability objective**. This is the ability of a bank to make normal profits. It is the responsibility of a bank to ensure enough liquidity because absence of cash disappoints customers and affects future profitability. This is the prime goal of any commercial bank. Commercial banks achieve profitability objective.

- By charging high interest rate on loans and overdrafts than what is offered on deposits.
- Through selling government securities. Taking short-term investments in treasury bills and bonds.
- Through charging fees on certain services rendered by the bank to customers such as keeping wills and storage of valuables
- By discounting bills of exchange and promissory notes. These are bought at low prices before maturity and sold at higher prices at maturity time
- By investing in other profitable ventures to generate income for instance construction project.

3) **Security objective/solvency**. This is the relative positions of assets and liabilities of a commercial bank. A commercial bank is considered solvent if its assets are more than its liabilities and insolvent if its liabilities are more than its assets. A bank should always be careful to avoid becoming insolvent. Commercial banks achieve security objective.

- By avoiding lending out money to risky ventures.
- By acquiring referees for any customer opening an account or getting a loan.
- By demanding for collateral security in getting a loan by customers such as land, buildings, shares, bills and bonds.
- By keeping fixed assets.

ROLE OF FOREIGN COMMERCIAL BANKS IN DEVELOPMENT OF UGANDA.

Foreign commercial banks are banks that are situated in the domestic economy but with their headquarters in other countries of origin.

For instance Stanbic bank, Barclays bank, Standard Chartered bank, Cairo International bank, Bank of Baroda, Kenya Commercial Bank, FINA bank, Equity bank.

Attractive investment incentives that have been given to foreign investors have attracted several foreign banks in the banking sector.

These commercial banks in Uganda are the majority and reap huge benefits from trade market and service industry and get a more than fair share of financing trade, imports and exports in Uganda. This has even increased the number of firms and entrepreneurs doing business in Uganda from the countries of origin such as Kenyans and South Africans.

POSITIVE ROLE OF FOREIGN COMMERCIAL BANKS IN UGANDA

1. **Contribute to infrastructure development.** They finance long term projects such as power supply, road construction necessary for development.
2. **They are source of government tax revenue.** They are among the top tax payers in Uganda thus strengthening government tax revenue realized.
3. **Encourage mobilization of savings and deposits from the public.** This increases future investment.
4. **Improve international relations and understandings.** This is necessary for increased trade and inflow of foreign aid.
5. **They create a competitive atmosphere in the local banking sector** thereby leading to improved efficiency and effectiveness and better service delivery. This stimulates the performance of the banking sector.
6. **They facilitate increased monetization of the country.** They encourage increased use of money because they provide loans for large scale investments thus breaking the large subsistence sector.
7. **They provide loans for investment.** They advance loans to local people necessary for increased investment.
8. **Provide employment opportunities to local people.** Many people are employed as tellers, bank managers, security guards. This enables people to earn income.
9. **Increase foreign exchange inflow for national development.** High foreign capital inflow which facilitates international trade.
10. **Promote private foreign investment.** Foreign investors usually prefer to keep their money in foreign banks. This increases capital inflow.
11. **They help in expanding the private sector.** The government is striving to expand and strengthen the private sector and such banks are helpful since most of them are large enough.
12. **Promote development of local skills in the banking sector.** Most of these banks are computerized and are helpful in equipping local Ugandans with modern skills in the banking sector.

NEGATIVE ROLE OF FOREIGN COMMERCIAL BANKS IN UGANDA.

1. **Increase profit repatriation.** They take profits to their home countries thus capital outflow which limits re-investment.
2. **They have discrimination employment policies.** They worsen unemployment situation due to employment of foreigners especially on top managerial posts and use of capital intensive technology.

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in need to create such liquidity from the public so as to reduce money supply and increase value of the currency.

9. **Rationing of credit**. This is where the government through the central bank portions the amount of money advanced to commercial banks. This is called credit/monetary squeeze. This helps to control money supply with either reduces or increases money supply.

10. **Direct intervention**. The central bank may intervene in the activities and management of commercial banks when they fail complainant to comply with tools of monetary policy so as to control monetary policy.

11. **Cash ratio**. The central bank restricts commercial banks to increase cash ratio so as to reduce money supply and cash ratio is reduced in order to increase money supply.

NB. Government securities are debt obligations issued by government authority and agencies with promised repayment of the principal upon maturity as well as interest repayment periodically. They are usually used by the government to control money supply, to raise money to pay for various government expenses.

UNEB 2002

a) Explain the objectives of monetary policy in an economy. (10 marks)

b) What factors limit the successful implementation of monetary policy in your country? (10 marks)

LIMITATIONS OF MONETARY POLICY IN LDCs.

(Factors that limit effective/successful implementation of monetary policy in LDCs)

NB. Mention the monetary tools that are limited where necessary in the process of explaining these limitations.

1. **Limited effective use of commercial banks.** Commercial banks have limited number of borrowers due to limited collateral security, low incomes, few credit worthy bank customers, existence of alternative sources of income which makes implementation of some monetary policies such as bank rate difficult.
2. **Dominance of foreign owned commercial banks.** Foreign commercial banks dominate the banking sector in most developing countries and yet follow directives form their countries of origin and therefore are not under direct control of the central bank which makes it difficult to control their lending policies and this fails tools such as bank rate and rationing of credit.
3. **Excess liquidity held by commercial banks.** Most commercial banks posses enough liquidity and therefore they do not normally borrow from the central bank making bank rate system less effective.

4. **Poorly developed money markets.** Money markets in developing countries are less developed and this limits effectiveness of open market operation.
5. **Conflicting government objectives.** For instance increasing interest rate to control inflation while providing cheap loans to the private to increase investment. Increasing economic growth while limiting money supply. This makes it hard to control money supply thus limiting effective use of bank rate.
6. **Ignorance of the public about open market operation.** The larger percentage of the population is ignorant about the sale of government securities through commercial banks and therefore the public cannot put these limiting operation of open market operation.
7. **Wide spread of corruption and embezzlement in banking work.** This fails the operation of selective credit control system in its implementation and therefore credit would not go to priority sectors. Loan applicants bribe bank officials and get loans even when it is not necessary.
8. **High liquidity preference among the public.** People prefer to hold their assets in form of cash or near cash and this leads to limited use of commercial banks. This makes is very difficult to control credit through bank rate and selective credit control since people do not deposit and borrow money from the bank.
9. **Political/government interference in activities of the central bank.** The government interferes with the activities of the central bank by dictating expenditure as a result loans are given out to individuals on political grounds and economic considerations are ignored which fails selective credit control.
10. **Existence of a large subsistence sector.** There is limited money in economic activities and this fails tools such as bank rate since the rate of public borrowing is low.
11. **Uneven/poor distribution of commercial banks.** Commercial banks in LDCs are mainly urban based due to infrastructure viability hence limiting the applicability of monetary policy in rural areas and yet it is through these commercial banks that monetary policies such as bank rate executed.

TERMS TO NOTE.

1) Cash ration

This refers to a fraction/percentage of commercial bank's total deposits must be retained by the bank in cash form to meet the daily cash demands depositors.

2) Liquidity ratio

This is a fraction of total assets of the commercial bank which remains in form of cash, or near cash form. It is the measure of the commercial bank to pay its debts and remain operating.

3) Reserve ratio

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This is a fraction/percentage of commercial bank's total deposits which by law must be kept with the central bank.

d) Credit control

This refers to measures adopted by the central bank to regulate lending ability of commercial banks in order to achieve desired economic objectives.

UNEB 2010

(i) Differentiate between cash ratio and reserve ratio (02 marks)

(ii) Give any two reasons why may be increased (02 marks)

REASONS WHY THE RESERVE RATIO MAY BE INCREASED BY THE CENTRAL BANK.

- To protect interests of depositors in times of crises and financial instability.
- To restrict credit creation by commercial banks
- To reduce liquidity level of the bank
- To control inflation
- To safe guard commercial banks against uncertainties such as periods of economic recession.

5) Instruments of credit.

These are written promises to settle payments at a future date. Examples of instruments of credit are; cheques, promissory notes, bills of exchange, bank drafts.

6) Treasury bills.

These are short term loan securities issued by the government treasury at a fixed interest rate for a given time.

They are documents issued by the central bank which represent debt obligations of the government. They are pieces of paper acknowledging government indebtedness of the stated sum of money to the holder and promise to repay it at a given date.

NB: *Credit means a system of borrowing and lending*

7) **A bill of exchange** is unconditional order in writing given by a creditor to a debtor to pay on demand a specific amount of money after a given period of time.

8) **A promissory note** is a document where a debtor promises to pay a specific sum of money to a named person at a given date.

9) **A treasury bill** is a short term loan security issued by the government treasury at a fixed rate for a given time. Its mainly period is less than a year and normally issued by the central bank to the public.

10) **A bond** refers to a long term government security whose maturity period is over one year and normally issued by the central bank.

11) **Security** refers to a document that gives a holder a right to have money or any property in possession in a specified period of time.

Factors that limit effective use of treasury bills in Uganda.

- *Limited public awareness about government securities*
- *High level of liquidity preference*
- *Limited capital to buy securities*
- *Low interest rate that discourage potential buyers of treasury bills*
- *Underdeveloped money markets.*

UNEB 2009

(i) Differentiate between a soft loan and a hard loan. (02 marks)

(ii) State any two reasons why your country continues to rely on loans.

(02 marks)

What is a loan?

A loan is a transfer of funds from one economic activity to another which must be paid back with interest at an agreed period of time.

Soft loan

A soft loan is a loan given at a low or no interest rate yet is provided a long repayment period and other concessions to the borrower such as interest holidays, extended grace periods.

Hard loan

This is a loan given at a high interest rate and yet with a short repayment period. It is mainly paid in currency of a nation that has economic stability and a sound reputation abroad.

Why does your country continue to rely on loans?

- To finance long term development projects
- Due to low tax revenue
- To close budgetary deficits of government
- Due to low domestic savings
- Due to low export earnings yet there is rising need for imports.

CIRCUMSTANCES UNDER WHICH AN INCREASE IN MONEY SUPPLY MAY NOT NECESSARILY CAUSE AN INCREASE IN PRICES/INFLATION.

- When an increase in money supply is accomplished by an increase in direct taxes which reduce disposable income.
- When there is effective price control measures and therefore inflation is suppressed.
- In case an increase in money supply is accompanied by a corresponding increase in production of goods and services.
- When people's marginal propensity to save is higher than marginal propensity to consume.
- When an increase in money supply is used to purchase capital goods and not consumer goods.

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Chapter 11: PUBLIC FINANCE AND FISCAL POLICY.

Public finance is a science which studies the way in which government obtains / mobilises revenue and how this revenue is spent in order to achieve major objectives of development.

Or

It is a science that is concerned with public revenue and public expenditure. It is about revenue and it deals with government revenue through taxation and other sources and public expenditure on various public utilities.

Public finance deals with the following

- **Public revenue.** Total income of the government from all sources such as deficit financing, taxation.
- **Public expenditure.** Total amount of money for government spending.
- **Public debt.** Total amount of money borrowed by the state, public authorities and corporations from both local and external sources.
- **Financial administration.** This involves studying how the national budget is prepared, implemented and audited.
- **Fiscal policy.** This is a deliberate policy under which government uses its expenditure and revenue (taxation) programmes to regulate the level of economic activities.

UNEB 2004

(i) What is meant by the term fiscal policy? (02 marks)

(ii) Mention only two sources of government revenue. (02 marks)

SOURCES OF PUBIC FINANCE.

Tax sources

This is the major source of government revenue which includes both direct and indirect taxes.

Non tax sources

a) Fees. These are payments made by individuals to the government for services rendered to them such as school fees in public schools and universities, valuating property, cost sharing in hospitals, stamp fees, postal services, land surveying fees.

b) Market dues. These are payments made by private individuals to the government to get permission to sell commodities in a given market place. These are paid on daily, monthly or weekly basis to the local government authorities.

c) Selling government securities to the public such as treasury bills which are sold to the public by the central bank through commercial banks.

d) Licenses. These are payments made by individuals before operating a given business or any gainful economic activity, for instance trade licence, driving permits.

e) Fines and penalties. These are imposed to punish law breakers, for example court fines and bails.

f) Compulsory saving schemes such as NSSF, insurance companies.

g) Gifts and donations. These are contributions made by individuals, international companies and friendly countries to the government for meeting costs of certain projects or events.

h) Privatization of public enterprises/disinvestment. The transfer of public enterprises to private ownership and control provide revenue to the government.

i) Loans/borrowing from internal and external sources. The government raises revenue by borrowing either internally or externally.

j) Deficit financing/printing more money. If there is shortage of funds the government issues new notes and coins through the central bank and this money is used to complete new development projects.

k) Earnings a surplus from gambling. This happens especially when such activities are clearly liberalized. This is effective in developing countries such as national lottery.

l) Profits/proceeds from public commercial sectors. Government enters into up commercial enterprises from which income is earned.

m) Rents on government owned property. This is obtained from government owned property such as buildings which may be rented to the public for commercial activities.

UNEB 1997

a) Define the term public finance. (04 marks)

b) What is the role of public finance in your country? (16 marks)

ROLE OF PUBLIC FINANCE IN DEVELOPMENT OF AN ECONOMY.

- **Achieving equitable distribution of income and resources/fight income inequality.** This is through government expenditure to income sections and tax systems such as progressive taxation to reduce income inequality.
- **Controls monopoly tendencies.** This is through high taxes on profits monopolists and increased subsidization of weak firms.
- **Enables the government to mobilize public revenue.** This is through taxation, contracting internal and external debts and through various sources. This revenue is important for public spending national development.
- **Enables the government to promote economic stability.** Such controlling demand pull inflation through increased direct taxation reduced government public spending.

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- **Influences proper use and allocation of resources.** Scarce resources are effectively utilised through proper budget allocations to basic but priority areas of development.
- **Important in stimulating economic growth.** It helps to increase aggregate demand especially in periods of economic recession to promote recovery and economic growth.
- **Discourages the consumption and production of demerit goods.** Undesirable and harmful goods are restricted by the government through imposing high taxes to increase their prices e.g. cigarettes and alcohol.
- **Improves Balance of payment position.** This is through the use of import and export duties to increase foreign exchange earnings and reduce foreign exchange expenditure. It helps to increase the volume of exports and reduce the volume of imports.
- **Protects and develops infant industries.** This is through subsidisation policy to local industries and high import duties on goods similar to what is locally produced by such industries.
- **Promotes employment opportunities.** This is done by facilitating both private and public investments through fair taxes and increased government expenditure on projects and subsidies to producers to generate more employment.

TAXATION.

Taxation refers to legal and compulsory transfer of money from the public to the government mainly as a source of government revenue and other regulatory purposes for economic development.

A tax is a non-quid proquo payment payable made by the tax payer to the government as a source of government revenue.

This implies that the benefits received by the tax payer from the government do not necessarily correspond to the amount paid as a tax i.e. the benefits from the government to the tax payer can be equal, greater or less than the tax paid.

UNEB 1999

a) Explain the principles of taxation. *(08 marks)*

b) Why is it necessary to levy taxes in your country? *(12 marks)*

REASONS/RATIONALE FOR TAXATION/OBJECTIVES OF TAXATION / WHY IS IT NECESSARY TO LEVY OR IMPOSE TAXES IN AN ECONOMY

NB: *these are given as reasons for taxation but not as effects of taxation.*

- **To raise public revenue.** Taxation through both direct and indirect taxes is a source of revenue to the government so as to finance public activities such as schools, roads and other recurrent and development expenditure.
- **To achieve equitable distribution of income and wealth.** Through progressive tax system, income inequality is reduced.

- **To protect domestic infant industries form imported cheap items/ dumping.** This is done through imposing high duties on goods similar to what is produced locally by infant industries leading to industrial development.
- **To influence the level of economic growth.** Fair taxes are imposed to encourage increased production or investments to achieve economic growth.
- **To regulate/control monopoly powers.** Taxes are imposed to eliminate profits of monopolists so as to discourage their operations.
- **To discourage production and consumption of undesirable goods** such as alcohol, cigarettes by imposing high direct taxes on such commodities which increases their prices and reduces demand.
- **To control demand-pull inflation.** High taxes imposed on personal incomes disposable income leading to a fall in aggregate demand and general price level.
- **To improve balance of payment position.** High taxes on luxury commodities form abroad reduce their demand thus reducing foreign exchange expenditure.
- **To regulate and influence allocation of resources.** In case the government wants to promote the use of a certain resources and increase production by attracting more investors in given sectors, low taxes are charged or removed on such economic activities.

UNEB 2014

a) Explain the importance of taxes in your country. *(08 marks)*

b) Discuss the dements of imposing taxes in your country. *(12 marks)*

UNEB 2007

a) Distinguish between direct and indirect taxes. *(04 marks)*

b) Assess the impact of taxation on an economy. *(16 marks)*

UNEB 2006

a) Assess the role of taxation in your country. *(08 marks)*

b) How can the current tax system be improved in your country? *(12 marks)*

POSITIVE ROLE/IMPACT OF TAXATION IN AN ECONOMY.

- **It is a means of raising public revenue.** Direct and indirect taxation provide revenue to government which used to finance public activities such as schools, roads, defence or for recurrent and development expenditure.
- **Ensures equitable distribution of income and wealth.** This is attained through progressive tax system.
- **Protects domestic infant industries from imported cheap items/ dumping.** This done through imposing high import duties on goods similar to what is produced locally which discourages dumping.

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- **Influences the rate of economic growth.** Taxation is done to obtain revenue to finance increased production of goods and services.
- **Regulates/controls monopoly powers.** Taxes are imposed on abnormal profits of monopolists so as to discourage their operations.
- **Discourages production and consumption of undesirable/harmful goods** such as alcohol and cigarettes. This is achieved by imposing high taxes on such commodities.
- **Controls inflation.** High taxation on incomes reduce disposable income leading to a fall in aggregate demand leading to reduced general price level.
- **Improves balance of payment position.** High taxation on luxurious commodities from abroad reduce their demand thus reducing foreign exchange expenditure.
- **Influences resource allocation.** In case the government wants to promote the use of certain resources and given sectors, low taxes are charged or removed on related activities.

NEGATIVE ROLE/IMPACT OF TAXATION IN AN ECONOMY.

- **Regressive taxation widens income inequality.** This is especially regressive tax systems and indirect taxes which treat buyers and the poor are therefore highly taxed.
- **Indirect taxes are inflationary/causes cost push inflation.** Heavy indirect taxation increases costs of production hence cost-push inflation and its negative effects.
- **Reduces consumer welfare/standard of living due to reduced consumption.** Taxation reduces disposable income leading to a reduction in welfare as consumption is lowered especially high income taxes such as progressive tax.
- **Discourages people's efforts and initiatives to work hard** especially progressive tax, high indirect taxes on producers and property. This leads to low investment and economic growth.
- **Creates resentment which leads to unpopularity of government.** High and unfair taxes on incomes and commodities are normally criticized by the public which creates resentment hence eroding government popularity.
- **Taxation leads to misallocation/diversion of resources.** Resources are shifted from production of highly taxed commodities to production of less taxed goods and non productive ventures.
- **Encourages trade malpractices/illegal activities.** Black marketing results especially where customs duties are very high as importers and exporters attempt to dodge such taxes since they reduce their profits.
- **Discourages investment.** Heavy corporate taxes are a disincentive to investment and discourage undertaking of risky ventures by both local and foreign investors.

- **Reduces volume and benefits of trade.** High customs duties discourage trade locally, importation and exportation of commodities due to reduced profits hence lowering the benefits from local and foreign trade.
- **Discourages savings.** High taxation reduces ability to save because of reduced disposable income among tax payers' income.

UNEB 2015

a) Describe the features of a good tax system. (08 marks)
b) Explain the role of taxation in the development of a country. (12 marks)

UNEB 2008

a) Explain the principles of taxation. (10 marks)
b) What are the problems faced by tax authorities in your country? (10 marks)

PRINCIPLES/CANONS OF GOOD TAXATION.

These are rule and regulation which should be observed in tax assessment, tax collection and tax administration.

In 1977, Adam Smith in his writing (Wealth of Nations) laid down major four canons of taxation which should be followed when imposing a tax. Other economists later some came up with other canons.

- ***Equity or fairness.*** This implies that tax should bear proportionately equal burden of the tax depending on their differences in income. It is divided into two;
  - *a) Horizontal equity.* This is where people in the same income bracket pay the same amount of a tax. Therefore, tax payers who are in equal income situations are treated equally.
  - *b) Vertical equity.* This is where people in different income levels pay different amount of a tax according to differences in their income. Therefore, tax payers who are in unequal income situations are treated differently where the rich should pay high taxes and the poor pay high taxes and the poor pay low taxes.
- **Certainty.** The nature of the tax, amount to pay, its assessment, mode of payment, place and time of payment must be clear and known to the tax payer and the tax collector. Therefore, the tax should be understood by the tax payer in terms of its of liability.
- **Convenience.** The places, periods and seasons when the tax is collected should be convenient to the tax payer. i.e. tax payers are taxed when they have money to pay. For instance farmers are taxed when they sell their crops, office workers are taxed when they receive their salaries and places of payment should be within a reasonable distance from the tax payer.
- **Economy or efficiency.** It should be economical to the government i.e. the cost of assessment administration and collection of the tax should

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be small in relation to tax revenue collected. The cost of tax collection should not exceed 5% of the tax collected

With changes in time and new thinking on taxation, other principles have been developed and added to the originally four stated by Adam Smith

- **Simplicity.** It should be easy and simple to calculate and understand by both the tax payer and the tax collectors so as to raise enough tax revenue. It should be in a clearest language easily understood by the tax payers.
- **Elasticity or flexibility.** Tax system should be flexible according to the prevailing economic conditions, requirements of government and incomes of people. It should not be static.
- **Comprehensiveness or diversity.** A good tax system should have a wide coverage/base so as to spread the burden of the tax to different categories of people. It should cover all potential tax payers and all sectors of the economy.
- **Productivity or adequacy.** It should produce sufficient revenue to justify its imposition by covering a wider area to increase tax revenue. It should be able to encourage people's efforts and initiatives and not to discourage investments. It should not be counter productive.
- **Neutrality or impartiality.** A good tax system should not discriminate among tax payers of the same category. All tax payers should be treated equally.
- **Consistency.** A good tax system should be in line with national economic objectives and most especially in resource allocation i.e. it should not contradict with national economic objectives.
- **Avoidance of double taxation.** A good tax system should not encourage double taxation to reduce negative effects of taxation on the tax payer.

TERMS USED IN TAXATION.

1. Tax bases

These refer to a range of economic units/activities on which taxes are imposed/levied.

It refers to an economic unit/activity on which a tax is imposed/levied. These economic entities may include individuals, firms, institutions, commodities among others.

UNEB 2013

a) Differentiate between taxable capacity and tax base. (02 marks)

b) State any two reasons for the narrow tax base in your country.(02 marks)

REASONS WHY THE TAX BASE IS NARROW IN LDCs.

- High level of unemployment and underemployment/limited employment opportunities.

- Political instabilities and insecurity which limit investment and makes it difficult to access tax bases.
- Poor identification of tax sources/inadequate information about sources of taxation.
- Narrow definition of lawful activities mostly being taxed hence leaving out potential tax payers. For instance gambling, prostitution, footballing, music industry, religious activities.
- Provision of excessive tax exemptions and tax holidays to some potential investors.
- Poorly developed infrastructures.
- Dominance of a large subsistence sector which are difficult to tax. (limited commercialization of the economy).
- A small industrial sector/low level of investment.
- Low levels of income.
- Large informal sector/small formal sector.

2. Taxable capacity.

This is the ability to which a tax payer is able to pay the tax assessed on him and yet remain with enough disposable income to maintain a standard of living which he is accustomed to.

Or

It refers to the ability of a tax payer to pay the tax levied on him and yet remain with enough disposable income to sustain/maintain usual standard of living/welfare.

Causes of low taxable capacity in LDCs.

- Wide spread poverty.
- Low level of industrialization.
- Poor political climate.
- Low tax awareness among tax payers.
- High income inequalities.
- Wide spread unemployment and under employment.
- Large subsistence sector.
- Low tax awareness among tax payers.

3. Tax avoidance.

This refers to a situation where a tax payer exploits loopholes or weakn in the tax system to pay less or no tax at all, it is legal. It is therefore illegal and not punishable by law. For instance investing in tax free proje investing in projects with tax holidays and tax exemptions.

4. Tax evasion.

This refers to a deliberate refusal by a tax payer to pay the tax impose him and it is illegal. It is illegal and punishable by law.

Reasons why people evade taxes in LDCs.

- Desire to retain all incomes earned

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CLASSIFICATION OF TAXES.

These are classified according to

- The tax income ratio
- The tax base

Classification of taxes according to tax income ratio.

This is according to ratio of paid tax to the amount of income of the tax payer.

a) Proportional tax.

This is a tax whose rate is uniform/same/constant for all tax payers regardless of the level of income.

This is a tax whose rate remains constant at all levels of income of tax payers. A uniform percentage of a tax is imposed on each tax payer's income regardless of the size of income. Every tax payer is required to pay the same percentage/proportion of the tax regardless of his income. For example, if 15% is charged, then it means who earn shillings 100,000 shillings 200,000, Shillings 500,000, shillings 1,000,000 will pay the same percentage of the tax. It does not favour low income earners since it increases their tax burden. It is said to be unfair to the poor because they feel the tax burden more than the rich.

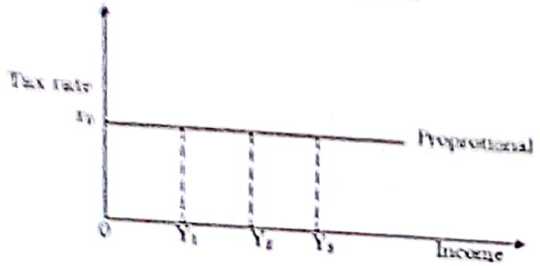

Figure 11.1: A proportional tax

The tax remains the constant regardless of charges in income of the tax payers.

Effects of a proportional tax.

- Easy to understand and calculate.
- Has less impact on work efforts, savings and investment.
- Adversely affects low income earners.
- Encourages income inequality.

b) Progressive tax.

A progressive tax is a tax whose rate increases as the tax payer's income increases. The proportion of income paid as a tax by rich is higher than that of the poor.

It helps to redistribute income from the rich to the poor. The rich pay a high percentage of their income as a tax than the poor.

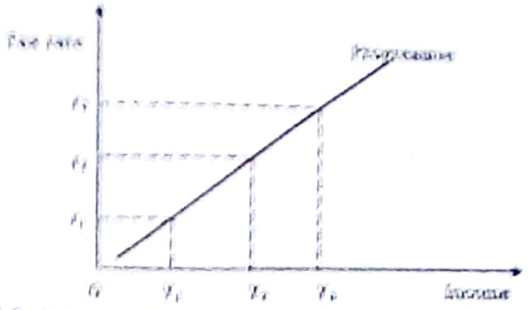

Figure 11.2: A progressive tax

An increase in income of the tax payer from Y_1 up to Y_3 leads to a corresponding increase in the tax rate from T_1 up to T_3

UNEB 2005, 2007, 2008, 2009

(i) Differentiate between a progressive tax and a regressive tax. (02 marks)

(ii) Give two reasons for imposing progressive tax in your country. (02 marks)

Advantages of a progressive tax.

- *It aims at reducing income inequality/promotes equitable distribution of income and wealth.*
- *It yields more tax revenue to the government.*
- *It favours the poor/low income earners.*
- *It helps to fight demand –pull inflation.*

Disadvantages of a progressive tax.

- It kills the initiatives to work hard.
- It discourages potential producers to produce more/investment is discouraged.
- It limits savings.
- It lowers aggregate demand.
- Causes political resistance.

UNEB 2012

a) Define the term regressive tax. (01 mark)

b) State any three effects of regressive taxes in an economy. (03 marks)

c) Regressive tax system.

A regressive tax is a tax whose rate reduces as income of the tax payer increase. It takes a high proportion of income of low income earners than high income earners. It is a tax that represents a small proportion of higher income paid groups than low income groups. Those who get more income suffer less from this tax. However, it hurts the poor more than the rich and those with low income.

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d) **Inheritance or death duty tax.** This is a tax imposed on, which is the property of the deceased person. It is meant to redistribute in...

d) **Income levy tax.** This a tax imposed when there is a national ... and there is a need for urgent revenue. For example during ... catastrophies such as earthquakes, floods and drought.

e) **Graduated tax/head tax.** This is a tax levied on every mature ... usually men above a certain age.

f) **Capital gains tax.** This is a tax levied on gains made by the ... certain capital/financial asset whose value has appreciated ... greatly from the time of purchase to the time of sale.

g) **Turn over tax.** This is imposed on the total sales of the business.

h) **With hold tax.** This is a tax imposed on dividends and interest ... as treasury bills and bonds.

UNEB 2009

a) *Distinguish between direct taxes and indirect taxes (04 marks)*

b) *Assess the impact of direct taxes on an economy (16 marks)*

POSITIVE IMPACT/EFFECTS OF DIRECT TAXES ON AN ECONOMY

- **They increase government revenue.** This helps to finance various projects.
- **They control monopoly powers.** Direct taxes are sometimes used by the state to reduce profit margins of monopoly firms.
- **They encourage production/economic growth.** This is through reduced taxation which increases demand hence encouraging more production.
- **They promote hard work.** People work hard in order to mobilize enough money and be able to pay taxes.
- **They create awareness/civic responsibility among tax payers.** Direct taxes force the public to demand for service delivery form government as accountability for tax revenue.
- **They control inflation.** This is through charging progressive taxes which helps to reduce disposable income hence reducing demand pull inflation.
- **They promote equitable distribution of income.** This is through increasing such taxes on high income earners and low taxes on low income earners.
- **They influence resource allocation.** Direct taxes are normally increased on earnings from certain activities to direct resources such activities to others where such taxes are low such as the use of corporate taxes.

ADVANTAGES OF DIRECT TAXES IN AN ECONOMY

- **They promote the principle of certainty.** This is because they are based on canons of certainty because the time of payment and the amount of pay are all known to the tax payer.
- **They are simple to understand by both the tax payer and tax collector.** This increases tax compliance because they are imposed on one's income and property that can be seen and valued.
- **They are in most cases flexible.** They can be increased or reduced depending on one's income and prevailing economic situation.
- **They are economical/cheap to collect.** They are easy to collect an administer since they are normally collected directly from people' salaries and collected by employers on behalf of government.
- **They are convenient to the tax payers.** They are spread over a lo period of time by paying in installments through monthly deduction from salaries/incomes and are paid after income has been received.
- **They do not shift the tax burden/incidence to another person.** T impact and the incidence of an indirect tax go to the person whom t tax has been imposed.

DISADVANTAGES/NEGATIVE IMPACT OR EFFECTS OF DIRECT TAXE

- **They discourage savings.** They are progressive in nature and therefo people will become reluctant to save due to reduced disposable inco especially after paying taxes.
- **They discourage investment.** High direct taxes on people's profit reduce the level of profits hence discouraging investment.
- **They discourage people's efforts and incentives to work ha** People's willingness to work hard is negatively affected especially wh extra earnings are taxed.
- **They are sometimes uneconomical/they involve high cost collection.** This is especially in rural areas where the tax payers dispersed which increases government expenditure on tax collection.
- **They reduce people's welfare.** This is because of reduced capacit buy goods and services especially due to low disposable income.
- **They lead to resource diversion.** They force companies to d resources from highly taxed activities to non taxed incomes / activiti
- **They cause wage push inflation.** They reduce disposable income workers and force them to demand for high wages thus fuelling push inflation.
- **They erode government popularity because they create resenti among people.** high taxes on incomes and property tend to make ruling government unpopular.
- **They tend to discriminate among tax payers.** High taxes are mor paid by high income earners and those who own a lot of property the poor.

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- **They widen income inequality**. This is especially where regressive taxes are imposed.

INDIRECT TAXES.

Indirect taxes are taxes levied on goods and services and a person who pays the tax can shift it to another person in form of high prices.
They are therefore taxes on consumption of goods and services and not income. They are paid indirectly as part of the price of the commodity.
The burden of the tax can be shifted to another person depending on the price elasticity of demand and price elasticity of supply.

Examples of indirect taxes.

a) **Excise duty.** This is a tax imposed on locally produced goods whether they are for export or local consumption.
b) **Sales tax.** This is a tax imposed on the sale of commodities. It is normally paid by the person who buys the commodity. In Uganda, it was replaced by VAT.
c) **Customs duty.** This is a tax imposed on either imports or exports. It can either be imports or exports. It can either be import duty or export duty.

UNEB 2000

(i) Define the term import duty. *(02 marks)*
(ii) State any three objectives of imposing import duties in your country. *(03 marks)*

Import duty.

This is a tax imposed on imported goods/commodities. It is imposed for the following reasons;

- To fight against imported inflation
- To discourage the importation of harmful and undesirable products
- To improve on balance of payment position of a country.
- To protect home infant industries form foreign trade competition.
- To raise revenue for the government.

Export duty.

This is a tax imposed in exported commodities. It is aimed at raising government revenue, encouraging stability of home prices, discourage exports and imports and satisfy home demand. Customs duty can be charged on either advalorem basis or specific basis.

d) **Advalorem tax.** This is a tax levied according to the value of a commodity. It is charged as the percentage of the value of the commodity.
e) **specific tax.** This is a tax imposed on each unit of output produced. It does not depend on the value of that unit of output produced.

f) **Sumptuary tax.** This is a prohibitive tax imposed on undesirable commodities so as to reduce their consumption. For instance taxes on given brands of cigarettes.
g) **Octroi tax.** This is a tax imposed on goods in transit passing through the territory of a country to another. It is intended to pay for services which travelers / businessmen enjoy while crossing over to some territory of a country.
h) **Dead weight tax.** This is a tax which when imposed on input makes that tax payer to abandon the activity which forms the tax base.
i) **Lump sum tax.** This is a tax at a fixed amount irrespective of the output produced. It is normally used to control monopoly power by increasing average cost of production and reducing profit.
j) **Value added tax (VAT).** This is a tax imposed on value added to the commodity as it passes through various stages of production.

Or

This is a tax imposed on net value added to the taxable product by business enterprises at its various stages of production. The percentage of VAT is in most cases uniform. This tax in Uganda has replaced sales tax and expenditure tax.

UNEB 2002

(i) What is meant by the term value added tax? *(02 mark.*
(ii) Give any three advantages of value added tax in your country. *(03 marks*

Advantages of value added tax.

- It is a more productive source of revenue/has a wider coverage base it is comprehensive and all factors are taxed equally.
- It is very difficult and evade since its distribution is at successive stage of production.
- It promotes efficiency in production especially in keeping tons of accounts. This is because, it cannot be computed without proper business records.
- It avoids double taxation.
- It is economical in terms of administration and collection.
- Reduces corruption since its payment is through the bank.

Disadvantages of value added tax.

- The rate of VAT is uniform and it affects small business more adversely than big businesses.
- It is difficult to calculate because it requires proper book keeping among traders.
- It increases cost of production which eventually leads to high prices of final output.

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it has loopholes as tax payers try to undervalue their commodities
2. exposes the secrets of the business
3. creates opposition from the public to the ruling government

UNEB 2001
a) Distinguish between tax base and taxable capacity (04 marks)
b) What are the advantages of relying on indirect taxes? (16 marks)

UNEB 2003
a) Explain the incidence of a tax when supply is elastic and demand is;
(i) Inelastic (04 marks)
(ii) Perfectly elastic (04 marks)
b) What are the advantages of levying indirect taxes? (12marks)

ADVANTAGES OF INDIRECT TAXES

- **They are comprehensive enough.** ... tax every income earning purchases. They have a wider cover ... as they cover a variety of goods and services. They are therefo... major sources of government revenue since they cover a wider range of economic activities.
- **They are convenient to pay since they are paid when spending occurs.** They are paid when the commodity is bought or sold. One can only pay them if he wants to buy the commodity.
- **They have less tax evasion and avoidance.** They are included in the price and can only be evaded and avoided when consumers refuse to buy the taxable commodities. Buying a commodity on which a tax is imposed means paying a tax.
- **They are less felt and resented.** Individuals cannot easily feel their impact since they are not directly imposed.
- **They are impartial because they do not discriminate.** i.e. at least every category of people must purchase goods irrespective of how much they earn.
- **They are more economical in collection.** i.e. they are cheap and easy to collect since they are collected by business intermediaries.
- **They can redistribute income when selectively imposed.** High taxes on luxurious commodities and low taxes on essential commodities which the poor must purchase helps to redistribute income.
- **They are flexible or elastic.** They can be adjusted by the government depending on the country's prevailing economic situation.

DISADVANTAGES/NEGATIVE IMPACT OR EFFECTS OF INDIRECT TAXES.

- **They widen income inequality.** They are regressive in nature since the poor and the rich have to pay the same amount of tax on commodities thus widened income gap.

- **They are inflationary in nature** because prices are bound to increase depending on price elasticity of demand or price elasticity of supply by a taxable commodity thus fueling cost inflation.
- **They have an adverse effect on investment and employment.** This is because they increase prices thus reducing aggregate demand which reduces production and employment.
- **They lead to misallocation of resources.** Producers shift from production of taxed commodities to non taxed commodities/less taxed commodities.
- **They undermine the volume and benefits of trade.** This is through high import and export duties which reduce benefits of international trade such as specialization.
- **They encourage trade malpractices.** Such as smuggling if they are high especially custom duties when importers and exporters try to dodge such taxes.
- **They lead to reduced consumption leading to reduced welfare.** They force consumers to resort on consumption of inferior goods. This lowers their consumption levels hence reducing their standard of living.
- **They breed inefficiency in protected firms.** Protected firms from foreign competition through high imported duties tend to remain infant in nature.
- **Lead to resentment of government/protest among traders and consumers.** They increase hatred to the ruling government form the public as a result of increased taxes especially on consumer goods.

UNEB 2010

a) Distinguish between tax evasion and tax avoidance. (04 marks)
b) Assess the impact of indirect taxes on the economy of your country.
(16 marks)

Positive impact/effects of indirect taxes on the economy of Uganda

- They influence allocation of resources/level of investment
- Provide revenue to the government
- They improve balance of payment position
- Discourage consumption of demerit goods.
- Protect infant domestic industries from foreign competition
- Promote efforts and hard work among the people.

Negative impact/effects of indirect taxes on the economy of Uganda.

- They undermine reduce volume and benefits of trade
- Promote trade malpractices such as smuggling
- Lead to cost push inflation
- They promote income inequality since they are regressive
- Lead to reduced consumption hence decline in people's welfare
- They discourage investment
- Lead to resentment of government/protest among traders.

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- Lead to misallocation of resources
- The breed inefficiency in protected firms. Protected firms tend to remain infant in nature.
- They lead to increased cost of production.

PROBLEMS/CHALLENGES FACED BY TAX AUTHORITIES IN LDCS/ UGANDA.

- **Existence of a narrow tax base.** There are limited entities on which taxes are levied due to low investment levels especially in the industrial sector.
- **Shortage of skilled man power to assess, administer and collect taxes.** There are limited qualified and experienced tax assessors and administrators hence inability to impose fair taxes and collect them.
- **Low taxable capacity and income.** Majority of the tax payers cannot pay taxes on them and remain with enough income to live a decent standard of living. This is because of wide spread poverty which makes it difficult to determine how much each individual should pay as a tax.
- **Poor/underdeveloped infrastructure** such as poor roads, limited telecommunication facilities to coordinate the collection of taxes especially in rural areas. Tax officials cannot travel to various areas to assess and collect taxes.
- **Wide spread corruption and embezzlement among tax officials.** Tax revenue us misused by those on broad and bribes are offered in the process of assessing taxes. This lowers the tax revenue on the part of government.
- **Ignorance of masses/public about the importance of paying taxes.** Because of high rate of illiteracy, people do not know the role of taxation which reduces the amount of tax collected.
- **Wide spread tax evasion and avoidance.** Many people dodge and avoid taxes by using loop holes in the tax system, give false information about their income. This reduces tax revenue because of weak tax laws.
- **Conflicting government policies on taxation.** This leads to excessive tax holidays and exemptions (tax concessions) given to investors alongside increasing tax revenue. The government gives excessive concessions to investors and this reduces the amount of tax revenue collected and yet there increased need for more tax revenue.
- **Political instability in some areas.** This limits collection of taxes in such areas and besides it discourages investment leading to low tax revenue.
- **Difficulty in identifying taxable sources.** People earn income in different ways which is difficult to tax because of large subsistence sector, informal sector which makes it very hard for tax officials to identify entities on which to impose taxes.
- **Frequent changes in employment and residences.** There are several target workers who change places of work due to increased labour

mobility hint. gang

collection in trying to follow up the tax payers to get certain taxes.

- **Hostility and resistance from the public against tax payment.** Tax payers are hostile to tax assessors and collectors especially with introduction of new taxes thus less tax revenue is realized.
- **Existence of high level of inflation.** Inflation reduces the value of revenue collected overtime and at the same time makes it difficult to carry out fair tax assessment on different activities.

UNEB 2002

a) Assess the role of taxation in an economy. (08 marks)

b) Suggest ways of how tax collection can be improved in your country. (12 marks)

MEASURES THAT HAVE BEEN TAKEN TO INCREASE TAX REVENUE COLLECTION IN UGANDA/WAYS THROUGH WHICH THE CURRENT TAX SYSTEM HAS BEEN IMPROVED

- **Sensitization of masses on the role of taxation/increase in education to raise awareness of people about role of taxation.** Masses have been sensitized on the taxation through various means such as seminars, mass media to increase tax payers' compliance by reducing tax evasion and avoidance thus creating positive attitude towards paying taxes.
- **Improved infrastructure.** This has been done through upgrading roads, improving telecommunication systems to ease tax collection through increased accessibility to different areas which has increased tax collection.
- **Widened tax base by introducing new taxes.** This has been done by introducing more indirect taxes since they have low administrative costs in order to widen the tax base. For instance VAT introduced in 1996, income tax introduced in 1997.
- **Ensured proper and effective use of revenue from taxes.** The government has endeavored to provide necessary social and economic services to the public to motivate tax payers to pay taxes promptly and they will be seeing what the tax revenue has done.
- **Recruitment and training tax personnel/use of trained personnel to asses and collect taxes.** This has been done to enable manpower gain skills in tax administration and collection which increases tax revenue.
- **Reduced corruption in tax system/Disciplinary measures against corrupt tax officials have been adopted.** Code is adopted to guard against corruption and strengthening procedures for investigating allegations of corruption in tax collection and administration by government to increase tax revenue.
- **Improved political climate and security to promote economic activity.** This has been done through peace talks with rebels and

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governance to ensure stability of the country politically and encourage various investments, increase the tax base and tax collection.

- **Use f fair tax assessment/principle of equity**. Fair taxation depending on one's ability to pay the tax has been emphasised. This motivates people to pay taxes and has been done to reduce on tax evasion and avoidance.
- **Improved implementation of tax laws/reforms**. Tax reforms have been implemented and this has helped to increase tax revenue collection.
- **Development of a tax payer friendly system of tax collection**. Tax collectors have been trained to use friendly methods of collecting taxes so as to encourage tax payers to pay taxes willingly. This increases tax payers' compliance.

NB: *there has been establishment of specialised institutions to deal with tax administration and collection such as URA in 1991*

TAX INCIDENCE ON PRICE ELASTICITY OF DEMAND.

When indirect tax is imposed, supply reduces and therefore, the entire supply curve shifts to the left.

1. When demand is elastic

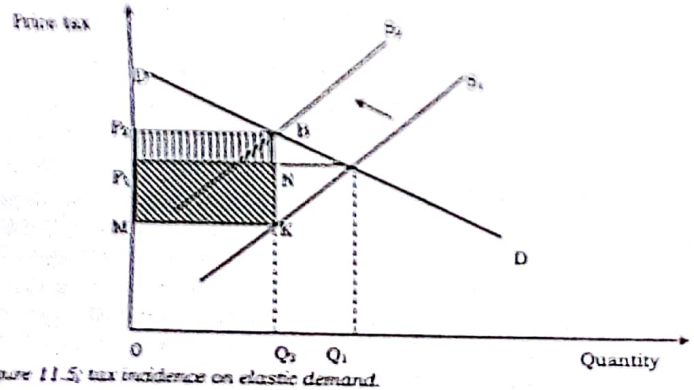

Figure 11.5: tax incidence on elastic demand.

- The vertical distance (KB) between the two supply curves is the total tax per unit of output
- Total tax is given by the area MP_2BK
- The biggest proportion of the tax is paid by the producer i.e. NK or (MP_1NK)
- The smaller burden of the tax is paid by the consumer (BN) or (P_1P_2BN)

UNEB 1999

(i) Distinguish between incidence of a tax and impact of a tax . (02 marks)

(ii) Determine the incidence of tax when demand is price inelastic (02 marks)

2. For inelastic demand.

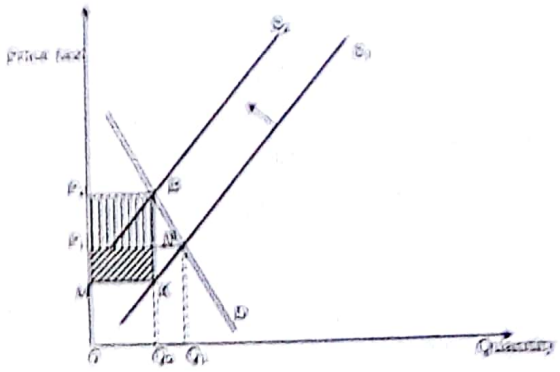

Figure 11.6: tax incidence on inelastic demand

- Total amount of the tax burden is given by the area MP_2BK
- The biggest proportion of the tax burden is paid by the consumer i.e. BN or P_1P_2BN
- The smaller burden of the tax is paid by the producer (NK or MP_1NK)

3. For perfectly elastic demand.

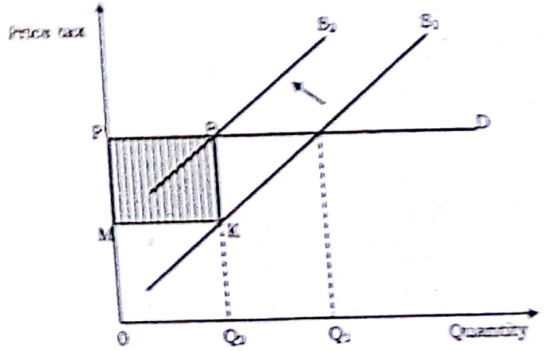

Figure 11.7: Tax incidence on perfectly elastic demand

- The total tax burden is MPB or KB, which is paid by the producer or

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4. For perfectly inelastic demand.

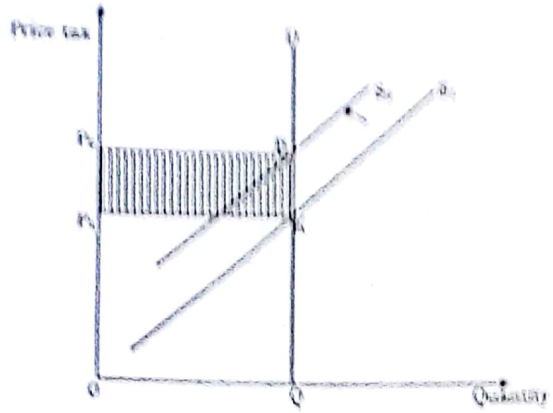

Figure 11.8: tax incidence on perfectly inelastic demand.

- Total tax burden is P_1P_2BK and it is paid by the consumer only

5. For unitary elasticity of demand.

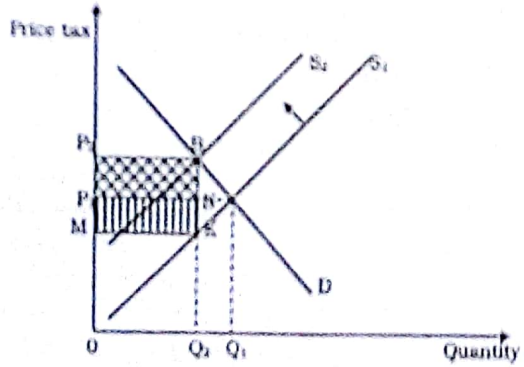

Figure 11.9: Tax incidence on unitary elasticity of demand

- Total tax is MP_2BK which if shared equally by the consumer and the producer i.e. MP1NK for the producer and P_1P_2BN for the consumer ($MP_1NK=P_1P_2BN$)

UNEB 2004

(i) What is meant by the term fiscal policy? *(01 mark)*

(ii) State any three sources of government revenue. *(03 marks)*

FISCAL POLICY.

Fiscal policy is a deliberate policy under which government ... expenditures and revenue (taxation). It is a deliberate government ... involved in the direction and action through the instrument of ... public expenditure to influence the level of economic activities.

UNEB 2005

(i) Distinguish between fiscal policy and monetary policy *(02 marks)*

(ii) State any two instruments of fiscal policy in your country *(02 marks)*

TOOLS/INSTRUMENTS OF FISCAL POLICY.

- *Taxation.*
- *Public/government expenditure.*
- *Licensing.*
- *Subsidization.*
- *Public borrowing.*
- *Fines.*

UNEB 2011

a) What is meant by the term fiscal policy? (02 marks)

b) Explain the objectives of fiscal policy in an economy. *(12 marks)*

OBJECTIVES OF FISCAL POLICY IN AN ECONOMY.

- To maintain price stability in the country by controlling ... through direct taxes to reduce disposable income and ... government expenditure to reduce the amount of money ... thus reducing demand pull inflation.
- To harmonize and improve on investment climate /influence ... levels through favourable taxes and increased subsidies to ... from both local and foreign sources.
- To reduce balanced regional development i.e. increase expendit... poor regions and fair taxes and reduced expenditure in ... developed regions and tax such regions highly.
- To promote high level of employment opportunities through ... expenditure on economic activities such as agriculture, ... social overheads to create job opportunities, reduced taxes to ... increased investment to generate more job opportunities.
- To protect local infant industries from foreign competition through ... import duties on finished imported products similar to what is ... by such infant industries thus encouraging consumption of ... produced commodities.
- To generate public revenue for both recurrent and capital budget ... taxation system where new taxes are introduced thus ... government revenue.

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- To ensure equitable distribution of income and resources through progressive taxation on high income earners and increased expenditure on projects that benefit the poor such as education and other social services.
- To improve balance of payment position by discouraging given imports through high import duties and encouraging exports through subsidising exporters.
- To discourage consumption of harmful / undesirable products through imposing taxes on such products to discourage their production and consumption since they are made very expensive.
- To influence the rate of economic growth through accelerating both private and public saving investments through tax holidays, tax exemptions to increase the productivity of the country.
- To control monopoly powers through increased taxation on profits of monopoly firms and subsidisation of weak firms to compete with the already existing monopoly firms.
- To influence resource allocation through tax holidays and tax exemptions and increased government expenditure to investment areas which the government wants to favour.
- To achieve desirable political objectives through reduction in taxes and increased public expenditure especially on the disadvantaged which is indented to win political support.

PUBLIC BORROWING AND DEBT MANAGEMENT.

Public borrowing. This is a method of raising public revenue through contracting internal and external debts is classified into two.

1. **Internal borrowing.** This is a method raising public revenue by borrowing from citizens of the country and domestic financial institutions.

An internal debt is the total amount of money borrowed by the government from the country's citizens and domestic financial institution. For instance from the central bank, from rich nationals and commercial banks within the country.

Or

It is the debt which the government owes to the country's citizens and domestic financial institutions.

INTERNAL DEBTS ARE RAISED THROUGH THE FOLLOWING WAYS.

- Selling of government securities to the public in form of treasury bills and bonds.
- Borrowing from the central bank
- Borrowing from the rich nationals
- Borrowing from domestic institutions like commercial banks
- Borrowing from strong firms/companies in the domestic economy.

2. **External borrowing.** This is a method of raising public revenue by acquiring loans from other countries and from external financial and multi-national institutions.

An external debt is the amount of money the government owes to foreign countries and foreign institution / agencies.

Uganda has been with huge external debts since independence. For instance in January 1986 it was 1.4 billion US dollars and in June 2003, it had increased to 3.9 billion US dollars.

The major sources of external debts in Uganda are multi-lateral creditors such as African development Bank, IMF, European investment Bank, European countries and commercial banks and non banks in foreign economies.

Sources of external borrowing.

- Borrowing from friendly outside countries.
- Borrowing from international financial institutions such as World Bank and IMF.
- Borrowing from multi-national corporations.
- Borrowing from regional cooperations such as EAC, EDU.

CLASSIFICATION OF DEBTS.

1. **Public debts**

This is a debt/money borrowed by central government, local authorities and public corporations either from internal or external sources.

Or

It refers to the total borrowing both internal and external by the central government, local authorities and public corporations in a country.

Or

It refers to a debt incurred by the central government, local government and public corporations as a result of borrowing from internal or external sources.

2. **National debt.**

This is a debt incurred by the central government on behalf of its nationals either from external or internal sources. It encludes the debts of local authorities and public corporations.

Or

It is the debt that the central government owes its nationals and outsiders/foreigners.

3. **Funded debt.**

This is a long term debt where the date for repayment is not specified/fixed at the time of securing the debt but the borrower keeps on paying annual interest on the principal.

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The borrower keep paying interest but the specific date for paying the principal is not known. The government is not obligated to repay the principal at a specific time but continues to pay interest until it is convenient for it to repay the principal.

4. Unfunded debt.
This is a short term debt where the time of repayment is specified/fixed and well known to both the lender and the borrower at the time of securing the debt. The date for repaying the interest and the principal is known.

5. Floating debt.
This refers to short-term debt by the government obtained from the sale of government securities of treasury bills and bonds.

6. A reproductive debt/self liquidating debt.
This is a debt used to finance productive projects that bring in returns used to pay back the loan i.e. it is a self liquidating debt.
It is a debt borrowed by the government and backed by real assets invested in productive activities which can easily pay back the debt. For example loans borrowed to construct development projects are usually self-liquidating such as power supply projects, purchase of industrial inputs. It represents the amount of money borrowed and spent on productive activities that generate revenue which can be used to repay the interest and the principal.

7. Dead weight debt/non – productive debt.
This is a debt used to finance unproductive activities that do not bring in returns i.e. it is not self liquidating. It is not backed by real assets (invested in non productive activities). For instance buying fire arms, financing elections, debts for organizing, swearing in ceremonies, debts to finance national celebrations, buying firearms.
Money has to be raised from other sources to pay the interest and the principal.

UNEB 2013
(i) Distinguish between a reproductive debt and a dead weight debt.
(02marks)
(ii) State any two ways in which a public debt can be redeemed.
(02marks)

UNEB 2004
(i) What is a public debt? *(01mark)*
(ii) Suggest three ways in which an external public debt may be cleared.
(03marks)

Ways of clearing an external public debt.
- *Creation and use of a sinking fund.*
- *Debt conversion/borrowing from cheaper sources.*
- *Use of foreign reserves.*
- *Disinvestment/ sale of investments at home and abroad.*
- *Taxation.*
- *Negotiation for debt cancellation/debt relief/ waiver.*
- *Utilizing grants, gifts from foreign sources.*

TAXATION FINANCING AND DEBT FINANCING.
Taxation financing
This is where government meets her expenditure through use of revenue from taxation.
Or
It is where the government uses revenue from taxes to finance its expenditure.
Debt financing.
This is where government uses revenue from borrowing is used to expenditure that may not be covered by tax revenue.
Or
It is where the government borrows to finance its expenditure that may not be covered by tax revenue. It is the government act of fulfilling its expenditure requirements through public borrowing either from internal or external sources.

UNEB 1997
a) Distinguish between dead weight debt and a funded debt. (04 marks)
b) What are the merits and demerits of government borrowing? (06 marks)

MERITS OF DEBT FINANCING/PUBLIC BORROWING AS A MEANS OF RAISING PUBLIC REVENUE
- **Bridges tax deficits/supplements tax revenue.** It helps the government to supplement tax revenue thus increasing funds available for government spending.
- **It is less costly on part of government to raise money.** It is easy and convenient way of raising public revenue since borrowing does not required a lot of government expenditure.
- **Enables the government to raise quick revenue for national emergence** for instance during natural catastrophes such as floods where urgent revenue is needed, debt financing becomes efficient.
- **It has less negative effects on consumption which improves people's standard of living.** It does not have direct burden shifting and does not affect welfare of people in the short run since it does not reduce disposable income.

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- **It facilitates large scale investments because enough revenue is raised.** Enables the government to finance long term projects and programmes which cannot be financed by taxation because it raises enough revenue by acquiring large sums of money.
- **Encourages international relationships and political cooperation** through external borrowing. This is between the borrowing country and the donor country thus increased international trade.
- **It is a tool used to check on demand pull inflation.** External borrowing by the government reduces amount of money supply thus reducing demand pull inflation.
- **Has limited negative impact on government popularity/has limited opposition from the public.** It is politically popular as means of raising public revenue since it has less resentment from the public compared to taxation which creates resistance from the public against paying taxes.
- **It is a source of foreign exchange through borrowing from external sources** which helps a country to increase her foreign reserves for developmental purposes.
- **Helps to finance balance of payment deficits in the short run.** Borrowed funds are used by the government to clear debts that had accumulated in the past.

DISADVANTAGES OF DEBT FINANCING (BORROWING) AS A MEANS OF RAISING PUBLIC REVENUE.

- **Increased the problem of external debt servicing.** High capital flight results especially where there are external debts in the process of external debt servicing.
- **Encourages extravagancy and mismanagement of public resources.** Debt financing leads to increased extravagancy in the use of borrowed funds especially among top politicians who use such funds to live luxuries life since it does not encourage civic responsibility.
- **Worsens balance of payment problem.** This is especially where there is excessive external borrowing when it comes to repaying thus high foreign exchange expenditure.
- **Lowers the level of consumption among future generation.** The future generation suffers through paying high taxes to raise enough revenue to clear the debts thus reducing their consumption levels.
- **Encourages laziness among citizens thus increased external dependence.** This is because nationals remain lazy since they are subjected to high taxes to encourage them work harder.
- **Borrowed funds are sometimes tied.** Such funds cannot be used to meet the interest of the borrowing country leading to resource misallocation.
- **Reduces capital accumulation.** This is because the amount of funds that would be used for increased investment is used to clear the debts accumulated in the past.

- **Shifts the burden of repaying the public debt to future generation.** This is because some debts especially due to external borrowing can be contracted for a very long period of over 25 years. This becomes worse especially where the borrowed funds are spent on unproductive venture such as fighting wars.

UNEB 2004

a) Distinguish between debt financing and taxation financing.
(04 marks)

b) Present the advantages of debt financing over taxation financing.
(16 marks)

UNEB 2013

a) Differentiate between taxation financing and debt financing
(04 marks)

b) Why may a government rely more on debt financing than taxation financing
(16 marks)

ADVANTAGES OF DEBT FINANCING OVER TAXATION FINANCING.

- Debt financing does not involve costly methods of collection (it is easier to borrow) compared to taxation financing which is in most cases uneconomical since high costs are incurred in the process.
- Debt financing enables a country to use both local and foreign sources of revenue compared to taxation financing which is only internal and resources raised may not be enough.
- Debt financing helps the government to realize a lump sum of money (large amount of revenue) compared to taxation where revenue comes in slowly and fluctuates.
- Debts financing has limited negative political effects to the government from the public compared to taxation financing which costs the government political popularity.
- Debt financing involves shifting of debt burden to future generation compared to taxation financing where the tax burden is felt by the present generation.
- Debt financing does not discourage production by raising production costs compared to taxation especially high indirect taxes which lead to high production costs and finally inflation.
- Debt financing does not have adverse effects on consumption in the short run since it does not reduce disposable income but taxation financing reduces disposable income and hence low consumption.
- Debt financing increases foreign reserves of the country and encourages foreign investment compared to taxation financing which discourages potential foreign investors.

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- Debt financing can be used to fight inflation especially internal borrowing compared to taxation financing which causes cost push inflation.
- borrowing is a quicker method of raising money than taxation financing

UNEB 2004

a) Why do countries incur public debts?
(06 marks)

b) Explain the methods used to reduce the burden of public debts in your country. (14 marks)

UNEB 2008

(i) Differentiate between a national debt and a public debt. (03 marks)

(ii) Mention any two reasons for incurring a public debt in an economy
(02 marks)

UNEB 2011

(i) What is meant by a public debt? (01 mark)

(ii) Mention any three reasons for raising money through a public debt
(03 marks)

WHY DO COUNTRIES INCUR PUBLIC DEBTS/REASONS FOR RAISING MONEY THROUGH PUBLIC DEBTS

- To repay mature public debts/meet debt repayment obligations (interest rate and the principal).
- To raise more funds currently needed for recurrent expenditure such as paying salaries of civil servants.
- To handle the effects of natural calamities such as floods, earthquakes and land slides.
- To ease the burden of taxation on nationals in the short run
- To fill savings investment gap/to raise more revenue for investment. This helps to finance budgetary deficits which would in turn speed up economic growth.
- To supplement tax revenue especially where the majority are poor.
- To finance short run balance of payment deficits.
- To sustain markets by leaving citizens with enough disposable income.
- To control inflation by reducing amount of money in people's hands.
- To achieve and maintain a given level of employment.

PROBLEMS ASSOCIATED WITH AN EXTERNAL DEBT/NEGATIVE IMPLICATIONS OF A LARGE PUBLIC DEBT.

- Worsens balance of payment position of a country.
- Encourages wasteful use of resources extravagancy.
- It is a burden to future generation due to increased taxation to pay back.
- It encourages over dependence of country on others.

- It may be inflationary.
- It has high administration costs.

PUBLIC DEBT MANAGEMENT.

Public debt management refers to the process of acquiring, utilizing servicing and repaying debts by the central authority, local authority a public corporations.

Or

This refers to the ways and means of how a public debt is administered i.e. how it is obtained, controlled, serviced and later on repaid.

It refers to the means undertaken by the government to raise public re ways of using the borrowed funds and how to repay the borrowed funds

- It involves the ways and means of how public debts are administe
- It involves when to borrow, how to use the borrowed funds, wh borrow from and when to pay back.

UNEB 2002, 2010

a) What is meant by public debt management? (02 marks)

b) Mention any three objectives of public debt management. (03 marks)

OBJECTIVES OF PUBLIC DEBT MANAGEMENT.

- To influence the prevailing rate interest.
- To mobilize financial resources.
- To reduce on the debt burden/minimize the cost of public deb
- To maintain price stability.
- To influence income distribution.
- To ensure proper utilization of funds minimize corruption.

UNEB 2009

(i) Differentiate between a reproductive debt and a dead weight deb
(02 marks)

(ii) Mention any two ways of managing a public debt. (02 marks)

UNEB 2006

a) Why do countries incur public debts? (06 marks)

b) Explain the methods used to reduce the burden of public debt i country. (14 marks)

WAYS OF PUBLIC DEBT MANAGEMENT/METHODS USED TO RE THE BURDEN OF PUBLIC DEBTS IN AN ECONOMY/WAYS IN WH PUBLIC DEBT CAN BE REDEEMED.

Clearing huge public debts and proper public debt management ope in developing countries had been a major challenge since it involves measures.

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- **Negotiation for debt cancellation/waiving/relief.** This where the borrower pleads to the lender to cancel part of the whole debt due to inability to pay back. Uganda has had some of her external debts cancelled.
- **Debt rescheduling.** It involves a request from the borrowing country i.e. the lending country to postpone the date for paying back the borrowed money.
- **Disinvestment/privatisation of public enterprises.** Governments sell state owned enterprises both within and abroad to private individuals to raise money and clear public debts.
- **Debt conversion.** It is a policy of the by borrowing from low interest sources and uses such loans to pay mature debts borrowed from high interest sources.
- **Use of donations, gifts and grants** from other states and multi-national corporations. These help to clear the outstanding public debt.
- **Debt repudiation/outright refusal to pay back the debt.** It is a deliberate government refusal to pay back the debts it owes to creditors. However, this is not a good measure of public debt management because it damages the credit worthiness of the country.
- **Setting up a sinking fund.** It is a policy of the government where it establishes a resource pool per year for clearing the mature public debts. The government successively puts aside a given amount of money year after year to accumulate and pay back the debt.
- **Sale of government securities to the public** such as treasury bills and bonds to accumulate revenue for paying back public debts.
- **Increased taxation/capital levy.** This is where nationals especially the rich are made to pay high taxes so as to raise money to clear the public debt.
- **Use of deficit financing/financial accommodation/borrowing from the central bank.** Government prints more money through the central bank in what we call financial accommodation to clear the public debt.
- **Use of accumulated foreign reserves.** The government uses foreign exchange reserves and gold reserves held by the central bank to repay the borrowed funds.
- **Use of accumulated profits from state owned enterprises.** State owned enterprises at times accumulate some profits which are used to clear the outstanding public debts.
- **Operation of a surplus budget.** The government uses money in excess of its expenditure at the end of a given year to pay back the debt.

NB: public debt burden refers to the cost of contracting public debt on the present or future generation. It may be real public debt burden or money public debt burden.

GOVERNMENT/PUBLIC EXPENDITURE.

This refers to the total amount of money spent by the government on different activities and projects on behalf of the state. It is divided into two:

Recurrent expenditure.

This refers to the day today spending of government aimed at maintaining the existing capacities/projects. For instance expenditure on salaries of civil servants, defence and maintenance of existing infrastructure, pension contributions to international organizations, paying interest on the national debt, pensions, general public administration.

Or

This is the daily expenditure by the government on the day today running of the state to maintain and finance the already existing projects.

NB: Over most of the years since 1962, recurrent expenditure in Uganda has been increasing because of increasing number of public servants, increasing size of parliament and cabinet, increasing size of public debt. This expenditure has been in form of servicing vehicles, repaying national debts, paying pensions and salaries of civil servants.

Development/capital expenditure.

This refers to spending by the government on capital goods/investment projects for the purpose of both expanding the existing capacities and creating new ones to generate more goods and services. For instance expenditure on establishment of infrastructure such as roads, railways, setting up hospitals and schools, energy projects, mining projects.

It is all about expenditure by the government on short term and long term development projects which will lead to future production of goods and services. It is concerned with increasing the productive capacity of the economy.

Government spends on capital goods, investment projects for the purpose of expanding capacities.

UNEB 2012

a) *Distinguish between government recurrent expenditure and development expenditure.* (04 marks)

b) *Account for the increase in public expenditure in your country.* (16marks)

CAUSES OF INCREASE IN PUBLIC EXPENDITURE IN UGANDA OVER THE YEARS.

- **Increasing public administrative costs.** This is due to increase in public service, creation of new districts, frequent by-elections, large cabinets and size of parliament. All these have led to high government spending.
- **Rising levels of corruption and embezzlement of public funds/rising costs of fighting corruption.** Public officials misuse large sums of public revenue which has been forcing the government to make new

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expenditure. There are rising costs of fighting corruption and embezzlement, several corruption scandals have increased the cost corruption through increased expenditure on public accounts committee, office of the inspector general of government and the police

- **Increasing costs of infrastructure development.** There has been increasing demand for tarmac roads, power supply projects and extension to different parts of the country thus high government expenditure.
- **Rising emergency expenditure due to frequent occurrences of natural calamities.** There has been frequent occurrences of natural calamities such as floods, landslides, epidemic diseases which have led to frequent emergency expenditure.
- **Rising expenditure on defence due to increasing social political unrest in the country.** Defence takes large section of government expenditure and the government has been trying to create political stability country wide and in neighbouring countries thus spending more money.
- **Increasing expenditure on servicing the public debt.** The government has been spending a lot of money on servicing external debts due to increased external borrowing and most of them are non productive
- **Continuous over ambitious planning.** The government comes drafts over ambitious plans for instance prosperity for all, universal secondary education, vision 2040 which require excessive government expenditure.
- **Rising expenditure on international commitments/engagements.** These include contributions made to various international organizations, peace keeping missions in other countries which increases government spending.
- **Persistent high rate of inflation.** This leads to high costs of project implementation. Inflation in Uganda has been a major macro economic problems which increases the cost of implementing projects since the real value of planned revenue is reduced and requires supplementary expenditure.
- **High population growth rates.** The population has been growing at a high rate per year which increases government expenditure on social services such as education, health facilities , provision of clean water which require high government expenditure.
- **Rising government expenditure on programmes intended to create more income and employment.** for instance youth fund, prosperity for all programmes which require increased government spending

GOVERNMENT/NATIONAL BUDGET.

A national budget refers to an estimate of expected/planned government revenue and planned government expenditure of a given financial year.

Or

it refers to an estimate
it plans to spend that revenue in a given financial year
in Uganda, the budget is read in the cabinet by the finance minister
beginning of every fiscal year in June it deals with the policy
both fiscal and monetary that are aimed at directing the economy
coming fiscal year
it is through the national budget that the government highlights
performances of the economy in the previous fiscal year and
course of action in the next fiscal year.

TYPES OF NATIONAL BUDGETS.

a) Balanced/neutral budget.

This is a budget (one) whose planned/expected government revenue
to planned government expenditure of a financial year. Such a
very rare in most LDCs and may simply be put in place to avoid
borrowing and foreign dependence.

b) Unbalanced budget.

This is a budget (one) which is either surplus where planned
revenue is greater than planned government expenditure of a
or a deficit where planned government expenditure is greater
government revenue of a financial year.

Or

It is one where there is either a deficit budget or a surplus budget.

Unbalanced budget can be;

a) A deficit budget. This is a budget (one) whose
government revenue is less than planned government
financial year. It should be noted that many governments
budgets and resort deficit financing.

b) A surplus budget. This is a budget whose
government revenue is greater than planned government
financial year.

c) Recurrent budget. This is one which involves
and estimated daily expenditure of the government.

d) Development/capital budget. This is one where
revenue and planned expenditure is meant for the
development projects. For instance construction of roads.

UNEB 2001, 2007

(i) What is meant by a government budget?
(ii) Mention any three objectives f a government.

UNEB 2015

(i) What is a national budget? (01 marks)
(ii) Mention any three objectives of a budget in your country.

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OBJECTIVES OF GOVERNMENT/NATIONAL BUDGET.

- To raise government revenue for providing social services/infrastructure development.
- To correct Balance of Payment deficits.
- To protect infant domestic industries from foreign competition.
- To reduce income inequalities/Redistribute income.
- Used as a collecting tool during both inflationary and slump periods.
- To increase the rate of economic growth through hence savings which are to invested.
- To ensure proper allocation of resources.
- To increase employment opportunities and reduce unemployment.
- To discourage production and consumption of undesirable goods.

Advantages of a deficit budget.

- **It helps to reduce unemployment.** Since it stimulated demand which increases investment opportunities thus more job creation.
- **It helps to remove an economy from a depression.** Since it helps to stimulate demand in an economy. This through increased borrowing.
- **Borrowing may be cheaper and quicker.** Therefore, a deficit budget is able to help the government raise money in the shortest possible time through increased borrowing.
- **It is politically acceptable.** This is because through this budget, the citizens are not normally subjected to heavy taxation since it normally implemented through borrowing.
- **It helps to promote large scale investments.** It enables the government to mobilize enough revenue for large scale investments through borrowing.
- **It encourages private savings.** A deficit budget reduces the burden of taxation on tax payers which enables them to save money that would have been used to pay taxes.

UNEB 1998

a) What is meant by unbalanced budget? (04 marks)
b) Why may government deliberately plan for unbalanced budget? (16 marks)

REASONS WHY THE GOVERNMENT MAY OPERATE/PLAN FOR DEFICIT BUDGET.

- To encourage borrowing which may be quicker and cheaper. This attracts foreign aid.
- To win political support of the masses especially towards general elections.
- To avoid negative effects of taxation and increase their disposable income.

- To increase consumption by creating disposable income.
- To raise more funds to encourage investment and growth by increasing government expenditure.
- To stimulate aggregate demand for goods and services.

REASONS WHY THE GOVERNMENT MAY PLAN FOR A SURPLUS BUDGET.

- To enable the government accumulate reserved for future investment especially where there are long term investment plans to be undertaken in future.
- To provide foreign aid to other countries which increases international cooperation and understanding.
- To improve on balance of payment position through reduced importation.
- To gain on government popularity since resources to improve social welfare are available through the budget.
- To prepare for any unexpected problems such as landslides, floods and earthquakes.
- To regulate aggregate demand so that pull inflation is controlled by increasing taxes and reduce money supply.
- To raise more revenue that the required expenditure so as to clear the already contracted public debts.

UNEB 2006, 2003

a) Distinguish between a surplus and a deficit budget. (04 marks)
b) How does government finance a deficit budget? (16 marks)

HOW DOES THE GOVERNMENT FINANCE A DEFICIT BUDGET.

(Ways/measures used by the government to finance/close deficits in its budget)

NB: *the government finances a deficit in the budget through / by;*

- **Soliciting for donations and grants.** The government seeks to donations from friendly countries, companies to mobilise revenue to close budgetary deficits.
- **Selling government securities to the public such as treasury bill and bonds.** These securities are said to the public through the cent bank which helps the government to raise revenue to finance the budg deficit.
- **Use of a country's foreign reserves/running down foreign reserve** The government uses all its held foreign currency such as dollars finance a budget deficit.
- **Printing of more money/borrowing from the central bank.** central government directs the central bank to print more money circulation which raises revenue to finance the budget deficit.

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- **Levying special taxes such as capital levy.** The government may tax individuals especially the rich and obtain revenue to close the budget deficit.
- **Borrowing from external sources such as world bank.** The government contracts external loans from friendly countries, international aid agencies and foreign financial institutions to finance a deficit budget.
- **Use of profit/revenue from government commercial ventures.** Government owned businesses make some profits and such revenue is used close a budget deficit
- **Introducing compulsory saving schemes such as NSSF.** Through government, the public is forced to save part of their incomes and such savings are used by the government to finance its deficits in the budget.
- **Disinvestment/sale of government enterprises to raise revenue.** The government privatizes its enterprises so as to raise revenue necessary for financing a deficit budget.
- **National lottery/earning a surplus from gambling.** This is effective where the related activities are legalized.

UNEB 2005, 1999

a) Distinguish between a budget surplus and a budget deficit. (04 marks)
b) Explain the significance of a national budget in an economy. (16 marks)

UNEB 2014

(i) Distinguish between a deficit budget and a surplus budget. (02 marks)
(ii) State any two reasons why a country may prepare a deficit budget. (02 marks)

UNEB 2002

a) Why may the government plan for a deficit budget? (04 marks)
b) Explain the role of government budget in an economy. (16 marks)

UNEB 2011

a) Explain the role of the national budget in your country. (08 marks)
b) Account for persistent budget deficits in your country. (12 marks)

ROLE/SIGNIFICANCE OF THE NATIONAL/GOVERNMENT BUDGET.

- **It helps to reduce balance of payment deficit/improve balance of payment position.** Through introducing high import duties especially on expensive imports to reduce foreign exchange expenditure and reducing taxes on exports, increased expenditure on exports to increase foreign exchange earnings.
- **It helps to protect local infant industries from foreign competition.** This is through introducing high taxes on imports competing with locally manufactured goods and increased government expenditure on such industries to increase demand for locally produced goods.
- **It influences proper resource allocation/investment.** This is done by introducing favourable taxes on given activities which the government wants to promote and allocating more resources to such activities according to priority.
- **Helps to mobilize public revenue by providing social services/essential goods.** Public revenue is mobilized through taxes and savings outlined in the budget to establish different types of infrastructures, provide goods at affordable prices.

  Several forms of infrastructure are outlined in the budget and resources are allocated to develop them.
- **It discourages consumption of harmful/undesirable/demerit goods.** Through the national budget the government introduces high taxes on harmful products which makes them expensive and reduces the demand.
- **It is used as a correcting tool during inflationary periods/controlling inflation.** It controls inflation by introducing high direct and indirect taxes in the budget to reduce aggregate demand and reducing government expenditure to reduce money supply and thus price stability.
- **Helps in achieving equitable distribution of income.** This is achieved by introducing progressive taxation on the rich, subsidization of goods for consumption, planning for distribution of projects in different parts of the country and introducing a minimum wage.
- **It helps to create and maintain high level of employment/help to reduce unemployment.** This is through the use of a deficit budget which leaves people with enough disposable income to consume which increases investment and job creation. In addition, through the use of high government expenditure is made on infrastructure and other activities that lead to job creation.
- **It accelerates the rate of economic growth.** this is achieved through increased taxation to encourage forced savings, government expenditure on subsidization of firms and other economic activities that lead to production of more goods and services thus achieving economic growth.
- **It helps to mobilize external resources/foreign aid.** Donor countries and agencies are interested in a well laid down budget in terms of revenue and expenditure. It highlights the rate of economic growth and performance of the economy which gives confidence to donors to finance such projects.
- **It helps in mobilization of the masses.** Through the budget, the government is able to win political support where certain political policies are put in the budget to win political support.
- **Helps in management of the public debt.** it is through the budget that various methods of acquiring, utilising and repaying public debts are outlined.
- **Helps to reduce economic dependence.** Through the budget, the appropriate measures are outlined in the budget to increase domestic production and reduce expenditure on imports and other requirements.

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UNEB 2000

a) Distinguish between recurrent expenditure and capital expenditure in the budget. (04 marks)

b) Account for persistent budgetary deficits in your country. (16 marks)

CAUSES OF PERSISTENT GOVERNMENT BUDGETARY DEFICITS IN UGANDA.

- **Low taxable capacity.** The ability to pay taxes in Uganda is limited due to poverty thus low taxable income implying limited tax revenue to balance the budget.
- **High corruption and embezzlement of public funds/low levels of accountability.** Increased misuse of funds by government officials leads to loss of funds that would have been used to off budget deficits.
- **Narrow tax base/few tax bases.** There are limited activities and low incomes on which taxes are imposed hence limited tax revenue.
- **Increased cost of infrastructure development.** Such as roads, power supply projects, hospitals, schools which have to be financed. These take a large percentage of government revenue thus budgetary deficits increasing population also increases demand for social services such as education through UPE, USE and university scholarship thus high government expenditure.
- **High military expenditure due to political instability.** This is non productive and does not bring in returns, increases government expenditure on maintenance of security organs, buying military hardware.
- **Persistent debt servicing and repayment of the principal.** Huge external debts normally take part of revenue that would have been used to finance domestic activities which reduces to be used for public expenditure thus budgetary deficits.
- **Limited non-tax sources of public revenue.** There are very few non-tax sources of government revenue such as fees, licenses and fines thus low government revenue.
- **High cost of public administration/civil servants and politicians.** There is high expenditure on politicians, civil servants due to creation of many districts, large cabinet thus high recurrent expenditure. Uganda has one of the biggest cabinets and many parliamentarians in Africa thus budgetary deficits.
- **Weak tax administration.** This leads to low government tax revenue due to high rates of tax evasion, tax avoidance leading to budgetary deficits.
- **Increased importation of expensive goods especially capital machinery.** This leads to high government expenditure abroad compared to revenue from abroad.

- **Frequent occurrence of natural disasters.** This is due to the occurrence of floods, drought, landslides which normally calls for huge emergence funding leading to increased government expenditure thus budgetary deficits.
- **Over ambitious planning.** Over generalized plans assumed a lot of money of implement leading to high government expenditure.
- **Heavy expenditure on international/external commitments.** For instance contributions to international organization leading to high government expenditure.

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