SIMPLIFIED NOTES FOR SENIOR SIX

UNIT 1: INTERNATIONAL TRADE THEORIES.

1.1.1: Meaning of International trade.

International trade is the exchange of capital, goods, and services across international borders or territories, which could involve the activities of the government, companies and individuals.

Or **International trade:** refers to the exchange of commodities across national borders of country. Or it refers to the selling and buying of commodities and services between or among nations.

Difference between domestic trade and international trade

1. Transactions in domestic trade involve the use of **one currency,** normally the national currency or legal tender. while for international trade though, **various currencies** may be involved.
2. Trade within a country is **not subjected to barriers** restricting the movement of goods internally. On the contrary, movements of goods across national boundaries are **subjected to varying degrees of restrictions, i.e. tariffs, quotas.**
3. Goods exchanged in domestic trade tend to be **more standardized than goods in international trade**.
4. The paper work involved in domestic trade is normally **less voluminous compared to that involved in international trade.** There is hardly any paper work involved in the domestic trade.
5. International trade is typically **costlier than domestic trade**. The reason is that a boarder typically imposes additional costs such as tariffs, time costs due to boarder delays and costs associated with country differences such as language, the legal system or culture which isn't the case with domestic trade.
6. Factors of production such as **capital and labour are typically more mobile within a country than across countries.**

1.1.2: Forms of international trade:

1. **Bilateral trade or clearing trade or side deal** is the exchange agreement between two nations or trading groups that gives each party favored trade status pertaining to certain goods obtained from the signatories.

Or **Bilateral trade** the exchange agreement of goods and services between two nations promoting trade and investment

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2. Multilateral trade refers to the exchange of commodities among more than 2 countries. or multilateral agreements are commerce treaties among three or more nations.

1.1.3: Terminologies used in international trade.

i) **Exports**; these are commodities sold from one country to other countries.
ii) **Imports;** these are commodities that are bought from one country to another country.
iii) **Export trade**; this is the selling of commodities from one country to another.
iv) **Import trade**; this is the buying of commodities from one country to another.
v) **Visible trade**; this is the exchange of commodities that involve only goods. i.e. exchange of tangible or physical commodities between or among countries.
vi) **Invisible trade**; this is the exchange that involves only services. i.e. exchange of intangible commodities like education, insurance, health, tourism etc.
vii) **Entrepot trade**; this is the type of trade where goods are imported by a country for purposes of re-exporting them to another country.
viii) **Balance of trade**; this is the relationship between visible exports and visible imports. The relationship can be positive, thus favourable balance of trade or negative, thus unfavourable balance of trade.
ix) **Vent for surplus**; this refers to the theory which emphasizes increased exploitation of domestic idle resources so as to increase exports or foreign exchange hence increasing country's GDP.
x) **Open economy**; this is an economy which is involved in international trade.
xi) **Closed economy**; this is an economy which is not engaged in international trade at all.
xii) **Gains from trade**; these are advantages which accrue from international trade.

1.2.1: Advantages or arguments for International Trade.

1. **It permits and fosters international specialization** in order to maximize output and minimize costs of production. This therefore leads to increased national income, savings, investment and employment opportunities for the participating countries.
2. **It overcomes shortages** i.e. if a country engages in international trade it overcomes such shortages brought by for example natural disasters.
3. **Market expansion;** i.e. international trade widens markets for the participating countries e.g. LDCs raw materials thus assured markets for their raw materials.
4. **Vent for surplus**; International trade enables a country to utilize her resources thus full utilization of resources due to assured markets.
5. International trade offers an opportunity to a country to sell **a surplus of products and to make use of available land and labour**
6. International trade stimulates **competition and forces home producers to become more efficient** which leads to better quality, lower prices and more output.

7. It leads to **introduction of new ideas**, **technologies, knowledge and skills, entrepreneurship and social change**. Thus, the dynamic effects of trade which stimulate economic development in the long run.
8. International trade provides **revenue to the government** from import and export duties. This revenue can be used to finance different development activities in the economy.
9. **Creation and maintenance of employment** i.e. once countries specialize for international trade in production of certain goods for export, it follows that there will be employment in those sectors.
10. **Promotes cultural and political ties** between or among countries since there is understanding among trading partners which creates global peace and harmony among countries.
11. International trade **avails wide variety of commodities** which increase the choice of consumers and their standard of living.
12. **It increases capital inflow** i.e. foreign exchange which it can use to pay off its foreign debts, pay contributions to international organizations and carry out development programs.
13. It enables a country **to get relief supplies by importing from other countries** e.g. in case it is hit emergencies like drought, floods and earthquakes.
14. It enables factor **mobility which promotes exchange of ideas and information** thus increase labour efficiency, solves unemployment problems and brings about development in the long run.

1.2.2: Disadvantages/ Arguments against International Trade

1. **It encourages dumping** which causes price instabilities in the domestic country/ market.
2. **Development of local industries is retarded** i.e. local industries may be outcompeted by more efficient foreign firms and this leads to increased unemployment in the domestic economy.
3. If a country trades with another that is affected by inflation, this may result **into imported inflation by the importing country.**
4. **Loss of social economic and political sovereignty or independence** especially by LDCs because MDCs always dictate unfair trading terms to LDCs.
5. **Loss of culture through demonstration effect** as consumers of imported goods adapt to foreign consumption habits and cultures.
6. **International trade may result into over exploitation of domestic resources** due to wider markets.
7. **Dangerous commodities may find their way into the country** e.g. guns, drugs etc. which may worsen health and standard of living of people.
8. **Balance of Payment position may worsen** where import expenditure may exceed export revenue.

9. **It may limit employment opportunities** in the country by the domestic people who are out competed by foreigners who might have superior skills over locals.

1.2.3: Limitations of International Trade

1. Rapid depletion of exhaustible natural resources: As countries begin to rise up their production levels, natural resources tend to get depleted with the time and it could pose a dangerous threat to the future generation.

2. **Import of harmful goods**: Foreign trade may lead to import of harmful goods like cigarettes, drugs, etc., which may harm the health of the residents of the country.

3. **It may exhaust resources**: International trade leads to intensive cultivation of land. Thus, it has the operations of law of diminishing returns in agricultural countries. It also makes a nation poor by giving too much burden over the resources.

4. Over specialization: Over specialization may be disastrous for a country. A substitute may appear and ruin the economic lives of millions.

5. Danger of starvation: A country might depend for its food mainly on foreign countries. In times of war, there is a serious danger of starvation for such countries.

6. **One country, gains at the expense of others:** One of the serious drawbacks of foreign trade is that one country may gain at the expense of other due to certain accidental advantages.

7. May lead to war: Foreign trade may lead to war; different countries compete with each other in finding out new markets and sources of raw material for their industries and frequently come into clash. This was one of the causes of first and Second World War.

8. Language diversity: Each country has its own language. As foreign trade involves trade between two or more countries, there is diversity of languages. This difference in language creates problem in foreign trade.

9. Differences in laws and regulations i.e. different countries have different laws and regulations that govern trade that do not coincide with laws of other countries which make it hard for traders from different countries to cope with those laws from other countries thus hindering international trade.

10. Competition to domestic producers: since goods are not only exported but also imported people are usually attracted to foreign goods and prefer to buy them instead of goods that have been produced within the nation. Domestic producers face a loss due to this.

11. Cost incurred for exporting: a lot of money on transportation facilities has to be incurred when goods are exported to other countries.

12. Too much dependence: when countries develop a habit of importing certain kinds of goods from another country, they usually reduce the amount of production of the same good within the country. So if the country that exports has a problem and is unable to export goods then the country that imports goods will suddenly face a shortage of goods.

13. Differences in standards of measurement. Different countries use different weights and measures.

14. Lack of standard currency to exchange commodities for i.e. there is no convenient means for buyers and sellers to exchange commodities since they both have different currencies. Exchanging to convertible currencies may distort the relative prices

15. Inadequate information about goods available, their prices, quality etc. which hinders smooth international trade.

16. Trade barriers which governments normally impose on flow of international commodities like tariffs, quotas, foreign currency, self-sufficiency etc. all limit international trade.

1.3.0: Theories of international trade.

1.3.1: Theory of absolute advantage:

The theory of absolute advantage was put forward by **Adam Smith**.

The law of absolute advantage states that "**Given two countries and same amount of resources, a country is said to have an absolute advantage over another in production of a given commodity if it can produce that commodity more efficiently at a lower input cost".**

Absolute advantage is therefore, the ability of an individual, a household or a firm or a country to produce some particular good or service with a smaller total input of labor, capital, land, etc. per unit of output than other economic actors.

1.3.1.2: Assumptions of absolute advantage.

- **Lack of Mobility for Factors of Production**
- There **are no barriers to trade for the exchange of goods**.
- **Trade Balance:** Smith assumes that exports must be equal to imports
- **Constant Returns to Scale:** Adam Smith assumes that we will get constant returns as production scales, meaning there are no economies of scale.
- **Assumes that there are two commodities**
- **Assumes there are two countries in the world**

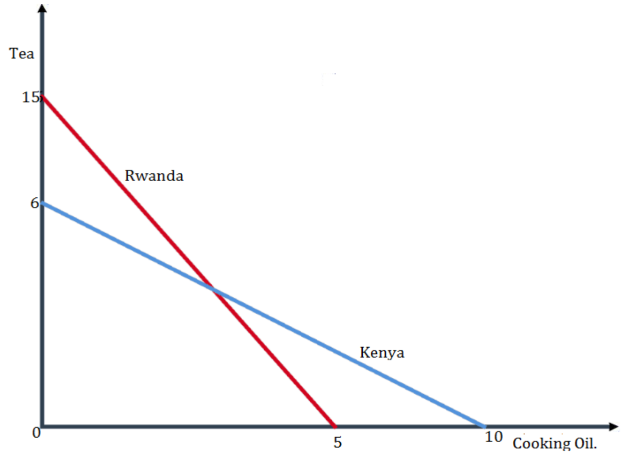
Let us take a two-country two-commodity case. E.g. Rwanda and Kenya producing Tea and Cooking oil respectively.

Table 1: Reciprocal absolute advantage production schedule.

Country	**Tea (tons)**	**Cooking oil (tons)**
Rwanda	15	5
Kenya	6	10
Total before specialisation	**21**	**15**
Total after specialisation	**42**	**30**

This information can be represented using production possibilities curve as below;

Figure 1: Absolute advantage between Rwanda and Kenya using a production possibilities curve.



In our Absolute Advantage example, we assume that there are two countries e.g. Rwanda and Kenya, which are represented by a red and blue line respectively. We also assume that only two goods are produced e.g. Tea and cooking Oil. From the table 1 above; we can determine how many units of each commodity each country produces using the same resources.

Rwanda has an Absolute Advantage in the production of Tea (15 tons) because it incurs less input costs to produce a unit of Tea than Kenya, which produces 6 tons of the same commodity, using the same input costs.

Kenya has an Absolute Advantage in the production cooking oil (10 tons) than Rwanda which produces 5 tons, using the same input costs.

As a result, Rwanda will be better off if it specializes in the production of Tea and Kenya will be better off if it specializes in production of cooking oil. This is the case of **reciprocal absolute advantage.**

As you can see from our example, it makes sense from businesses and countries to trade with one another. All countries engaged in open trade benefit from lower costs of production.

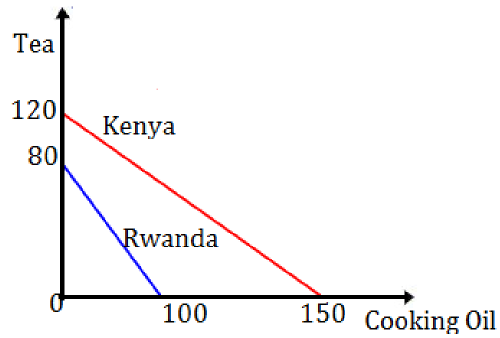
On the other side, given equal quantity of resources one country can produce both commodities better than another. Thus one country can have absolute advantage in production of both commodities than the other.This indicates a case of **non-reciprocal absolute advantage.**

Table2: non-reciprocal absolute advantage between Kenya and Rwanda production schedule.

Country	Tea (tons)	Cooking oil (tons)
Rwanda	80	100
Kenya	120	150
World total	**200**	**250**

The above information can be illustrated on the graph as below;

Figure 2: Absolute advantage between Kenya and Rwanda using a production possibilities curve.



From the above information in the table and graph, it can be seen that if Kenya decided to produce only Tea, it would produce 120 tons and if it decided to produce only Cooking oil, it would produce only 150 tons. Similarly, if Rwanda decided to produce only tea, it would produce only 80 tons, and if it decided to produce only cooking oil, it would produce 100 tons. Each country has several possible combinations of tea and cooking oil it can produce as shown along the production possibilities curve.

Because the Production possibilities frontier for Kenya is above that of Rwanda, it means that Kenya has absolute advantage over Rwanda in production of both tea and cooking oil. In this case of non-reciprocal absolute advantage, gains from trade can be realized when countries specialize basing on the opportunity cost of producing each commodity. This is explained by the theory/ principle of comparative advantage.

1.3.2: The theory of comparative advantage:

Theory of comparative advantage was advanced by **David Ricardo in 1817**.

Comparative advantage is the ability of a country to produce a commodity at less opportunity or real cost than another**.** Thus, a country has comparative advantage over another when it incurs less opportunity cost than another in the production of a given commodity.

The theory thus states that **"Given 2 countries and 2 commodities, with a given amount of resources, a country should specialise in producing a commodity where it has a least opportunity cost compared to another country**

1.3.2.2: Assumptions underlying comparative cost advantage

1. There is **no intervention by the government in economic system**, meaning there is free trade between two countries.
2. **Perfect competition exists both in the commodity and factor markets**.
3. There are **static conditions in the economy**. It implies that factor supplies, techniques of production, exchange rates and tastes and preferences are given and constant.

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4. Production is **governed by constant returns to scale**; i.e. Production function is homogeneous which implies that output changes exactly in the same ratio in which the factor inputs are varied.
5. **Labour is the only factor of production** and the cost of producing a commodity is expressed in labour units.
6. **Labour is perfectly mobile** within the country but perfectly immobile among different countries.
7. **Transport costs are absent** so that production cost, measured in terms of labour input alone, determines the cost of producing a given commodity.
8. There are **only two commodities** to be exchanged between the two countries.
9. **Money is non-existent** and prices of different goods are measured by their real cost of production.
10. There is **full employment of resources** in both the countries.
11. **Trade between two countries takes place on the basis of barter**. Thus, the two countries have a double coincidence of wants with barter system of trade.

Table 3: Example; production possibilities between Rwanda and Kenya.

Country	Tea (tons)	Cooking oil (tons)
Rwanda	10	80
Kenya	40	100
Total	**30**	**120**

Kenya has absolute advantage in the production of both commodities, Tea and cooking oil over Rwanda. Kenya has the absolute advantage in Tea than Rwanda (4:1) and it has an absolute advantage in cooking oil than Rwanda (5:4). However, if we examine the domestic opportunity cost ratios, it is clear that each country has a relative or comparative advantage in the production of one commodity.

To get to know of who should specialise in what, we must calculate the opportunity cost of one commodity for the other. This is done by the formula;

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

From the above example it can be calculated as;

i. In Rwanda to produce Tea they forego cooking oil
   Thus = quantity of cooking oil/ quantity of tea = 80/10= 8
ii. In Rwanda to produce cooking oil, they forego Tea,
   Thus = quantity of Tea/ quantity of cooking oil = 10/80= 0.125
iii. In Kenya to produce Tea, they forego cooking oil,
   Thus = quantity of cooking oil/ quantity of tea = 100/40= 2.5
iv. In Kenya to produce cooking oil they forego Tea,

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Thus = quantity of tea/ quantity of cooking oil = 40/100= 0.4

This can be tabulated as;

Table 4: production schedule showing opportunity cost between Rwanda and Kenya

Country	Tea (tons)	Cooking oil (tons)
Rwanda	8	0.125
Kenya	2.5	0.4

In Rwanda, the domestic opportunity cost ratio is such that only 8 tons of cooking oil must be given up for each ton of Tea produced. The opportunity cost of producing one unit of cooking oil is 0.125 tons of Tea that must be foregone. However, in Kenya, the domestic opportunity cost ratio is such that 2.5 tons of cooking oil must be given up for each ton of Tea produced. The opportunity cost of producing one ton of cooking oil is 0.4 tons of Tea.

Rwanda therefore has a comparative advantage in the production of cooking oil since for each ton of cooking oil that is produced fewer units of tea are sacrificed than in Kenya. Similarly, Kenya, has a comparative advantage in the production of Tea since, for each ton of Tea that is produced; less cooking oil is sacrificed than in Rwanda.

If now Kenya concentrates on Tea and Rwanda on Cooking oil, then the two countries are bound to benefit assuming that the value of one ton of Tea is the same as that of one ton of cooking oil.

After specialization, the situation looks as indicated in the table below. The assumption is that resources have doubled in each country.

Table 5: Production after specialisation.

Country	Tea (tons)	Rice (tons)
Rwanda	0	160
Kenya	80	0
World Total	**80**	**160**

The production of Tea has increased by 50 and the production of cooking oil has increased by 40 tons.

1.3.2.3: Relevance/applicability of the comparative cost advantage.

1. Developing countries have tended to **specialize in producing primary products where they have a least opportunity cost** e.g. Rwanda exports raw materials.
2. **Developing countries still have barter trade** among arrangements themselves.
3. **Developing countries use labour intensive technology while developed countries use capital intensive technology** so the assumption of no change in technology is realistic.
4. There is some degree of **mobility of factors of production** among developing countries especially labour.
5. Developing countries **import manufactured commodities** where they have a high opportunity cost.

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6. There are some cases of **free trade among developing countries** especially in economic integrations.

1.3.2.4: Criticisms/ limitations of the comparative cost advantage.

1. The model deals only with the situation in which trade **takes place between two countries and in two commodities**. However, this is a hypothetical situation which does not exist in real life since international trade takes place among more than two countries and in more than two commodities
2. The theory assumes that people all **over the world have similar tastes**. But this is untrue. People belonging to different levels of income have different tastes. In addition, the tastes also change according to the growth of an economy and with the opening of world markets and development of trade relations.
3. The theory **does not recognise the role of technological innovations in international trade**.
4. The theory rests upon the assumption that there is **complete specialisation or division of labour**. However, in the real world, complete specialisation is not possible.
5. It is wrong to assume **the existence of free world trade**. Countries do not always trade freely with each other. Different countries have always imposed different restrictions on the free movement of goods to other countries from time to time.
6. In his theory, Ricardo has shown no **consideration for transport costs, which play an important role in determining the profitability** and pattern of international trade.
7. The prevalence of **perfect competition in international trade is also an unrealistic assumption.** The conditions of perfect competition cannot be achieved in the real world.
8. The assumption that **all units of factors of production are equally efficient is too simplistic**. It is very difficult to find factors of production, which are equally efficient.
9. The theory assumes that countries **can shift resources from the production of one good to the production of another good.** In practice, there is likely to be a certain amount of factor immobility, which prevents this, especially in the short run.
10. The theory assumes the operation of the **law of constant costs or returns which is entirely unrealistic.** In practice, the usual rule in the production of goods is the operation of the law of increasing costs or diminishing returns, that is, beyond a certain point additional output can be obtained only at an increasing per unit cost.
11. **The theory assumes similar needs.** E.g. Uganda must want Rwanda's Tea, and Rwanda must want Uganda's Rice. This, however, may not be true in reality. For one reason or another, the cheapest source may not appeal to the customer country such that the customer prefers to buy from an expensive source. It should also be noted that two different currencies are used. However, the theory mentions nothing about them.

12. It is possible that the two **countries may incur the same cost in the production of certain commodity**. In such a case, it is hard to find which country should specialise in a particular commodity.
13. The principle of comparative advantage has been **criticized by developing countries on the grounds that if adhered to, it would perpetually commit them to being producers of raw materials.** Hence, condoning them to eternal poverty.

1.3.2.5.1 Factors that determine comparative advantage.

1. The quantity and quality of natural resources available for example some countries have an abundant supply of good quality soils, waterbodies, minerals farmland, oil and gas, or easily accessible fossil fuels which makes them able to have a comparative advantage than other countries which don't have or have little quantities or poor quality of such resources. The more available quantity and quality natural resources a country has, the more the comparative cost advantages and vice versa.

2. Demographics: A country that has a bigger and highly educated and skilled working-class group with a higher participation of women in productive activities, has a more comparative advantage than another which has an ageing or young population, high net outward and less educated and skilled labourforce and few women's participation in the labour force. This has an effect on the quantity and quality of the labour force available for industries engaged in international trade hence affecting a country's comparative advantage.

3. Rates of capital investment including infrastructure: Greater public infrastructure investment can reduce trade costs and hence increasing supply capacity of a country hence its comparative advantage over another country which does not have such infrastructures. Investment in roads, ports and other transport and ICT infrastructure strengthens productive and competitive capacity of a country for internal and international exchange.

4. Market levels: Rising demand/market helps countries to encourage specialisation, higher productivity and internal and external economies of scale. These long-run scale economies give regions and countries a significant unit cost advantage than those countries with less demand or market for their commodities.

5. Investment in research & development which can drive innovation and invention. A country that invests much in research and development, promotes mushrooming production techniques hence giving a greater comparative advantage than another which doesn't.

6. Foreign exchange rate stability: Fluctuations in the exchange rate affect the relative prices of exports and imports and cause changes in demand from domestic and overseas customers hence putting such affected countries at a less comparative advantage than another whose exchange rate is stable for long period of time.

7. Import controls such as tariffs, export subsidies and quotas – these can be used to create an artificial comparative advantage for a country's domestic producers.

8. Non-price competitiveness of producers - covering factors such as the standard of product design and innovation, product reliability, quality of after-sales support. These help a country to win market for their commodities hence giving such countries products a comparative advantage than others. Many countries are now building comparative advantage in high-knowledge industries and specializing in specific knowledge.

9. Institutions: Availability of institutions that facilitate production are important for comparative advantage and for growth of a given country. E.g. banking systems needed to provide capital for investment and export credits, legal systems that help to enforce contracts, political institutions and the stability of democracy is a key factor behind decisions about where international capital flows. These institutions provide a strong milestone to a country's production capacity hence its comparative advantage than another which has weak or non-existent institutions.

10. Size of entrepreneurial class: A bigger size of entrepreneurs in a country develops a new comparative advantage in a product either because they find ways of producing it more efficiently or they create a genuinely new product that finds a growing demand in home and international markets than a small size entrepreneurial class.

11. Trade Barriers: Subsidies and taxes implemented by the government create an artificial comparative advantage in a sense that a subsidy makes exports more competitive and a tax would discourage imports thus giving countries comparative advantage.

12. Inflation: An increase in the rate of inflation would make exported goods more expensive and imported goods cheaper thus putting the affected country at a lesser comparative advantage than the other.

13. Tradition: Sometimes comparative advantage maybe largely the result of acquired skills and tradition. People get used to doing a thing and keep on doing it, generation after generation. For example, the Swiss have a tradition of making watches, the Norwegians of operating a far-flung merchant fleet, and the French, of producing cheeses. Each of these traditions is certainly consistent with the resource endowment of the country in question, but it is not an inevitable outcome of it.

14. Technology: Technological differences between countries account for differences in labour productivity. The countries with the most advanced technology will have a comparative advantage with regard to those goods that can be produced most efficiently with modern technology.

15. Factor Abundance: Goods differ in terms of the resources, or factors inputs, required for their production. Countries differ in terms of the abundance of different factors of production: land, labour, capital and entrepreneurial ability.

16.**Human Skills: C**ountries with a relatively abundant stock of highly-skilled labour will have a comparative advantage in producing goods that require relatively large amount of skilled labour. Likewise, developing countries would be expected to have a comparative advantage in industries requiring a relatively large amount of unskilled labour.

Benefits of comparative advantage.

1. It encourages **competition and improvement in efficiency** so as to reduce costs of production.
2. It encourages **specialisation and exchange.**
3 .It increases **global output of commodities** due to specialisation.
4. It encourages **economic cooperation and free trade** among countries.
5. It encourages mass production and **reaping of economies of scale**.
6. It **discourages duplication of industries i**.e. setting up of industries which already exist in other countries.
7. It **widens market for exports** between or among countries.
8. It **enables countries to get commodities which they cannot produce**, thus increasing consumers choice.
9. It enables countries to **get foreign exchange** through increased exports and other form of capital inflow.
10. Specialisation results into **effective utilisation of resources** some of which would be idle.

UNIT 2: TERMS OF TRADE.

2.1.1: Meaning of terms of trade:

Terms of trade (TOT) *refers to the relative price of exports in terms of imports*. It is the ratio of export prices to import prices. It can be interpreted as the amount of import goods an economy can purchase per unit of export goods. *I.e. import purchasing power of exports*. For example, if an economy is only exporting Flowers and only importing telephones, then the terms of trade are simply the price of flowers over the price of telephones. In other words, how many telephones can you get for a unit of flowers sold?

Terms of trade is also the ratio of a country's export price index to its import price index, multiplied by 100.

Terms of trade can be expressed as;

$$\textbf{TOT}=\frac{\text{Average price index of exports}}{\text{Average price index of imports}}\times \textbf{100} \text{ or } \qquad \textbf{TOT}=\frac{\text{Px}}{\text{Pm}}\times \textbf{100}$$

Where; **Px** = average price index for exports, **Pm** = average price index for imports

Basically, TOT is Export Price over Import price times 100. If the percentage is over 100% then an economy is doing well (Capital Accumulation) thus ***favourable terms of trade*****.** When this persists year after year, a country is said to have '***improving terms of trade'*****.**

If the percentage is under 100% then an economy is not going well (More money going out than coming in) thus ***unfavourable terms of trade***. When this persists year after year, a country is said to have ***deteriorating terms of trade.***

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2.1.2: Forms of Terms of Trade

a) Barter/ commodity terms of trade.

This is the relationship between export prices and import prices. I.e. the ratio of average price index of exports to the average price index of imports. Symbolically, it can be expressed as:

Barter terms of trade= $\frac{Px}{Pm} \times 100$

Where P = price, the subscript x =exports and m =imports.

Taking 2018 as the base year and expressing Rwanda's both export prices and import prices as 100, if we find that by the end of 2019 its index of export prices had fallen to 80 and the index of import prices had risen to 180. The terms of trade had changed as follows:

Barter TOT = $\frac{Px}{Pm} \times 100 = \frac{80}{180} \times 100 = 44.4$

It implies that Rwanda's terms of trade declined by about 55.5 per cent in 2019 as compared with the 2018, thereby showing worsening of its terms of trade.

If the index of export prices had risen to 190 and that of import prices to 185, then the terms of trade would be

Barter TOT = $\frac{Px}{Pm} \times 100 = \frac{190}{185} \times 100 = 102.7.$

This implies an improvement in the terms of trade by 2.7 per cent in 2019 over 2018.

b) Income/ monetary terms of trade

This refers to the ratio of the value of exports (revenue from exports) to the price index of imports. This index is calculated by dividing the index of the value of exports by an index of the price of imports. This is called the "***Export Gain from Trade Index***."

It can be expressed as;

Income TOT= $\frac{Px.Qx}{Pm}$ **or** $\frac{\text{index of export price X export quantity}}{\text{index of import prices}}$

Example 1:

Taking 2017 as a base year and expressing Rwanda's both export prices and import prices as 100, if in 2019, the price of exports (PX) is 140, price of imports (Pm) is 90 and quantity of exports is 80 then income terms of trade is;

$\frac{Px.Qx}{Pm} = \frac{140 \times 80}{90} = 124.4.$

It implies that there is improvement in the income terms of trade by 24.4percent in 2019 as compared with 2018.

Example 2**:**

Taking 2018 as a base year again, and expressing Rwanda's both export prices and import prices as 100. If in 2019 Price of exports = 80, Price of imports =180 and Quantity of exports =120, then

Income TOT = $\frac{Px \text{ X } Qx}{Pm} = \frac{80 \text{ X } 120}{180} = 53.3$

It implies that the income terms of trade have deteriorated by 46.7% percent in2019 as compared with 2018.

Causes of unfavourable TOT and deteriorating Terms of Trade in LDCs

1. The less developed countries are mainly **primary producing countries** which are price and income inelastic, but their imports include capital goods which are expensive. Thus, the terms of trade for LDC's are always unfavourable and deteriorating year after year.

2. Adoption of **raw-material saving techniques by developed countries** which reduces the demand for LDC's export.

3. Most of the international **trading policies are influenced by MDCs** which favour them however disfavor LDCs. For example, LDCs are price takers in the world market hence their export prices are usually low, making them to have unfavourable terms of trade year after year.

4. Discovery of substitutes such as synthetic fibers e.g. plastics, nylon, which replace natural fibers in LDCs. This reduces on the volume of exports for LDCs.

5. Price movements through **business cycles**: The prices of primary products rise sharply in the prosperous periods and fall in the downswing of the business cycle. Thus, over successive cycles, the prices of the primary products have always fluctuated, and the primary producing countries have suffered an unfavourable movement in their terms of trade.

6. Long-term disparity in demand for manufactured and primary products. In the industrial countries, the income elasticity of demand for primary products is inelastic (i.e., less than one), while in the poor countries, the income elasticity of demand for manufactured goods is more elastic (exceeds one). This brings about unfavorable terms of trade year after year.

7. The less developed countries **use backward technology** as compared to the developed countries. As a result, their relative productivity is low, cost ratios are high, and price structure is also relatively high.

8. Most of the less developed countries experience **overpopulation and high population growth**. As a result, there is high internal demand for the goods and low exportable surplus. Moreover, the import demand of these countries is highly inelastic. This causes their terms of trade to fall.

9. Lack of Import Substitutes: Poor countries are greatly dependent on the advanced countries for their imports and have not developed import substitutes. On the other hand, the advanced countries are not so much dependent on the poor countries because they are capable of producing import substitutes. Thus, the poor countries have weak bargaining position in the international trade.

10. High transport costs: Most LDCs are land locked countries, this makes it difficult to link to regional or international markets make it difficult for trade development in the country. Therefore, making it costly to transport commodities to and from international markets, adversely affecting their terms of trade.

11. Unlike, the advanced countries, the less developed countries **cannot quickly adapt their supply of goods which are high in demand and whose prices are rising.** The reasons for this

are: backward technology, market imperfections, immobility of factors of production, etc. Thus, the terms of trade of less developed countries tend to deteriorate and these countries fail to reap gains by increasing their supplies of exports during inflation due to Lack of adaptability.

12. Most LDCs produce more less **the same products which leads to limited market** among themselves. They therefore tend to increase their export shares to MDCs by reducing prices, yet they have to continue importing manufactured goods from MDCs which are highly priced.

13. Most LDCs lack a considerable manufacturing **sector as a result of political instability and insecurities**, thus reduce the volume of manufactured commodities that would be exported.

14. Lack of diversification in production in LDCs; Most LDCs depend on a few traditional cash crops like tea, coffee, cotton tobacco, sisal, cocoa etc. which limits the amount of income they get from exports compared to developed countries that export to LDCs a wide variety of manufactured goods.

2.2.2: How to improve Terms of Trade for LDCs

1. Carry out **adequate market research** so as get enough information to widen markets for their commodities. This enables them to access new clients and overcome supply constraints domestically, regionally and internationally.

2. Human resource development through education and training so as to reduce expenditure on imported labourforce which is always expensive.

3. Promote peace and security in all parts of their countries so as to instill confidence, for their security and property as well, among both local and foreign investors.

4. Ensure good governance for example, by fighting against all forms of financial indiscipline like corruption and embezzlement of government funds in all sectors which promotes transparency and efficiency thus increased gains from trade.

5. Promote **regional integration and economic co**operation among developing countries. by trading among themselves in order to avoid exploitation by developed countries. For example, Rwanda is already a member to regional and international bodies like East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and its free trade area and is able to access the whole market without any barriers to trade.

6. Promote the development of private sector so as to promote efficiency in production and increase the exploitation of idle resources which increases export volume thus increasing gains from international trade.

7. Make all possible efforts to establish business legal reform task force mandated to reform all business laws which will create conducive legal environment for trade by both local and foreign investors and increase the gains from international trade among themselves.

8. Establish financial sector task force with the mandate of solving all problems in the financial sector. This will help avail easy and cheap credit facilities to potential investors and business class which boosts their productive levels thus increasing the export ba**se.**

9. Establish the trade points which will provide all trade related information; this becomes an opportunity as trade information will be easily obtained in one place. This attracts different investors from within and outside the country's economy thus promoting production directed towards export and or reducing import expenditure.

10. Enhance the establishment of **permanent national and international trade fair grounds** which creates an opportunity for trade development as itgives business men a chance of regular expositions which helps them in sell and advertisements of their products.

11. Enhance the establishment of **business development centers (BDS) which facilitate easy coordination of business activities in rural areas** to promote continuous and coordinated production.

12. Establish **Export processing zone which facilitate trade development in particular** and development in general. This helps transform their commodities into finished products so as to increase the export value and gains from trade as well.

13.Form producer cooperatives and associations to bargain for higher prices for their exports. Governments should take initiative in cooperatives development so as to create an opportunity for trade development, as from a strong cooperative movement trade is improved.

14. Take up strong measures to control population growth e.g. through family planning campaigns so as to increase on the level of exports and reduce the volume of imports as well.

15. Diversify domestic production so as to reduce dependency on few traditional exports where terms of trade are unfavourable and keep on fluctuating.

16. Adopt Import substitution strategy so as to minimize import expenditure

17. Research innovations and inventions so as to promote technological development and use of intermediate technology to reduce expenditure on expensive capital.

UNIT ASSESSMENT.

1 a. What distinguish barter terms of trade from income terms of trade?

b. Study the table below showing terms of trade for a country (2012-2016) and answer the questions that follow;

Year	Export price index	Import price index	Terms of Trade
2015	100	100	
2016	130	110	
2017	110	124	
2018	120	140	
2019	165	190	

i) Calculate the terms of trade for the years 2015 to 2019

ii) Explain the nature of terms of trade between 2016 and 2019 and support your answer.

2. a) Why have terms of trade tended to move against developing countries' economies?

b) Does favourable terms of trade mean favourable balance of trade

UNIT 3: FREE TRADE AND TRADE PROTECTIONISM

3.1 FREE TRADE

Free trade refers to the unrestricted purchase and sale of goods and services between two or more countries.

3.1.2: Advantages of free trade

1. **Improves consumers' welfare.** Free International trade avails consumers in a particular country with a wider choice of goods and services because it makes easy for them to find both imported and locally produced goods and services cheaply
2. **Reduced costs of production by domestic businesses**. With free trade, domestic businesses may also have **a** chance to reduce their costs of production by buying imported raw materials or new technology without restrictions and this in turn leads to reduction in general price levels in the country.
3. **Encourages specialization among countries.** With free trade, a country is able to specialize in the production of a commodity where they incur lower costs than other countries and cheaply get buy commodities where they incur higher costs from other countries
4. **Encourages competition between domestic and foreign industries:** Free International trade increases competition as domestic industries must compete with foreign firms in the same industry in their own country.
5. **Increased earnings for the factors of production.** Under free trade, factors of production will also be able to earn more, as they will be employed for better use i.e. optimally utilized.
6. **Imports become Cheaper.** Free trade enables the country to get imports at cheap rates since it is becomes easy for the country to get goods and services from other countries with little or no restriction and this reduces prices in the domestic market which later favours customers.
7. **Enlarges a country's market in other countries**: Free trade widens the size of the country's market in the way that a country is able to sell their products in other countries without any restriction.
8. **Restricts consumers' exploitation by domestic monopolists**: Free trade prevents grow of domestic monopolies who always exploit the consumers through charging high prices.
9. **Promotes international cooperation among countries and mutual understanding as well**. It is also known that the more countries work together in terms of buying and selling goods and services even their relationships tend improve in the same direction.

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10. **Widens tax base in the economy** as a result of variety of goods and services produced and exchanged. This increases a country's tax base which in turn increases a country tax revenue used for further development.
11. **Reduces administrative costs of protectionism** such as enforcing quotas, foreign exchange control, subsidies etc. The government to enforce such policies incurs a lot of administrative costs such as supervision costs etc
12. **Eliminates possibilities of trade malpractices** like smuggling with its negative effects. Free trade gives all people an opportunity to with little or no government restrictions and this helps people to trade freely without getting involved in such malpractices.

3.1.3: Disadvantages of free trade

1. **Unemployment increases**. Free trade makes it becomes easy to import some products at a cheaper price than the domestic ones and this causes some industries to be out competed and pushed out of business by such cheap foreign products hence causing unemployment.
2. **Increases uneven distribution of income among countries.** As a result of free international trade, some countries will be able to take advantage of their natural resources, skilled workforce or economies of scale to sell their goods and services internationally on more favorable terms than other countries without such advantages and then get more revenue compared to other.
3. **Prices fluctuation on the global market.** Most developing countries always export semi or unprocessed products whose prices are always fluctuating on the global market hence making such countries to gain less from free trade.
4. **Increases dumping of goods.** Free trade enables other countries to sell their surplus products in our countries at lower prices compared to their home prices. This has a number of negative effects on the economy like reducing market for domestically produced goods, causes unemployment and narrowing a country's tax base and many others.
5. **Degradation of natural resources**. Since free trade expands a country's market in other countries this leads to over exploitation of natural resources like timber, minerals and other natural resources as the way of increasing more products on the market which later leads to environmental degradation.
6. **Destruction of native culture**. Since free trade also allows free movement of people between countries. This makes it easy for people with bad cultural practices to spread it in other countries which leads to destruction of a country's good culture and sometimes accompanied with other negative effects like diseases and death.
7. **Reduced tax revenue for government.** Since free trade allows countries to trade with other with little or no restrictions, this means that a country's import and export duties are reduced which also slows down a country development.

8.Worsens a country balance of payment problem. Free trade becomes unfavorable for a country which exports primary products and imports full manufactured goods.

9.**Worsens the importation of undesirable commodities in the country.** Free trade has adverse effects on consumers since there is no check on production and trade of various harmful goods. This undermines the health conditions of local people.

10. **Unfair competition between developed and developing countries**. Competition induced under free trade is unfair and unhealthy. Backward countries cannot compete with advanced countries.ie Local infant industries are outcompeted by cheap imported products from abroad since they cannot compete favourably with MDCs.

11. **Encourage brain drain.** Since it allows people to move freely between countries with little or no restrictions this makes it easy for many people to move to developed countries looking for greener pastures which in turn reduces skilled labour force in developing countries.

12. **Discourages self-reliance**. It makes a country to over depend on imported goods since importation of goods becomes easy and cheap.

Activity

1. **Why do we buy goods from abroad if we can make them locally.**
2. **Consider the view that gains from free trade are biased in favour of advanced industrial countries.**

Expected answers to home activity

1. We buy goods from abroad when we can actually make them locally due to the following reasons:
   - Domestic production might be **expensive than importing** thus basing on comparative advantage we have to import such commodities where we face a high opportunity cost.
   - Imported goods might be of **good quality** than domestic ones because the imported ones might be from technologically developed nation. Thus, on health grounds and living standards of citizens we need to import however much we can produce that commodity.
   - A country would be limited to the goods and services within its borders thus need to **increase consumer's choice** through increased variety.
   - **To increase efficiency in domestic producers** by exposing them to competition with foreign commodities.
   - Our home-made commodities might be of **higher value/ grade** thus need to export them and import the same but less value commodities, the difference in price is a lot to the country in form of exchange.
   - Sometimes a country would import raw materials even if they have them in their country so that **they don't use up their supply**. This helps in periods when other sources around the world dry up or become inaccessible.
2. **Gains from free trade are biased in favour of advanced industrial countries due to the following reasons:**

- Declining price/ value of exports of developing countries due to **low quality products which cannot compete favourably in the world market**
- Increasing prices of imports due to **increased demand for capital goods and tariffs on imports** which increases prices further.
- Declining volume of exports which reduce income terms of trade due to **protection by developed countries** and low production as a result of lack of capital and skills
- **High rates of inflation in developing countries** which reduce demand for their exports
- **Poor investment climate in developing countries** that encourage people to invest in developed countries thus continuous capital outflow.
- **Natural calamities in most developing countries** which has caused agricultural failure and led to low agricultural export earnings.
- **Most developing countries are landlocked** thus the high transport costs reduce the gains from trade by developing countries.
- **Poor infrastructure** like storage facilities and air transport in most developing countries which makes export of delicate products like fruits and flowers difficult.
- **Weak economic integration** among developing countries.
- **Monopoly power of developed countries** which pay less for raw materials and charge high prices for final commodities. Etc.

3.2.1: Meaning of trade protectionism

Trade protectionism refers to the different forms of barriers imposed on international trade to influence the flow or volume of commodities exchanged.

3.2.2: Reasons for trade protectionism

1. To **protect infant industries** against unfair competition from low cost products from abroad. Infant industries normally produce at high costs and their products are of poor quality and thus need to be protected from cheap and high quality import goods.

2. **To discourage dumping** through imposing high tariffs on cheap and expired commodities from other countries into the country.

3. **To increase employment opportunities** at home by reducing imported goods. When a country limits imported goods, this stimulates domestic demand for local products which contains local industries in operation so that they can keep providing employment.

4. **To reduce external economic dependence and promote self-sufficiency** eg through establishment of import substitution industries to produce formerly imported commodities to ensure self-reliance in the economy.

5. **To increase government revenue through import and export duties**, of which revenue can be used to finance government development programs.

6. **To prevent importation of undesirable commodities and thus protect health of citizens** e.g. ban (total refusal) of certain drugs, food staffs and even other commodities basing on health grounds.

7. **To check imported inflation by increasing tariffs or prohibit importation of commodities** from countries experiencing hyperinflation.

8. **To encourage full utilization of domestic resources** especially for import substitution industrial strategy.

9. **To improve on the BOP position of a country**. Restrictions may be imposed on imports in order to reduce the amount of goods imported and this helps to reduce foreign exchange expenditure abroad thus improving BOP position of a country.

10. **For security purposes** e.g. a country may impose restrictions like embargo or total ban on importation of strategic commodities like firearms, military hardware etc. to maintain security in the country.

11. **For retaliation purposes** i.e. countries impose restrictions to retaliate against other countries restrictions on her exports.

3.2.3: Tools of protectionism (Barriers to Foreign/International Trade)

Tariff barriers to trade

These are restrictions in form of **taxes on imports and or exports**. They are at times called ***customs duties***. They are divided into;

(i) Import duties: These are taxes imposed on goods and services imported into the country.

(ii) Export duties: These are taxes imposed on goods and services exported to other countries.

Non-tariff barriers to trade

These are **non-tax restrictions or regulations** in international trade. It can also be taken as other forms the government use to restrict imports and exports rather than imposing taxes.

Forms of Non-tariff barriers to trade

1. Total ban. The government of a country by law may totally ban the import or export of certain commodities for reasons of health or for promoting the growth of certain industries in the country. For instance, when foot and mouth disease attacks cattle in a certain country, the government may totally prohibit the import of beef from the country experiencing that problem.

2. Foreign exchange control. Exchange control implies the government regulations relating to buying and selling of foreign exchange. The government then may allocate the foreign exchange among only the licensed importers so as to reduce the amount of foreign exchange given to importers in order to reduce on imports.

3. Quotas. These are physical quantities of commodities that are supposed to be imported or exported in a given period of time set by the government. In order to reduce imports, the government may specify the maximum amount of a commodity which can be imported from each producing country in a given time.

4. Preferential treatment. The government of a country may give preferential treatment in the rate of taxes to some of the countries. The granting of preferential treatment results in the formation of trade blocks because imports from countries which are not giving preferential treatment will be highly taxed thus limiting amount of goods imported.

5. Import monopolies. When the government of a country takes responsibility of importing all the necessary commodities herself, this also reduces on the amount of imported goods in the country because all other importers are restricted.

6. Import licenses. Another barrier which restricts the import of goods from abroad is the import license. If the government of a country allows the import of foreign commodities to the licensed importers, the trade is very much brought under control because all unlicensed importers will be restricted from importing goods into the country which reduces on the physical amount of goods imported.

7. Embargo/ sanctions:

This is an extreme form of trade barrier. Embargoes prohibit import from a particular country as a part of the foreign policy. In the modern world, embargoes are imposed in times of war or due to severe failure of diplomatic relations

8. **Anti-dumping legislation:** Supporters of anti-dumping laws argue that they prevent "dumping" of cheaper foreign goods that would cause local firms to close down. However, in practice, anti-dumping laws are usually used to impose trade tariffs on foreign exporters.

9. Political campaigns advocating domestic consumption . This involves encouraging citizens to consume their home made commodities e.g. the "Buy made in Rwanda" campaign in Rwanda.

This promotes the market for local products which has a number of benefits to citizens and in turn leads to reduction in the amount of goods imported.

10. Employment-based immigration restrictions. This may involve labour certification requirements or numerical caps on work visas. If such requirements are at higher levels, it will restrict many unnecessary workers to enter in the country.

11. Direct subsidies: Government subsidies (in the form of lump-sum payments or cheap loans) are sometimes given to local firms that cannot compete well against imports. These subsidies are supposed to "protect" local jobs, and to help local firms adjust and meet their standards to those of the world markets

3.2.4: Advantages / arguments for trade protectionism.

1. **Protectionism reduces unemployment reduces:** The use of tariffs discourages imports and raises their prices to the domestic consumers. This increases the production of locally produced goods due to the increased local market and this in turn more employment is provided for the home population.
2. **Preserves certain class of population or certain occupation:** The government of a country on political or social grounds may favor protectionism for preserving certain classes of people or certain occupations
3. **Protects the domestic infant industries**. A newly established industry is just like a newly born baby. As the baby cannot grow up unless it is nursed and well protected, similarly, an infant industry cannot face the blast of foreign competition unless it is given full protection till it grows to its full structure
4. **Protectionism guards against dumping:** Protectionism discourages dumping of cheap and at times substandard or expired goods in the country
5. **Keeps money at home.** Protectionism is also advocated on the grossly fallacious argument of "Keeping money at home". When we buy manufactured goods abroad, we get the goods and the foreigners get the money. When we buy the manufactured goods at home, we get both the goods and the money which has a great advantage towards the development of the country.
6. **Protectionism increases government revenue:** Protectionism is also advocated on the ground that it raises revenue for the state through import and export duties. To this it is pointed out that if prohibitive high tariffs are imposed on the import of foreign goods, then they may not be imported at all and the government would not able to collect the revenue at all. On the other hand, if a moderate protectionism duty is levied, then it may serve both the purposes of collecting revenue and protecting industries.
7. Protectionism helps in **checking imported inflation** by putting sanctions or even total ban on commodities from countries affected by inflation.

8. **Protectionism conserves national resources:** Protectionism is essential for preserving the natural resources of a country which can be used to meet the needs of the future generation. The unrestrained trade often leads to quick exhaustion of mineral resources which would be very vital for the development of the country.
9. **National security purposes:** It also helps to safe guard a country's national security especially when importation of military armies are restricted into the country by unauthorized people.
10. **Reduces shortages in the home country.** The government can use protectionism to reduce shortage in the country through restricting exports and favouring imports so as to increase the amount of goods available on the domestic market.
11. **It encourages full utilization of domestic resources.** If imports are discouraged and demand for domestic goods is encouraged, it encourages domestic producers to use the available idle resources in order to increase production to meet the domestic demand.
12. **It checks on the production and consumption of harmful products in the economy.** High import duties on certain imported commodities or their total ban discourages inflow of such commodities on health and moral grounds which improve the standards of living of the citizens of the protecting countries.

3.2.5: Dangers of protectionism

1. **Market distortion and loss of allocative efficiency**: Protectionism can be an ineffective and costly means of sustaining jobs.
2. **It may lead to trade diversion in case trade protectionism** is in form of regional integration. It makes the country shift her trade from low cost nonmember state to high cost member states.
3. **It may lead to inflation** due to high import tariff especially if imports have inelastic demand because such goods will still be imported even if high taxes are imposed which in turn affect the price of other goods leading to inflation.
4. **Trade barriers spoil the relationship between countries**. Protectionism acts as retaliation against the trading partners (beggar-my neighbor policy) i.e. when a certain country restricts goods from another country even that country restricts goods from that country which in turn ends up spoiling their trade relationships.
5. **It encourages smuggling which reduces government revenue** because smuggled goods are always not taxed.
6. **It promotes monopoly** i.e. protected domestic industries will become monopolies when imports are restricted and as a result such industries begin exploiting consumers by charging high prices.
7. **Over protectionism leads to inefficiency** whereby local producers will produce local quality goods because of limited competition caused by restriction of imports.

8. **Loss of economic welfare**: Welfare is reduced through higher prices and restricted consumer choice since imports are restricted and consumers may end up consuming low quality and expensive commodities.
9. **Extra costs for exporters:** For goods that are produced globally, high tariffs and other barriers on imports act as a tax on exports, damaging economies, and jobs, rather than protecting them It leads to high production costs thus high prices for domestic final goods due to the fact that LDCs normally import raw materials and spare parts
10. **It may lead to scarcity inflation** especially if there are high taxes on imports which limits supply of goods and services thus scarcity in the country that results into high prices for the few commodities available.
11. **Limited inflow of skilled labour into the country**. If foreign workers are restricted into the country this may create inefficiency in some sectors of the country due to limited skilled workers and this may result into poor performance of such sectors which also affects a country's development.
12. **Production of poor quality products**. When home producers are protected from external competition this makes it easy for them produce poor and expensive products which in turn affects people's standards of living

3.3. Commercial policy

A Commercial policy or **trade policy** or **international trade policy or economic policy** refers to the set of rules and regulations that are intended to change international trade flows and particularly to restrict imports.

Or

Commercial policy is the government policy meant to influence, control and direct the volume of trade, value and the direction of trade in the country.

3.3.2 Objectives of commercial policy

1. To increase the **quantity of trade** with foreign nations.
2. **To preserve, the essential raw material** for encouraging the development of domestic industries.
3. **To stimulate the export of particular products** with a view to increasing their scale of production at home.
4. **To prevent the imports of particular goods** for giving protection to infant industries or developing key industry.
5. **To restrict import**s for securing diversification of industries.
6. **To encourage the imports of capital goods** for speeding up the economic development of the country.
7. **To restrict the imports of goods** with a view to correct the unfavorable balance of payments

8. **To assist or prevent the export or import** of goods and services for achieving the desired rate of exchange.
9. **To enter into trade agreements** with foreign nations for stabilizing the foreign trade.

3.3.3 Instruments/Tools of Commercial Policy:

1.**Tariffs or Custom Duties:** Tariff's or custom duties refers to the taxes imposed goods exported, imported or passing through the territories of another country.

Custom duties are generally classified into three classes;

(a) Transit duties are those taxes which are levied upon merchandize passing through the territories of another country.

(b) Import duties are those taxes which are levied on the goods brought into the country. Import duties are chiefly levied for revenue or for protection purpose or for both.

(c) Export duties are those taxes which are imposed on goods exported from the country. Export duties, like import duties, are also imposed for raising revenue and to restrict the export of certain raw material with the view to encourage the development of domestic industries.

2. Subsidizing domestic industries. When the government subsidies her domestic firms, they grow and expand and then sell their products at a cheaper price than foreign goods which reduces on importations. The subsidies may be direct or indirect. **Direct subsidies** are paid in cash from the public treasury but the **indirect subsidies** involve reducing taxes imposed on locally produced goods.

3. Direct Restrictions on Imports: The government may totally prohibit the import of certain commodities into the country with the intent of increasing foreign exchange or for protection of domestic industries or for discouraging the use of particular commodities because they are injurious to health.

4. Trade Agreements: The government of a country may enter into trade agreements with other countries for the exchange of goods.

5. Economic integration. This is the economic cooperation of countries in the same region so as to improve gains from trade among themselves.

6. Devaluation. This is the legal reduction in the value of a county's currency in terms of other countries' currencies. This is done to increase the demand for exports as they become cheap and reduce that of imports since they become expensive.

7. Import substitution strategy. This is where a country establishes domestic enterprises at home to produce goods at home which were previously imported in to the country. This is done with the intent of reducing import expenditure.

8. Foreign exchange control. This is the regulation of inflow and outflow of foreign exchange e.g. by fixing the foreign exchange rate.

9. Basic infrastructure policy. This involves expansion and improvement of domestic infrastructure like roads, railway, dams and many others in order to promote domestic production so as to reduce the amount of goods imported in the long run.

UNIT ASSESSMENT 3.1

1. Distinguish between tariff barriers and non-tariff barriers to trade
2. Explain the various non-tariff barriers used to restrict international trade in your country
3. Explain argument for and against protectionism policy.
4. (a) What is trade liberalization?

   (b). Would you advocate for trade liberalization, why?

UNIT4: BALANCE OF PAYMENT (BOP).

4.1.1: Meaning of Balance of Payment (BOP)

Balance of payment (BOP) also known as balance of international payments, is a statement that summarizes an economy's transactions with the rest of the world for a specified time period. It is a summary statement of a nation's financial transactions with the outside world.

4.1.2: Terminologies used in BOP:

a) **Balance of trade;** this refers to the difference between visible exports and imports.
b) **Balance of invisible trade;** this refers to the difference between invisible exports and imports.
c) **BOP deficit or unfavourable BOP**; this is where total expenditure abroad is greater than total receipts from abroad.
d) **BOP surplus or favourable BOP;** this is where total receipts from abroad are greater than total expenditure abroad.
e) **BOP disequilibrium**; this is where receipts from abroad are not equal to expenditures abroad i.e. either there is a BOP deficit or a BOP surplus.
f) **BOP equilibrium;** this is a situation where revenues from abroad are equal to expenditures abroad.
g) **BOP accounts;** this refers to the statistical record of the character and dimensions of the country's economic relationships with the rest of the world.
h) **Visible trade;** this involves the exchange of goods only
i) **Invisible trade;** this involves the exchange of services only

Activity

Balance of Payment Account	
Credits (+) - Receipts	**Debits (-) - Payments**
1. Current Account	
Exports	**Imports**
a) Goods b) Services c) Transfers	a) Goods b) Services c) Transfers
2. Capital Account	
a) Borrowing from foreign countries b) Direct investments by foreign countries	a) Lending to foreign countries b) Direct investment in foreign countries
3. Official settlement account	
a) increase in foreign official holdings	a) increase in official reserve of gold and foreign currencies.
4. Errors and Omissions	

Analyse the information in the table above and answer the questions that follow.

a) What does the table portray?
b) Why are some items recorded on the credit items while others on the debit side?
c) What examples can you give on transfers on either side?
d) What does direct investment by foreign countries and direct investment in foreign countries mean?
e) Describe how each account works.

4.2.1: The BOP accounts.

The balance of payments account of a country is constructed on the principle of ***double-entry book-keeping***. Each transaction is entered on ***the credit and debit side of the balance sheet***. In balance of payments accounting, the practice is to show credits on the left side and debits on the right side of the balance sheet. The balance of payment represents a summation of country's current demand and supply of the claims on foreign currencies and of foreign claims on its currency. It is prepared in a single currency, typically the domestic currency for the country concerned.

When a payment is received from a foreign country, it is ***a credit transaction*** while payment to a foreign country is ***a debit transaction***. The principal items shown on the credit side (+) are exports of goods and services, unrequited (or transfer) receipts in the form of gifts, grants etc. from foreigners, borrowings from abroad, investments by foreigners in the country and official sale of reserve assets including gold to foreign countries and international agencies. Therefore, sources of funds for a nation, such as exports or the receipts of loans and investments, are recorded as positive or surplus items.

The principal items on the debit side (-) include imports of goods and services, transfer (or unrequited) payments to foreigners as gifts, grants, etc., lending to foreign countries, investments by residents to foreign countries and official purchase of reserve assets or gold from foreign countries and international agencies. Therefore, uses of funds, such as for imports or to invest in foreign countries, are recorded as negative or deficit items.

These credit and debit items are shown vertically in the balance of payments account of a country according to the principle of double-entry book-keeping. Horizontally, they are divided into the following categories: the current account, the capital account, the official settlements account or the official reserve assets account and the errors and omission account as explained below.

1. Current Account:

The current account of a country consists of all transactions relating to trade in goods and services and unilateral (or unrequited) transfers. **Service transactions** include costs of travel and transportation, insurance, income and payments of foreign investments, etc. **Transfers** relate to gifts, foreign aid, pensions, private remittances, charitable donations, etc. received from foreign individuals and governments to foreigners.

In the current account, merchandise, exports and imports are the most important items. Exports are shown as a positive item and are calculated f.o.b. (free on board) which means that costs of transportation, insurance, etc. are excluded. On the other side, imports are shown as a negative item and are calculated c.i.f. (costs, insurance and freight) and included.

The difference between exports and imports of a country is its balance of visible trade or merchandise trade or simply balance of trade. *If visible exports exceed visible imports, the balance of trade is favourable. In the opposite case when imports exceed exports, it is unfavourable.*

It is, however, services and transfers or invisible items of the current account that reflect the true picture of the balance of payments account. The balance of exports and imports of services and transfer payments is called *the balance of invisible trade.*

The invisible items along with the visible items determine the actual current account position. *If exports of goods and services exceed imports of goods and services, the balance of payments is said to be* ***favourable.*** *In the opposite case, it is* ***unfavourable.*** The net value of these visible and invisible trade balances is the ***balance on current account.***

2. Capital Account:

The capital account of a country consists of its transactions in financial assets in the form of short-term (between three months and less than one year) and long-term (one year or more) lending and borrowings and private and official investments. In other words, the capital account shows international flows of loans and investments, and represents a change in the country's foreign assets and liabilities.

There are two types of transactions in the capital account—private and government. Private transactions include all types of investment: direct, portfolio and short-term. Government transactions consist of loans to and from foreign official agencies.
In the capital account, borrowings from foreign countries and direct investment by foreign countries represent ***capital inflows***. They are positive items or credits because these are receipts from foreigners. On the other hand, lending to foreign countries and direct investments in foreign countries represent ***capital outflows***. They are negative items or debits because they are payments to foreigners. The net value of the balances of short-term and long-term direct and portfolio investments is ***the balance on capital account***. *The sum of current account and capital account is known as the* ***basic balance.***

3. The Official Settlements Account or official financing account (cash or monetary account).

The official settlements account or official reserve assets account is, in fact, a part of the capital account. It measures the change in nations' liquidity and non-liquid liabilities to foreign official holders and the change in a nation's official reserve assets during the year. It includes a country's gold stock, holdings of its convertible foreign currencies and SDRs, and its net position in the IMF". It shows transactions in a country's net official reserve assets.
This account records all the transactions related to the change in the country's foreign exchange reserves and also shows the official foreign reserves in response to current and capital accounts. If there is a surplus on the combined current and capital accounts, this means that the foreign exchange reserves of a country have increased. If there is a deficit on the combined current and capital accounts, this means that the foreign exchange reserves of a country have decreased.

4. Errors and Omissions:

This is a balancing item so that total credits and debits of the three accounts must equal in accordance with the principles of double entry book-keeping so that the balance of payments of a country always balances in the accounting sense. In theory, the Capital and Financial Account balance should be equal and 'opposite' to the Current Account balance so that the overall Account balances, but in practice this is only achieved by the use of a balancing item called ***net errors and omissions***. This device compensates for various errors and omissions in the balance of payments data, and which brings the final balance of payments account to zero.
The errors may be due to statistical discrepancies & **omission may be due to certain transactions may not be recorded**. For e.g.: A remittance by a Rwandan working abroad to Rwanda may not get recorded, or a payment of dividend abroad by an MNC operating in Rwanda may not get recorded or so on. The errors and omissions amount, equals to the amount necessary to balance both the sides.

Activity

1. With examples, distinguish between credit and debit items on the BOP account.

2. What do the following mean on the BOP accounts?
   i) A “+” placed on the credit entry.
   ii) A “-” placed on the debit entry.
3. Fill in the gaps below.
   i) Any time an item (good, service or asset) is exported from a country, the value of that item is recorded as a ………………… (…) entry on the balance of payments, while
   ii) Any time an item (good, service or asset) is imported into a country, the value of that item is recorded as a …………….. (…) entry on the balance of payments.
4. a) If credits are Rwf5, 000,000 and debits are Rwf4, 000,000, what is the net balance on the BOP account? Interpret your answer.
   b) If exports are Rwf80bn and imports are Rwf100bn then how much are net exports? Interpret your answer.

4.2.2.1 Financing deficits/ How to correct a BOP deficit.

1. Selling gold or holdings of foreign exchange, such as US dollars, yen or euros,
2. Borrowing from other Central Banks or the International Monetary Fund (IMF)
3. Using of foreign exchange reserves available
4. sale of public assets abroad
5. Seeking aid and grants from other countries
6. Attracting foreign investments into the country
7. Import substitution strategy
8. Restrictive monetary policy i.e. reduces the amount of money in circulation
9. Improving the service industry e.g. tourism
10. Devaluation.
11. Export promotion strategy — increase the volume of exports and improve the quality of exports.
12. Increase taxes and reduce government expenditure i.e. fiscal policy.
13. Direct control — tariffs; quotas; exchange controls; complete ban, i.e. import restrictions.

N.B

Establishing BOP balance by using the above measures is called ***accommodating BOP*** and the items used to get rid of a BOP deficit are known as ***settlement or accommodating or compensatory or induced items.***

4.2.2.2: Financing surplus/ How to offset a BOP surplus.

1. Buying gold or currencies.

2. Paying off debts.
3. Building a stock of foreign exchange reserves
4. Lending to foreign countries
5. Providing aid and grants to other countries
6. Purchase and storage of durable goods
7. Opening current account deposits in foreign banks
8. Purchase of short- and long-term securities from abroad
9. Direct investments abroad.

N.B

The expenditure aiming at getting rid of the BOP surplus through the above means is known as ***autonomous expenditure*** and the items used are known as ***autonomous items.***

Activity

1. A balance of payments surplus means;
a) A country's export earnings are less than her expenditures on imports.
b) A country's export earnings are more than her expenditures on imports.
c) A country's earnings from exports are equal to what it spends on imports.
d) Only exports but does not import at all.
2. The balance of payments always balances in the accounting sense because of the following except;
a) Total domestic expenditures (C + I + G) must equal current income (C + S + T)
b) Domestic saving (Sd) must equal domestic investment (Id).
c) An export surplus on current account (X > M) must be offset by an excess of domestic saving over investment (S > Id).
d) Inflows must always be greater than outflows.
3. Explain how a deficit or surplus is measured in the balance of payments.
4. Fill in the gaps below;
a) If the total debits are more than total credits in the current and capital accounts, including errors and omissions, the net debit balance measures…………………………………………………………………………….
b) If total credits are more than total debits in the current and capital accounts, including errors and omissions, the net debit balance measures……………………………………………………………………………….

4.2.3.1: Causes of BOP deficits in developing countries.

1. **Narrow Export Base**: Most developing countries have a narrow export base, basically agricultural commodities
2. **Consumption oriented society:** Due to rapid rise in population and increased consumption habits in most developing countries, the domestic manufactured goods are mostly consumed in the country
3. **Poor technology in less developed countries:** There is less modernisation, balancing and replacement of machinery in the industrial sector in most developing economies.
4. **Production of primary products:** Most developing countries produce and export primary products which are both price and income inelastic thus earning less from international trade
5. **Devaluation**: The repeated devaluation of developing countries' currencies has not helped in the increase of exports. It has made the imported inputs costlier. The demand for their goods in the international market is inelastic
6. **Heavy protectionist policies by Developed countries**: Protectionist policies by developed countries on developing countries like imposition of tariff and non-tariff barriers have adversely affected developing countries' exports..
7. **Fall in Terms of Trade**: The import unit values are higher than the export unit values for most Developing countries. A decline in terms of trade causes imbalance in the balance of payment.
8. **Foreign Debts Servicing**: High expenditure on debt servicing since most Developing countries are poor and mostly rely on foreign resources especially through borrowing.
9. **Import of Capital Goods**: Most Developing Countries import expensive capital goods for rapid industrialization of their countries in order to build up the economy. The heavy import of machinery has considerably increased the import bill and has adversely affected balance of payment.
10. **High demonstration effect**: Most developing countries have Import oriented economies through demonstration effect leading to high demand for capital and luxurious goods thus leading to high foreign exchange expenditure which adversely affect BOP position.
11. **Rise in Oil Prices**: The sharp rise in the prices of oil in the recent past is taking a big amount of the foreign exchange earnings. Developing countries import bill of petroleum group increases year after year leading to BOP problems in Developing Countries.
12. **Political instabilities and insecurity**:Experience shows that political instability and disturbances in Developing countries cause large capital outflows and hinder Inflows of foreign capital.
13. **Fluctuations in the prices of exports of Developing Countries:** Since Developing Countries normally export primary products, their prices keep on fluctuating in the international market therefore BOP deficit when export prices fall.
14. **Imported inflation.:** Since most Developing Countries import expensive capital goods, it makes them to produce expensively thus leading to expensive exports which reduces their demand in the external markets thus less foreign exchange earnings from them.

15. **High population growth in Developing Countries:** High population growth in poor countries adversely affects their BOP because it increases the needs of the countries for imports and decreases their capacity to export.
16. **Natural calamities in Developing Countries:** Natural calamities like bad weather reduce the yields from the agricultural sector as their dominant export sector thus leading to adverse BOP.
17. **Poor infrastructure in most Developing Countries:** Most Developing countries have poorly developed and insufficient socio-economic infrastructure which has led to supply rigidities thus less export volume and therefore less earnings from them.
18. **Changes in fashions, tastes and preferences in the world market:** This has reduced on the demand for Developing countries' exports thus adversely affecting their BOP position.
19. **Unfair International Commodity Agreement (ICA):** Weak ICA leading to less bargaining powers in the international markets leading to low export prices and low earnings from exports hence BOP deficits.
20. **Insufficient export promotion institutions** to promote export sector through encouraging vent for surplus in most Developing Countries.
21. **Inflation in most Developing Countries' economies:** Most Developing countries' economies are hit by inflation which makes their exports expensive leading to low demand for them in the international markets thus earning less from them.
22. **Depreciation of Developing countries' currencies:** Persistent depreciation of Developing countries' currencies has made their products (exports) cheap while imports expensive thus high foreign exchange expenditure.

4.2.3.2: Solutions to BOP deficits in developing countries:

1. Export promotion: Export promotion agencies, Export Development Fund and Export Processing Zones etc. should be made more active to increase export and to correct the BOP.

2. Import restrictions and Import Substitution. Governments should increase import duties on commodities similar to those produced at home, encouraging domestic industries to use local raw materials so as to manufacture Import substitutes in the country

3. **Use restrictive monetary policy to control inflation** which discourages exports and encourages imports. This lowers the prices in the country for domestic commodities thus raising their demand in and out of the country.

4. **Government should control foreign exchange** by ordering all exporters to surrender their foreign exchange to the central bank and then ration out foreign exchange among licensed importers.

5. **Devaluation of domestic currency** which makes domestic goods cheaper for the foreigners. However, care should be taken that devaluation should not cause rise in internal price level.

6. **Encouraging investors** through establishing institutions that help and advise investors on investment prospects in the country.

7. **Opening new markets** and making regional groupings to widen markets for their exports.

8. **Ensuring political stability and security** in all parts of the country so as to attract investors, easy exploitation of resources which increases production activities thus increase the volume of exports and as well reduce on the expenditure on importation of military hard ware.

9. **Training local manpower** e.g. through universal primary and secondary education and setting up different training institutions so as to increase skills of indigenous manpower and reduce foreign expatriates.

10. **Seeking and being granted a debt relief** so as to reduce expenditure on debt servicing.
11. **Population Control** so as to reduce on foreign exchange expenditure on imported commodities to cater for the alarming population.
12. **Innovations and inventions** to improve on technology so as to improve on productivity, increase the volume of exports and foreign exchange earnings as well. This also improves the quality of products according to international standard.
13. **Strengthening the tourism industry** as an export diversifier.
14. **Strengthening the ICA** so as to increase the export volume and bargaining power as well.
15. **Economic legalization** so as to increase domestic productivity and export volume.
16. Developing countries should process their primary products which adds value to them thus more foreign exchange earnings.
17. Labour intensive industries should be established, because labour is cheaper in Rwanda, these industries can be set up at lower cost. The products of these industries can be exported.
18. **Reduction in export duties which** makes developing countries' export competitive in the international market. Foreigners will prefer to import from developing countries because of low prices.
19. **Joint Venture:** Establishing industries with joint venture of foreign investors can also push up the export sector. The products of these industries can be sold in the foreign market.
20. **Import of Only Essential Items:** Only essential items should be imported which are needed for our industrial production. Import of luxuries should be banned. People should be educated to come out from the complex of foreign goods.
21. **Infrastructural development:** Rehabilitate and develop socio-economic infrastructure to increase production and exchange of goods and services across national borders to increase foreign exchange earnings.
22. **Exchange Control** so to minimize the imports. Exchange control should be followed, so that there is no wastage of foreign exchange to import of un-necessary commodities and luxuries.

End unit assessment:

1. a) To what extent is inflation a cause of BOP in LDCs.

b) What policy measure would you suggest to reduce BOP problems in Rwanda?

2. (a) What fiscal and monetary measures may be employed to reduce inflationary pressures on the external balance of payments?

(b) What is the relationship between the domestic economy and the balance of payments?

3. Balance of payments must always "balance". With reference to your country, explain the Existence of either "favourable or unfavourable" balance of payments position.

UNIT 5. EXCHANGE RATES.

5.1.1: Meaning of Foreign Exchange

Foreign exchange is the conversion of one currency into another currency**.**

Foreign exchange market refers to the global market where currencies are traded virtually around the clock. The term foreign exchange is usually abbreviated as ***"forex"*** and occasionally as ***"FX."***

5.1.2: Terms used in foreign exchange.

- **Foreign exchange rate.** The rate/price at which given currencies are exchanged for each other in the foreign exchange market
- **Exchange rate regime:** This is way in which an authority manages its currency in relation to other currencies in the foreign exchange market.
- **Floating exchange rate:** This is a system where the value of currency in relation to others is freely determined by the market forces of demand and supply for the currency.
- **Fixed exchange rate:** This is a system where a currency's value is tied to the value of another single currency, to a basket of other currencies, or to another measure of value, such as gold.
- **Pegged float exchange rate:** A currency system that fixes an exchange rate around a certain value, but still allows fluctuations, usually within certain values, to occur.
- **Spot Market**. This is where the price of a currency is established on the trade date but money is exchanged on the value date.
- **Floating currency.** This is a currency that uses a floating exchange rate
- **Forward Market.** A forward market/ trade is any trade that settles further in the future than spot.
- **International Currency Exchange**. This is a rate at which two currencies in the market can be exchanged.
- **Currency Pairs.** These are two currencies with exchange rates that are traded in the retail market.
- **Foreign Exchange Market.** This is a market where participants buy, sell, and exchange currencies daily.

- **Foreign Exchange Reserves:** These are reserves assets in foreign exchange that are held by a central bank.
- **Foreign Exchange Risk:** Foreign exchange risk is the chance that an investment's value will decrease due to changes in currency exchange rates.

Sources of Foreign Exchange

- Export of goods and services
- Transfer payments e.g. grants and aid
- Remittances and transfers of nationals working abroad
- Selling of public assets abroad
- Capital inflow through direct and foreign investments
- Profits, dividends and interests repatriated from investments abroad
- Funds from charitable organizations e.g. UNICEF
- Private foreign bank deposits in the local banks
- Borrowing from international countries, companies and individuals.

5.1.3: Forms/ types of exchange rates/ exchange rate systems/ regimes

1. The gold standard

Under the gold standard, a country's government declares that it will exchange its currency for a certain weight in gold. In a pure gold standard, a country's government declares that it will freely exchange currency for actual gold at the designated exchange rate.

Advantages of the gold standard

- It solves the **BOP problems automatically** because of the automatic adjustment mechanism.
- There is **neither currency appreciation nor currency depreciation** since every unit of currency is tied to gold.
- There is **economic stability** because of a stable exchange rate system.
- **Liquidity problem** is easily solved because of free flow of gold.
- There **is smooth international trade** because gold is used as a medium of exchange.

b) Disadvantages of the gold standard exchange rate system

- It is difficult for the central bank to **control money supply**.
- When gold is in excess supply, **it loses exchange value**.
- It does **not favour economic growth** in countries with small quantities of gold.

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5.1.3.2. Fixed Exchange Rate System:

Fixed exchange rate system refers to a system in which exchange rate for a currency is fixed by the government at a specific rate in relation to a specific foreign currency for a period of time. Once this rate is fixed, it becomes illegal to exchange a currency at a parallel rate.

Under this system, each country keeps value of its currency fixed in terms of some 'External Standard'.

This external standard can be gold, silver, other precious metal, another country's currency or even some internationally agreed unit of account. When value of domestic currency is tied to the value of another currency, it is known as ***'Pegging'***.

The fixed exchange rate may be ***undervalued or overvalued*** i.e. ***undervalued exchange rate*** is where the exchange rate is fixed below the market or equilibrium value of the currency. For example, if the equilibrium rate is 600frw for a dollar and the rate is fixed at 300frw for a dollar, this leads to cheap imports and expensive exports hence BOP deficits.

Overvalued exchange rate is where the exchange rate is fixed above the market or equilibrium value of the currency. This leads to undervalued local currency which makes exports cheap and imports expensive hence improved BOP position.

In a fixed exchange rate system when the external value of the currency is increased, we refer to this as ***revaluation*** (increase in the value of domestic currency by the government) and when the external value of the currency is reduced, we refer to this as ***devaluation (***reduction in the value of domestic currency by the government***).***

Forms of pegged float exchange rate

- **Crawling bands.** The market value of a national currency is permitted to fluctuate within a range specified by a band of fluctuation. This band is determined by international agreements or by unilateral decision by the central bank. Generally, the bands are adjusted in response to economic circumstances and indicators.
- **Crawling pegs.** This is an exchange rate regime, usually seen as part of a fixed exchange rate regime that allows gradual depreciation or appreciation in an exchange rate.
- **Pegged with horizontal bands:** This system is similar to crawling bands, but the currency is allowed to fluctuate within a larger band of greater than one percent of the currency's value.

a) Advantages of fixed exchange rate system

- **It encourages international trade** by ensuring certainty and predictability of prices with goods involved in international trade
- **It ensures stability in foreign exchange markets** by avoiding constant appreciation and depreciation with in the currency which ensures confidence in the domestic market
- **It minimizes speculation in the economy** by both goods and foreign exchange markets and it is negative effects

- **It reduces exploitation and cheating of foreign exchange** buyers and holders by money markets and foreign exchange markets.
- **It facilitates planning** since income in form of foreign exchange assessed and predicted according to the rate of exchange.
- The government can easily **use foreign exchange rate to minimize BOP deficits** i.e. by raising the exchange rate and devaluing the domestic currency which makes exports cheap and imports expensive hence improvement in the BOP position.
- **Encourages long term capital inflows** in an orderly manner thus encouraging investment
- **Fixed exchange rates impose a price discipline on nations** with higher inflation rates than the rest of the world, as such a nation is likely to face persistent deficits in its balance of payments and loss of reserves.

b) Disadvantages of fixed exchange rate system

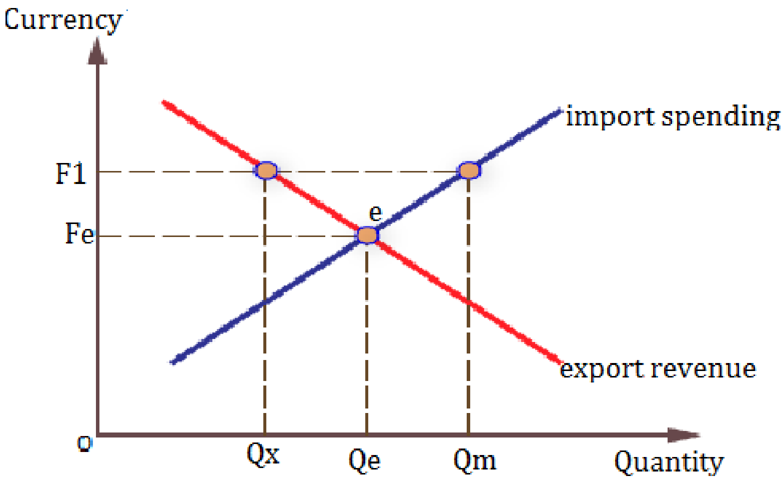
- **It is expensive to maintain** because it requires a lot of foreign exchange reserves.
- **It requires strict monitoring** of the economy which is affected by insufficient personnel.
- **It may lead to inflation** if it is fixed above the market price or deflation if it is fixed below the market price.
- **It reduces speculation** which reduces business profitability.
- **It discourages competition in foreign exchange markets** which leads to inefficiency.
- The announced **exchange rate may not coincide** with the market equilibrium exchange rate, thus leading to excess demand or excess supply.
- **The central bank needs to hold stocks of both foreign and domestic currencies** at all times in order to adjust and maintain exchange rates and absorb the excess demand or supply.
- **The cost of government intervention** is imposed upon the foreign exchange market.
- It fails to identify the **degree of comparative advantage or disadvantage of the nation** and may lead to inefficient allocation of resources throughout the world.
- **Fixed exchange rate does not allow for automatic correction of imbalances in the nation's balance of payments** since the currency cannot appreciate/depreciate as dictated by the market.

5.1.3.3. Flexible /floating/free/market/ fluctuating Exchange Rate System

Flexible exchange rate system refers to a system in which exchange rate is determined by forces of demand and supply of different currencies in the foreign exchange market. The value of currency is allowed to fluctuate freely according to changes in demand and supply of foreign exchange. There is no official (Government) intervention in the foreign exchange market.

The exchange rate is **determined by the market**, i.e. through interactions of thousands of banks, firms and other institutions seeking to buy and sell currency for purposes of making transactions in foreign exchange.
When the supply of foreign exchange is equal to the demand for it, then **equilibrium exchange rate is determined.**

Figure 2: Exchange rate Equilibrium



From the figure above, forex equilibrium is obtained when import spending is equal to export revenue. i.e. at point 'e' in the above diagram. This means that the demand for forex is equal to its supply. Fe is equilibrium currency rate while Qe is equilibrium quantity demanded and supplied of currencies. Below or above Fe, the demand for and supply of currencies isn't equal thus causing disequilibrium in the forex market (forex shortages or excess).
In a floating exchange rate system, when the external value of the currency increases, then this is called ***currency appreciation*** (low exchange rate) and when the external value declines, this is called ***currency depreciation*** (high exchange rate)

Table 1: Fixed Exchange Rate System Vs. Flexible Exchange Rate System:

Basis	**Fixed Exchange Rate**	**Flexible Exchange Rate**
Determination of Exchange Rate:	It is officially fixed in terms of gold or any other currency by government.	It is determined by forces of demand and supply of foreign exchange.
Government control	There is complete government control as only government has the power to change it.	There is no government intervention and it fluctuates freely according to market conditions.
Stability in Exchange Rate:	The exchange rate generally remains stable and only a	The exchange rate keeps on changing.

	small variation is possible.	

a) Advantages of flexible exchange rate

- The system is automatic and therefore does **not need a lot of government involvement** and expenditure on foreign exchange rate monitoring.
- **Trade imbalances** i.e. surpluses and deficits are corrected automatically by the forces of demand supply.
- It responds to **the rapid economic changes quickly** since it is automatic.
- It encourages **proper resource utilization** into their optimal use.
- It increases the **volume of international trade** because of the freedom in the foreign exchange markets.
- It encourages **efficiency and competition** in the money market.

b) Disadvantages of the flexible exchange rate.

- **It creates uncertainty** as it fluctuates and discourages international trade and capital movements
- **It creates instabilities in the foreign exchange rate** thus affecting planning and hence discouraging economic growth and development.
- It encourages **speculation in the foreign exchange** where foreign exchange buyers may be cheated.
- **It is inefficient in correcting BOP deficits** as the domestic demand for exports and imports remain inelastic.
- It leads to **fluctuations in export earnings** which affects budgeting of the government
- **It discourages long term contracts between borrowers and lenders** which may discourage investments and economic growth and development.
- In case there is no understanding between governments about manipulation of exchange rates, **it may result into war of exchange rates** with each country trying to establish favourable rates with other countries.

c) Causes of Currency depreciation in LDCs

- Decline in the **volume and value of exports** (primary products).
- Decline in **foreign exchange inflow** due to political instabilities.
- Decline **in international payments** in the domestic banks.
- Reduction in **the volume of grants, aid and loans.**
- Increase in **demand for imports especially capital inputs and essential consumer goods.**
- Increase in **foreign exchange expenditure** e.g. on embassies, official trips abroad etc.
- Government policy of devaluation.
- High rates of **inflation** which reduces domestic production.

d) Effects of currency depreciation

Positive effects

- It increases the **volume of exports** hence foreign exchange earnings
- It encourages **export promotion and import substitution industrialization** which reduces foreign exchange expenditure.
- It encourages **domestic investments** because the cost of production is low at home if inputs are not imported.
- It reduces the **BOP problems** because the expenditure on imports reduces
- It increases **capital inflow and foreign investments**
- It encourages **exploitation of domestic resources** because it is cheap to produce at home

Negative effects

- It reduces **the volume of imports which might lead to scarcity of goods and services** in the economy.
- It makes projected **planning difficult and distorted.**
- It increases **the cost of production at home** because of expensive imported inputs
- It increases the country's indebtedness abroad.
- **It worsens BOP problems** since imports become expensive than exports
- It leads to **loss of confidence** in the local currency
- It **may lead to over exploitation of resources** since it is cheaper to produce at home.

5.1.3.4. Mixed/multiple/Managed/ Dirty Floating Rate System:

This refers to a system in which foreign exchange rate is determined by market forces and central bank influences the exchange rate through intervention in the foreign exchange market. It is a hybrid of a fixed exchange rate and a flexible exchange rate system.

a) **Advantages of the managed floating exchange rate system**

- It helps a country to **export and import commodities of national priority**
- Government can **reduce unfair competition of foreign currencies over domestic currencies.**
- It reduces **excessive foreign exchange fluctuations** in the foreign exchange market
- **It reduces speculation** hence reducing hoarding and scarcity of foreign exchange

b) **Disadvantages of the managed floating exchange rate system**

- **It is expensive for the government to supervise** and maintain maximum and minimum margins
- **It limits free convertibility of currencies** hence limiting the flow of exports and imports
- **It doesn't allow free exchange of currencies** to determine the real value
- **It might lead to malpractices** such as over invoicing imports and under invoicing exports.

5.2.0: Devaluation.

Devaluation refers to deliberate government policy of reducing the value of domestic currency in the terms of other currencies i.e. the domestic currency becomes cheaper in relation to other countries' currencies.
Devaluation is only possible under the fixed exchange rate system.

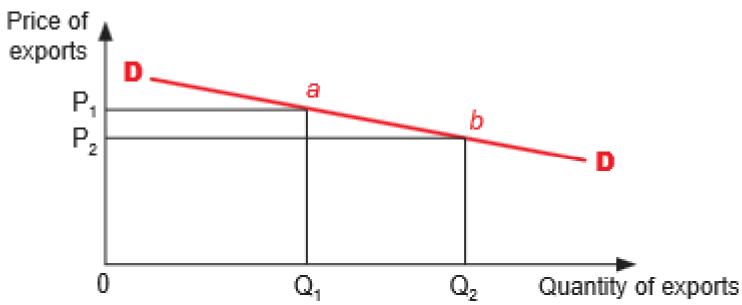
Reasons for devaluation

1. **To make exports cheap and hence lead to more export,** there by leading to increase in foreign exchange earnings.
2. **To collect balance of payment problems by reducing imports** by making them expensive.
3. **To attract foreign and domestic investors** as it becomes cheaper to invest in the economy as little foreign exchange can be exchanged for a lot of the local currency.
4. **To protect domestic infant industries from competition** by cheap imports by making similar imports expensive.
5. **To promote self-sufficiency** by encouraging import substitution industries and reduce dependency on imports from other countries.
6. **To conserve foreign exchange** as it discourages imports and minimizes foreign exchange out flow and therefore can reduce on the problem of trade shortage.
7. **To increase on the level of productivity and thus domestic resource utilization** this calls for employment of idle resource.
8. **To increase on employment opportunities** at home through increased domestic production.
9. **Some LDCs undertake devaluation** in order to fulfill IMF conditionalities in order to receive loans..
10. **To check on imported inflation** because after devaluation, the inflation hit imports are too expensive and this discourages importers.
11. **To increase the nominal income** of the producers of primary products that are exported

5.2.3: Conditions necessary for devaluation to be successful

1. The demand for exports must be price elastic. That is, a small price reduction resulting from devaluation will lead to a proportionately large increase in their purchase and more foreign exchange will be earned.

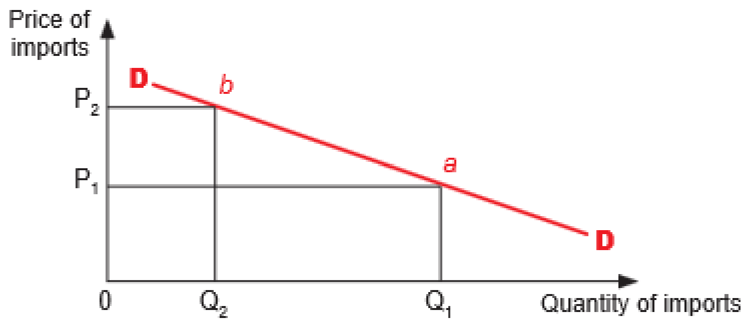
Devaluation and foreign exchange earnings.



From the figure above before devaluation foreign exchange earning from exports are OQ_1aP1 and after devaluation foreign exchange earnings increase to OQ_2bP_2. Rectangle OQ_2bP_2 is bigger than rectangle OQ_1aP_1 meaning that more foreign exchange earnings are as a result of a fall in the price from OP_1 to OP_2 which increased quantity exported from OQ_1 to OQ_2.

2.The demand for imports should be price elastic so that imports appear to be expensive after devaluation and less of them are demanded hence less foreign exchange expenditure.

Devaluation and foreign exchange expenditure.



From the figure above, before devaluation, the price for imports was OP_1 and the quantity imported was OQ_1. After devaluation, the price for imports increased from OP_1 to OP_2 and the quantity demanded of imports fell from OQ_1 to OQ_2 thereby reducing the foreign exchange expenditure from OP_1aQ_1 to OP_2bQ_2. Rectangle 0Q2bP2 is smaller than rectangle 0Q1aP1.

3. The supply of export in the devaluating country should be elastic such that as demand for **export increases then more quantity of exports should be supplied**.
4. The supply of imports should be price elastic in that when there is devaluation and there is a **decrease in demand for imports**, the quantity supplied for them should be able to reduce greatly.
5. **There should be no inflation in devaluing country** so that after devaluation exports will be cheap and attractive to foreign importers hence more will be imported.
6. **There should be no restrictions on exports from the devaluing countries** otherwise this would limit exports and hence earnings from exports.
7. **There should be no counter devaluation or other countries should not retaliate by devaluing their currency** because this will neutralize the intention of devaluing countries.
8. **There should not be trade union** to put pressure on wages and increase the cost of production.
9. **There should be excess capacity in devaluing country** such that as exports are produced, imports are discouraged and more output is produced to substitute import.
10. **The marginal propensity to import in devaluing** country should be low.
11. The devaluing country should **be able to compete favorably in the world market**
12. The devaluing country **should be politically stable** so as to ensure stable production
13. **There should be stability in the exchange rate system** i.e. fixed exchange rate regime.

5.2.4: Effects of devaluation.

Positive effects

1. **It increases the volume of exports** by making them cheap.
2. **It increases the volume of foreign exchange earnings** by increasing on the volume of exports.
3. **It increases the capital inflow e**.g. through foreign investment because it becomes cheaper to produce in the devaluing country.
4. **It improves balance of payment position** due to increased foreign exchange earnings and reduced foreign exchange expenditure on import.
5. **Increase in domestic investments** which increase exploitation of idle resources.
6. **It increases employment opportunities at home**, e.g. through export promotion and import substitution industries.
7. **It leads to development of domestic infant industries** by making similar imports expensive.
8. **It promotes self-sufficiency** by encouraging exports and reducing the volume of imports.

Negative effects

1. It worsens the balance of payment position because external market for products from developing economies is poor.

2. It leads to imported inflation since devaluation increases prices of imports yet imports in developing economies have inelastic demand.

3. **It leads to capital flight by nationals** because they will tend to invest outside to earn high value foreign currency.

4. **Due to inflation that may result from devaluation** imported inputs become expensive which discourages production yet developing economies heavily depend on imported capital.

5. **It increases borrowing rate and debt servicing burdens** by developing economies since they need a lot of income in terms of domestic currencies in form the foreign resources.

6. It leads to persistent government budgetary deficit as a result of increased expenditure on imports which increases expenditure due to devaluation that makes import expensive.

7. Saving levels can decline in economy because of liquidity preference to meet high price of imported commodities thus causing inflation.

8. It affects fixed income earners because where as prices are increasing due to devaluation their income remains constant hence low real incomes.

9. If it is common**, it may discourage investors** who lose confidence in the local currency.

10.It may reduce the standards of living of people due to shortage of commodities in the economy as a result of restricting imports yet developing economies heavily depend on imports.

11. **It also discourages competition by protecting infant industries** which may provide low quality commodities yet charging high prices.

12. **It may hinder technological transfer** because of the increase in the cost of imported commodities and inputs.

5.2.5: Success of devaluation policy in LDCs.

1. **Domestic elasticity of demand of their imports is low** because of high population growth rate
2. **Developing economies import commodities that are price and income inelastic** because they are mainly essential commodities
3. **There is protectionism by developed economies** on products from developing economies so as to increase employment in MDCs.
4. **The elasticity of supply of products from developing economies** is low because of domestic supply rigidities.
5. **Developing economies have competitive supply** i.e. supply of similar commodities; they therefore tend to carry out competitive devaluation.
6. **Developing economies have inadequate co-operant factors** especially capital and entrepreneur hence low production for exports.
7. **Most developing economies experience high rates of inflation** which discourage export due to high costs of production
8. **Developing economies pursue unfavorable economic policies** like trade legalization which increase the inflow of imports.
9. **There is high degree of malpractice** for example smuggling because of inefficient administrative machinery hence increasing the volume of imports.
10. **Political instability and insecurity in developing economies** discourage domestic production and foreign investment.
11. **There is counter devaluation among developing economies** i.e. other countries retaliate by devaluing their currency.
12. **There is high marginal propensity to import** due to the desire for essential capital input and imported raw materials.
13. **Developing economies exports** are limited by low export quotas in the international commodity Agreement (ICA)
14. **There are weak export promotion institutions in developing economies** which reduce the benefits of devaluation.
15. **Developing economies face foreign exchange instabilities** because of adapting liberal exchange rate systems.

UNIT ASSESSMENT

1. a) When and why is devaluation carried out?

b) How is devaluation of a currency supposed to address an economy's balance of payments current account deficit?

2. Under what circumstances may devaluation fail to achieve its intended objectives in an economy?

3. Explain the merits and demerits of floating exchange rate system.

UNIT 6: ECONOMIC INTEGRATION

6.1.1. Meaning of economic integration.

Economic integration is a commercial policy where countries come together for the sake of economic benefits by eliminating trade barriers among themselves.

OR

Economic integration is the coming together of countries in a given region so as to promote trade and enjoy economic benefits by working collectively.

Examples of economic integration include

1. East African Community-EAC,
2. Common Market of East and Southern Africa-COMESA,
3. Oil and Petroleum Exporting Countries- OPEC,
4. Southern Africa Development Community (SADC),
5. Economic Community for West African States-ECOWAS,
6. European Union-EU,
7. African Union- AU,
8. African Caribbean Pacific Countries (ACPC)
9. Economic Community of the Great Lakes Countries (CPGL) and many others.

6.1.2: Objectives of economic integration

1. **To enlarge and diversify market** for locally produced commodities in the region.
2. **To reduce or eliminate trade barriers** among themselves e.g. use of one currency or allowing local currencies among member states or encouraging barter trade.
3. **To avoid duplication of commodities** by encouraging specialization in each country.
4. **To increase the utilization of domestic resources** which cannot be exploited by a single country.
5. **To enhance free flow of ideas**, skills and technology in the region.
6. **To reduce the cost of production** by adopting large scale enterprises which makes them enjoy economies of scale.
7. **To increase the bargaining power of member** states in the international market.
8. To improve the terms of trade of member states.
9. **To boost industrialization and production of commodities** to out compete manufactured imports and reduce dependence among member states.
10. **To promote political harmony** and security in the region.
11. **To expand employment** opportunities for member states.
12. **To decrease the exploitative powers of developed countries** by reducing or stopping imports from developed countries that are always expensive.

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6.2: Conditions necessary for successful economic integration.

1. **Geographical proximity** i.e. countries coming together into an integration should be geographically close to one another or should share common boarders in order to effect preferential treatment to each other.
2. **Common and same ideology** i.e. they should have common historical background and ideology so as to harmonize their social economic policies e.g. socialism capitalism and mixed economies.
3. **They should be at the same level of development** so as to ensure fair flow of resources otherwise resources would flow from less developed countries to developed countries.
4. **There should be strong political will or similar political organization** among cooperative countries i.e. commitment by leaders and their population.
5. **Countries should be preferably of equal size** because there is a likelihood of them having unequal quantities of resources.
6. **The economies of countries should be in position of producing different products** so that exchange is promoted.
7. **There should be production of diversity of commodities** thus specialization and exchange to be encouraged.
8. **Citizens in the cooperative countries** should have enough income so as to promote adequate market for commodities.
9. **There should be political stability** among cooperative countries so as to ensure smooth operation of the regional activities.
10. **There should be a well-developed infrastructure** like roads in all cooperative countries so as to make transportation of goods and services within the region simple and cheaper.
11. **Countries should be complementary to one another** so as to exchange their commodities.
12. **There should be a common language in the region** so as to make communication easy to all people within the region.

6.3: Process/ stages/ levels of economic integration.

1.Preferential Trade Area (PTA): This is the initial level in the development of economic integration where countries start their cooperation. In here member countries give preferential treatment to each other. There are low tariffs charged on selected commodities from member states while high tariffs are charged on commodities from non-member states.

2. Free Trade Area (FTA): Here member countries agree to **abolish or eliminate tariffs or trade barriers among themselves but each country retains separate tariff structure** on commodities from non-member states.

3. Custom union (CU): This is where member countries **eliminate all tariffs or trade barriers amongst themselves and in addition countries adopt a common tariff structure** on commodities that are from non-member countries but there is no free flow of factors of production among member countries.

4. Common market (CM): In here, member countries **eliminate trade barriers amongst themselves; charge a common tariff on commodities from non-member countries and allow free mobility of factors of production** within the region e.g. capital and labor. This is done to boost production, increase employment and increase reward for factors of production and improve economic welfare in the region

5. **Economic community/ union (EC/ EU);** This is where there is **eliminating of all tariffs among member states, adoption of a uniform tariff structure on commodities from non-member countries; free mobility of factors of production within the region; adoption of harmonious economic policy** where countries in the same region have the same economic strategy, use the same policies and policy tools, joint ownership of enterprises and use of the same currency is adapted thus have the **monetary unions**, harmonization of the **social services** like education, health etc. increase the level of political identity and formation of political federation.

6.4.1. Advantages of economic integration.

1. **Trade creation effect**. This is where the creation/formation of the economic cooperation results into a shift from consumption of expensive products from non-member countries to consumption of cheap products in member countries.
2. **Expansion and extension of large markets**; most economic integration provides sufficient wide export markets since member countries have to import within the region which therefore boosts production and promote rapid economic growth.
3. **Skill development and technological transfer** i.e. due to free mobility of factors of production, it facilitates skill development and technological transfer within cooperative countries.
4. **It increases the bargaining power of member countries in the international market**, therefore this increases their benefits from the international trade.
5. **It increases the competition which leads to high productivity** in terms of quantity and quality.
6. **It facilitates specialization based on comparative cost advantage** i.e. countries avoid competition in the production but instead specialize on the basis of comparative advantage which boosts production hence more volume of exports.
7. **Sharing of common services** like research, education health transport and communication becomes very easy which in turn increases efficiency since they are jointly operated thus reduction of duplication of services
8. **It promotes industrialization among member states** by establishing manufacturing industries.
9. **Common currency** is used and states adopt a common currency and it is strong and always stable which stabilizes prices in the region.

10. **There is creation and expansion of employment opportunities** and reduction of unemployment among member states due to the flow of factors of production freely amongst themselves.

11. **It enhances political harmony and stability in the region** i.e. common political problems can be solved through consultation and sharing of ideas

12. **It helps in redistribution of income in the region** i.e. economic integration fosters a more equitable distribution of resources when factors of production are allowed to flow freely between or among countries thus equalizing returns to each factor.

13. **It reduces balance of payment deficit** because economic integration leads to reduction of foreign exchange expenditure and increased export earnings.

14. **It increases consumers' choice** i.e. since a variety of goods are produced with in the region, countries get commodities at low prices and low costs thus maximizing profits.

15**. It reduces administrative costs** involved in import-export restrictions.

16. **It promotes self-reliance among the cooperative countries** i.e. it reduces economic dependence of LDCs on MDCs

17. **It is a vent for surplus**; the resources formerly unutilized can be exploited because of a wider market created by the integration.

6.4.2: Disadvantages of economic integration

1. **Trade diversion** i.e. this is where trade is diverted from low cost producers outside the integrated region to high cost producers with in the region. In addition, countries might continue using low quality products from within the region when they could have secured high quality goods from outside region.
2. **Loss of revenue which could have been got from tariffs** due to free flow of goods and services and factors of production within the region and common tariff structure on non-member states.
3. **It may lead to loss and movement of resources and goods** from less developed countries to more developed countries.
4. **Most LDCs produce similar products and find it hard to trade** among themselves leading to surplus.
5. When many industries are constituted in one country due to pull factors, **it causes uneven distribution of industrial benefits.**
6. Cooperative countries are forced to forego some of their national interests which **reduce self-reliance and sovereignty.**
7. **It may lead to production of low quality products** because of restriction of similar commodities from non-member countries.
8. **It may lead to over exploitation and quick exhaustion of resources** in order to supply a large market created in the region.
9. **Large scale ventures may experience diseconomies of scale**. It leads to loss of political sovereignty in case of a political integrated federation.

10. **When there is political instability in one country**, it may affect the whole integrated region because all countries depend on each other.
11. **Other countries may retaliate and also impose restrictions on imports** and thus may lead to formation of rival trade blocks.
12. **It may lead to unemployment** i.e. firms will be relocated to more cost effective location within the block thus it may lead to unemployment to other countries from where the firms move.

6.5: Obstacles/ impediments to successful economic integration in LDCs.

1. Political instabilities in some developing countries. This hinder economic integration because most countries fear absorb the problems of other countries after integrating. Even after
2. Integration, some countries may fail to work with others effectively in the region because of political problems in their countries hence hindering effectiveness of the regional integration.
3. Inadequate political commitments among member countries where some member states are not committed to the activities of the integration. Sometimes do not send to meetings those officials who have the appropriate expertise on the issues to be discussed, and other times regional meetings are not attended to regularly.
4. **Differences in political ideologies**, itis very hard for the integration to be successful if member states have different ideologies. Most integrations in developing countries have failed simply because of differences in political ideologies.
5. Differences in levels of development. It is very hard for countries to integrate successfully when some countries are more developed than others
6. External obstacles by developed countries. These developed countries always fight against the economic integration of developing countries.
7. Unfavorable exchange rate system. Some countries have currencies which have more value than other countries. When the value of currencies in the integration have different values this means that the exchange rate may be in favour of some countries and disfavour of others hence hindering integration.
8. Differences in cultures. It is always very hard for countries to integrate successfully when people totally have different cultures.
9. **Production of similar products.** It is totally hard for the integrated countries to reach higher stages of the economic integration simply because of producing similar products which makes it hard for countries to benefit from each other as it is always intended for thus being a big obstacle.
10. Need for self-reliance. Some countries may refuse to integrate with others because of their need for self-reliance
11.**Difference in fiscal and monetary policies.** It is very hard for countries to integrate if their monetary and fiscal policies are totally different
12. **Differences in geographical boundaries**, it is also very hard for countries to integrate

successfully if they are not near each other because this makes transportation of goods so costly and very hard.

6.6.1 East African Community (EAC)

The East African Community (EAC) is an intergovernmental organization composed of six countries in the African Great Lakes region in eastern Africa: Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda, with its Headquarters in Arusha. The organization was founded originally in 1967, collapsed in 1977, and revived on 7 July 2000 following its ratification by the Original 3 Partner States – Kenya, Uganda and Tanzania. And later in July 2009 Rwanda and Burundi Joined East African community and in April 2016 South Sudan has also joined east African countries.

6.6.2 Aims and Objectives

The EAC aims at widening and deepening co-operation among the Partner States in, among others, political, economic and social fields for their mutual benefit and the following are some of the specific objectives of East African community.

Objectives of the EAC Integration

1. **The attainment of sustainable growth and development of the Partner States** by the promotion of a more balanced and harmonious development of the Partner States
2. **The strengthening and consolidation of co-operation in agreed fields** that would lead to equitable economic development within the Partner States and which would in turn, raise the standard of living and improve the quality of life of their populations.
3. **The promotion of sustainable utilization of the natural resources** of the Partner States and the taking of measures that would effectively protect the natural environment of the Partner States.
4. **The strengthening and consolidation of the long standing political, economic, social, cultural and traditional ties and associations** between the peoples of the Partner States so as to promote a people-centered mutual development of these ties and associations;
5. **The mainstreaming of gender in all its endeavors and the enhancement** of the role of women in cultural, social, political, economic and technological development;
6. **The promotion of peace, security, stability within, and good neighborliness** among the Partner States.
7. **The enhancement and strengthening of partnerships** with the private sector and civil society in order to achieve sustainable socioeconomic and political development.

6.6.2. Achievements of the East African Community.

1. The most important achievement was the **establishment of the EAC Custom Union**. The Custom Union Protocol was signed in March 2004 and came into effect on January 1, 2005.

Under Customs Union arrangements, goods produced within the EAC move across the border of partner states without taxation provided they qualify under rules of origin.

2. It has increased both inter and intra-regional trade, increased competition that has increased consumer's choice, reduction of costs, and attraction of foreign direct investments.

3. It has witnessed an increase in intra-EAC Foreign Direct Investments as well as Foreign Direct Investments from outside.

4. There is mutual recognition of standards marks across the region where the bureaus of standards have developed an EAC catalogue of standards.

5. It has led to establishment of One Stop Boarder Posts that have already been articulated within the auspices of the community law. This has facilitated trade within the community.

6. As part of the joint effort to promote East Africa as a single tourist destination, partner states have participated in major international travel markets forums including the World Travel Market in London November 2005 and the International Tourism Bourse in Berlin in March 2006 which has helped in promoting East Africa as a single tourist destination and has resulted in attracting more tourists and increasing the contribution of the tourism industry to the East African economy.

7. Promotion of foreign policy co-ordination through collaboration in diplomatic and consular activities; collaboration in economic and social activities; liaison and exchange of information; and collaboration in administration and capacity building

8. The partner states have adopted an action program that has focused on increased employment and poverty reduction in the EAC. In this regard, the EAC projects and programs are assessed as to how they contribute towards poverty eradication in the region. Furthermore, the East African Community established an annual Ministerial Forum to focus on employment creation and poverty reduction.

9. Launched Lake Victoria Commission i.e. East African partner states have taken a number of steps to preserve the lake through the implementation of the Lake Victoria Environmental Management Program. This has ensured sustainable use of Lake Victoria as vital for the sustainability of Lake Victoria.

10. **Improvement of East African Infrastructure** through the East African Road Network Project where a Tripartite Agreement on Road Transport has been ratified by partner states.
11. **Harmonization of Monetary and Fiscal Policies** i.e. Steps toward the harmonization of monetary and fiscal policies have included convertibility of the partner states' currencies, harmonization of banking rules and regulations, harmonization of Finance Ministries' pre- and post-budget consultations, regular sharing of information on budgets, and reading of budget statements on the same day.
12. **Strengthened an East African Identity** i.e. there have been developments designed to foster the feeling of integration among the people of the EAC and to facilitate an East African identity. These have included the introduction of the East African Community flag, the launching of an East African anthem and the East African passport.

6.6.3. Challenges of the East African Community

1. **Some citizens of some member states lack awareness of the regional integration process** and cannot articulate the benefits that can be drawn from the EAC integration process. e.g. in Tanzania
2. **Differences in social political ideologies amongst member states** e.g. in Tanzania the social political system that was in place for over 3 decades after independence, makes people both in public and private sectors not very entrepreneurial as they tend to rely on the government
3. One of the reasons for the collapse of the previous East African Community in 1977 was the perception of disproportionate sharing of economic benefits accruing from regional markets **and lack of a formula for dealing with the problem**. It is still a challenge to the community to address problems arising from the implementation of the treaty.
4. **Improving the performance of major ports such as Mombasa and Dar-es Salaam**, and the East Africa Road Network and East Africa Railway Network are key challenges facing the East African Community. Improving supply conditions will enhance EAC capacity to withstand the forces of globalization
5. **The EAC report on Fast Tracking (2004:81) reports that the fear of loss of sovereignty** is an issue in the minds of some members of the political elite of East Africa. The fear is that as a Federation, the nation states would cease to have any meaningful powers

UNIT ASSESSMENT

1. a) What are the features of economic union

b) Analyze the objectives behind economic integration by nations

c) Examine the factors that may encourage formation of economic union in eastern Africa.

2. a) Why did the former East African Community fail in 1977?

b) What good things can the current EAC learn from the former EAC?

3. In what ways may economic integration solve problems of underdevelopment.

UNIT 7: GLOBALISATION

Globalization is the integration among the people, government and companies of different countries.

Or it is the process by which most economies of the world are becoming more interdependent and close into one society.

7.1.2: Forms of globalisation:

1. **Economic globalisation**

Economic globalization is the increasing economic interdependence of national economies across the world through a rapid increase in cross-border movement of goods, services, technology, and capital. Example: Multinational corporations.

2. **Technological globalisation.**

This is the connection between nations through technology such as television, radio, telephones, internet, etc. Technological globalization makes it possible for countries to connect in other ways, such as financially through sending loved ones money across the globe or culturally by watching movies from other nations.

3. **Political globalisation.**

Political globalization refers to the growth of the worldwide political system, both in size and complexity. It includes national governments, their governmental and intergovernmental organizations as well as government-independent elements of global civil society such as international non-governmental organizations and social movement organizations.. For example, global organizations such as the United Nations and the World Trade Organization were created to diffuse political issues and maintain order on an international scale.

4. **Cultural globalisation.**

Cultural globalization refers to the transmission of ideas, meanings, and values around the world in such a way as to extend and intensify social relations. e.g. food, entertainment, language, etc. This process is marked by the common consumption of cultures that have been diffused by the Internet, popular culture media, and international travel.

5. **Financial globalisation**

This is the interconnection of the world's financial systems e.g. stock markets, more of a connection between large cities than of nations.

6. **Ecological globalisation**

This refers to seeing the Earth as a single ecosystem rather than a collection of separate ecological systems because so many problems are global in nature e.g. International treaties to deal with environmental issues like biodiversity, climate change or the ozone layer, wildlife reserves that span several countries.

7. **Sociological globalisation**

This is a growing belief that we are all global citizens and should all be held to the same standards and have the same rights e.g. the growing international ideas that capital punishment (death penalty) is immoral and that women should have all the same rights as men.

8. Environmental globalisation:

This refers to the internationally coordinated practices and regulations (often in the form of international treaties) regarding environmental protection. An example of environmental globalization would be the series of International Tropical Timber Agreement treaties (1983, 1994, 2006.Environmental globalization is usually supported by non-governmental organizations and governments of developed countries, but opposed by governments of developing countries which see pro-environmental initiatives as hindering their economic development.

9. **Military globalisation:**

Miltary globalisation reflects both the expanding network of worldwide military ties and relations, as well as the impact of key military technological innovations (from steamships to satellites), which over time, have reconstituted the world into a single geostrategic space. Military globalization implies former integration of armed forces around the world into the global military system.

7.1.3.1: Causes of Globalisation:

1. **Improved transport, making global travel easier**. As transportation technology improved, travel time and costs decreased dramatically between the 18th and early 20th century. Today, modern aviation has made long-distance transportation and movement of people and goods across the globe, quick and affordable.
2. **Increased rise in International education:** More and more students are seeking higher education in foreign countries and many international students now consider overseas study a stepping-stone to permanent residency within a country.
3. **Transnational marriages:** There has been a growing rise in marriages between people from different countries thus spearheading globalization.
4. **Improved technology:** Technological advances allows states to learn of others' existence and this makes it easier to communicate and share information around the world. E.g. through internet.
5. Globalization has been spread by **global journalism** which provides massive information and relies on the internet to interact, "makes it into an everyday routine to investigate how people and their actions, practices, problems, life conditions etc. in different parts of the world are interrelated.
6. **Increased inter-dependency, stability, and regularity among world economies**. Interdependence is one of the driving forces behind global connections and trade.
7. **Growth of multinational companies** with a global presence in many different economies.
8. **Growth of global trading blocs** which have reduced national barriers. (e.g. European Union, NAFTA, ASEAN)
9. **Improved mobility of capital**. The general reduction in capital barriers, making it easier for capital to flow between different economies. This has increased the ability for firms to receive finance. It has also increased the global interconnectedness of global financial markets.
10. **Increased mobility of labour**. People are more willing to move between different countries in search for work. Global trade remittances now play a large role in transfers from developed countries to developing countries.
11. **Increase in Consumer Demand** acts as a main driver to facilitate globalization. Over the years, with increase in the level of income and standard of living, the demand of consumers for various products has also increased.
12. **High Competition:** Organizations generally strive hard to gain competitive edge in the market. The frequent increase in competition in the domestic market compels organizations

to go global. Thus, various organizations enter other countries (for selling goods and services) to expand their market share.

13. **Reduction in Cross-trade Barriers:** Gradual relief in the cross-border trade restrictions by most governments has induced free trade, which, in turn, has increased the growth rate globalisation.

7.1.3.2: Effects of Globalisation:

Positive effects of globalisation.

1. Inward investment by Trans-National corporations (TNCs) has helped countries by **providing new jobs and skills for local people**.
2. **Foreign direct investment (FDI) have increased at a much greater rate than the growth in world trade,** helping boost technology transfer, industrial restructuring, and the growth of global companies.
3. **It has enabled the sharing of ideas, experiences and lifestyles of people and cultures**. People have experienced foods and other products not previously available in their countries.
4. **Increased competition from globalization** has helped stimulate new technology development, particularly with the growth in FDI, which has helped improve economic output by making processes more efficient.
5. **Globalisation has increased awareness of events in far-away parts of the world**. This has helped to make people more aware of global issues such as deforestation and global warming and alerted them to the need for sustainable development
6. **Globalization has tended to bring people into contact with foreign people and cultures.** This has reduced the issue of xenophobia and its negative effects.
7. **Open world trade has increased economic growth and raised living standards** of people in different countries across the world.
8. **Globalization enables large companies to realize economies of scale** that reduce costs and prices, which in turn supports further economic growth, although this can hurt many small businesses attempting to compete domestically.
9. **Economic globalization has given governments of developing nation's access to foreign lending.** When these funds are used on infrastructure including roads, health care, education, and social services, the standard of living in the country increases..
10. **Globalization has led to free trade between countries**. This is one of its largest benefits to developing nations. Homegrown industries see trade barriers fall and have access to a much wider international market.
11. **It has allowed businesses in less industrialized countries to become part of international production networks** and supply chains that are the main conduits of trade.
12. **Globalisation has led to more access to capital flows, technology, human capita**l, cheaper imports and larger export markets.

13. **Access to new markets**; It creates greater opportunities for firms in less industrialized countries to tap into more and larger markets around the world
14. **Reduced tariff barriers encourage global trade**. Often this has occurred through the support of the WTO.
15. **Globalisation has helped build a global economic order** governed by mutually accepted rules and overseen by multilateral institutions. This has created a better world with countries seeking to cooperate with one another to promote prosperity and peace. E.g. International Monetary Fund (IMF), World Bank (WB), United Nations (UN), North Atlantic Treaty Organisation (NATO), World Trade Organisation (WTO) etc.
16. **Globalization encourages each country to specialize in what it produces best** using the least amount of resources, known as comparative advantage.
17. **Larger markets enable companies to reach more customers** and get a higher return on the fixed costs of doing business, like building factories or conducting research.
18. **Competition from abroad drives different firms in different countries** to improve their products. Consumers have better products and more choices as a result.
19. **Expanded trade spurs the spread of technology, innovation**, and the communication of ideas. The best ideas from market leaders spread more easily globally.
20. **Better-paying positions have opened up in manufactured exports**, especially in high-tech areas, such as computers, chemicals, and transportation equipment and other high-skill work, notably in business services, such as finance and real estate.
21. **Globalization has helped narrow inequality between the poorest and richest people** in the world. By outsourcing their services to developing countries, Transnational companies have saved money and changed people's lives. Because of this, poverty rates have declined worldwide over the past decades.
22. **Globalization enables free trade of goods and resources**. For instance, a country that specializes in motor vehicles will produce cars and accessories in a location that achieves the lowest costs possible, and sell them on both local and foreign markets.
23. **Globalization has allowed people to relocate to wealthier countries** and start their own business or find work. This has led to higher incomes and more opportunities in life.
24. **The free movement of information and technology has enabled trade unions** to fight for workers' rights worldwide. As new policies and regulations were enforced, labor rights increased.
25. **Multinational corporations are constantly expanding and hiring people** in the countries where they operate.

Negative effects of globalisation

1. The free trade of goods, services and information set the world economy into a **cycle of income and employment growth**. However, This, has led to declining money flows and tight credit across local and national economies.

2. **Employees in developed countries are losing their jobs due to pay cuts**. More and more companies are choosing to outsource work and export jobs as a means to keep the costs low, and this has led to unemployment in most countries.

3**. Large enterprises are now able to exploit tax havens worldwide**, which has affected the local economy.

4. **The growth of international trade is worsening income inequalities**, both between and within industrialized and less industrialized nations.

5. **The practice of outsourcing for cheaper labor is exploitative** and widens the gap between the world's rich and the world's poor.

6. **Globalization has led to the interdependence between nations** which has caused regional or global instabilities where local economic fluctuations have ended up impacting a large number of countries relying on them.

7. Political **globalization has led to declining importance of the nation-state and the rise** of other actors on the political scene.

8. **Globalization has often been criticized for taking away jobs from domestic companies and workers.** Domestic industries go out of business because imports from other countries drive down prices, even if consumption increases.

9. **Globalisation has contributed to job displacement** especially low-wage workers in certain regions.

10. **Globalization has led to the increase in wages for workers** which has hurt corporate profitability. For example, rich countries which have a high comparative advantage in developing software, have driven up the price of software engineers around the world, thus making it difficult for foreign companies to compete in the market.

11. **The benefits of globalization have been unfairly sloped towards rich nations or individuals**, creating greater inequalities and leading to potential conflicts both nationally and internationally as a result.

12. **Globalisation has increased Capital flight** especially in developing where assets or money rapidly flow out because of there is increase in unfavorable financial conditions such as taxes, tariffs, labor costs, government debt and capital controls as a result of sharp drop in the exchange rate.

13. **Globalisation has moved taxation away from corporations, and onto individual citizens**. Corporations have the ability to move to locations where the tax rate is lowest.

14. **Globalisation has encouraged dependence on other countries** for essential goods and services. With globalization, goods can often be obtained cheaply from elsewhere. Countries have come to believe that there is no point in producing their own food and clothes which they can obtain cheaply from other countries.

15. **Globalisation ties countries together, so that if one country collapses, the collapse is likely to ripple through the system,** pulling many other countries with it. This is because countries are increasingly interdependent.

16. **Cultural uniqueness has been lost in favor of homogenization and a "universal culture**" that draws heavily from the western culture. As a result of globalisation, the values and norms of developed countries are gradually rooted in developing countries. This has led to erosion of the cultures and loss of identity of developing countries.
17. **Global commerce is increasingly dominated by transnational corporations** which seek to maximize profits without regard for the development needs of individual countries or the local populations.
18. **Competition among developing countries to attract foreign investment** leads to a "race to the bottom" in which countries dangerously lower environmental standards.

7.2: MULTINATIONAL CORPORATIONS (MNCs)

A **multinational corporation** or **worldwide enterprise** is an enterprise operating in several countries but managed from one (home) country.

OR it is an organization that owns or controls production of goods or services in one or more countries other than their home country.
It can also be referred to as an **international corporation**, a "**transnational corporation",** or a **stateless corporation**
A multinational corporation is usually a large corporation which produces or sells goods or services in various countries.

MNCs can get involved in;

- Importing and exporting goods and services
- Making significant investments in a foreign country
- Buying and selling licenses in foreign markets
- Engaging in contract manufacturing i.e. permitting a local manufacturer in a foreign country to produce their products
- Opening manufacturing facilities or assembly operations in foreign countries

Foreign Multinational Corporations in Rwanda

- Korea Telecom Rwanda Networks (KTRN)- the wholesaler of fourth-generation long-term evolution (4G LTE)
- Liquid Telecom- independent data, voice and IP provider and supplier of fibre optic, satellite and international carrier services to Africa's largest mobile network operators, ISPs and businesses of all sizes.
- Petroleum companies like Kobil Petroleum Rwanda, Engen etc.
- Mobile network providers like MTN and Airtel-Rwanda
- Financial institutions like EcoBank, GT Bank, Bank of Africa, I &M bank etc.
- Construction companies like SMEC Rwanda, NITSAL INTERNATIONAL, Roko Construction Limited**,** STRABAG / ZÜBLIN INTERNATIONAL.

7.2.2: Effects of Multinational Corporations

Positive effects

1. **MNCs bridge the forex gap** in developing countries by increasing forex inflow.
2. **They increase employment opportunities** for citizens of the host countries since they operate on large scales.
3. **They close the investment gap** through forex investment abroad.
4. **They lead to improvement in domestic technology** through transfer of superior technology to developing countries based on research and development.
5. **MNCs produce more output** especially processed or manufactured which increase exportation of manufactured goods hence more forex to developing.
6. **MNCs promote capital accumulation** in developing countries through transfer of capital and building infrastructure.
7. **MNCs produce better quality** products which help to improve standards of living of people in the society.
8. **They bring new marketing techniques** developing countries markets research and promotional methods which encourage competition and efficiency.
9. **They provide revenue to the government** through taxes imposed on activities of the MNCs.
10. **They help to train labor in the management** basic skills and entrepreneur ability in developing countries.
11. **MNCs make a lot of profits** which are ploughed back leading to the expansion of the economy there by promoting economic growth.
12. **They under take high risks and can invest** in long term projects like mining plantation and agricultural industries that bring about rapid economic growth and development.
13. **They are financially strong** and hence provide large and cheap capital to developing countries by way of direct investment.
14. **They increase infrastructural development** through construction of telecommunication etc.
15. **MNCs increase the exploitation of domestic resources** which increase volume of productivity hence increasing export exchange.
16. **They promote international cooperation** through consortiums hence increasing the volume of trade.
17. **They encourage competition** which leads to efficiency and better-quality products.
18. **They help in filling the skilled manpower gap** through exportation of expatriates or trained personnel to the recipient countries.

Negative effects of MNCs

1. **MNCs repatriate their profits to their mother countries** which lead to resources outflow from developing countries thus disabling their development potentials.
2. **They are given tax exemption and holidays** which reduce net government revenue from them.

3. **MNCs usually use capital intensive technology** and therefore may not help to reduce their problems of unemployment in developing countries since are labor surplus economies.
4. **They create social costs like quick exhaustion of natural resources**, environmental degradation etc. since they operate on large scale.
5. **MNCs influence internal policies of developing countries** by bribing the legislature for example offering employment to the relatives of politicians in their companies and at times they subvert domestic fiscal policies which result into low standards of living.
6. **MNCs accelerate regional or sector imbalances** e.g. urban and rural areas since they mostly set up their production activities in urban areas where infrastructure is already developed.
7. **MNCs cause income inequalities** because they reserve top jobs for their national who are highly paid and low paying jobs to the national of investment countries.
8. **They promote external dependency** of host countries on the countries where they originate.
9. **They reduce domestic initiative** in technological and manpower development.
10. **MNCs can bring about discontent and unrest among workers** employed by the government and indigenous firms due to the wage differentials between the workers in MNCs and other workers.

7.3.0: FOREIGN DIRECT INVESTMENTS (FDI

Foreign direct investments are the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor.

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Examples of FDIs in Rwanda

Movit Uganda Ltd, JKK International from Dubai, which started a construction company; Mukwano Industries, Roofing Uganda, China Electronics, Lifan moto taxi-Chinese, ALINK Technologies, and Yvonne Exclusive Design, an upmarket fashion store, Egyptian House of Kitchenware, which opened a shop in Kimironko – Gasabo district for general trading, and Tanzania's Dodoma that makes mattresses

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7.3.2: Advantages of Foreign Direct Investments

1. **They increase the stock of capital in LDCs** thus help break the cycle of poverty which enables LDCs to achieve rapid economic growth.
2. **They Provide managerial, administrative and technical personnel, new technology, research and innovation in LDCs**. this help to improve LDCs technics of production hence more employment opportunities.

3. **Increase government revenue from taxes** imposed on production activities under taken by foreign investments.
4. **Increase productivity and efficiency** due to high levels of technology used which leads to more export earnings and improvement in the Balance of payment position.
5. **Encourages entrepreneurial development in the country** due to competition thus would lead to the citizens of that country to invest in their country hence more foreign exchange earnings.
6. **Create employment opportunities** in the recipient countries.
7. **Increase savings** thus closing the savings investment gap in LDCs.
8. Due to the inflow capital assets, foreign investment **promotes capital accumulation in LDCs.**
9. **Help in the exploitation of idle resources in LDCs** thus promoting economic growth and development.
10. **Increase consumer choice** due to production of wide variety of quality products due massive productions.
11. **Increase the exploitation of domestic infrastructure** e.g. transport facilities, communication facilities etc.
12. **It accelerates industrial growth** through manufacturing and provision of services.
13. **Promotes international cooperation** hence increase the volume of imports and exports.
14. **Local firms become efficient** through competition.
15. **It fills the manpower gap** through importation of expatriates' manpower.

7.3.3: Disadvantages Foreign Direct Investments

1. **It leads to profit repatriation and capital outflow** thus worsening the balance of payment deficits in LDCs.
2. **Increased government expenditure** in form of provision of basic facilities like land, power and other basic facilities as well as tax concessions, tax holidays, subsidized inputs etc.
3. **Cause income inequality in the recipient countries** because top posts are reserved for their national and pay them very highly while citizens of the recipients' country occupy low status and low paying posts.
4. **Foreign investors at times exert pressure on the government and may influence the decision made by the government of the recipient country** which brings about dependency and of autonomy in the recipient country.
5. **They bring about instabilities in the recipient country** due to re-allocation of their investments into other countries.
6. **Foreign countries use capital intensive technology** which creates technological unemployment thus may not help in solving the problem of unemployment.

7. **Increase demonstration effect in the recipient country** due to increased number of foreigners who impose life style of developed countries in LDCs thus starting copying the consumption habits and lifestyle of the foreigners.
8. Most of the private foreign investments are urban based and this **creates the problems of rural urban migration and its negative effects.**
9. **It leads to loss of government revenue** through tax holidays, concessions etc.
10. **Causes dumping through importation of outside products** or low-quality equipment.
11. **May lead to loss of markets** of products from indigenous enterprises.
12. May lead to irrational and **exhaustion of domestic resources**.

7.3.4: Ways of attracting foreign investors in Rwanda.

1. The establishment of **Rwanda Development Board (RDB) in 2006, which serves today as the country's chief investment promotion agency.**
2. There **is no difficulty obtaining foreign exchange in Rwanda or transferring funds associated with an investment into a usable currency** and at a legal market-clearing rate since the central bank holds daily foreign exchange sales freely accessed by commercial banks.
3. The government has maintained a **high-profile anti-corruption effort** and senior leaders articulate a consistent message emphasizing that fighting corruption is a key national goal.
4. Rwandan law provides **permanent residence and access to land to investors who deposit USD 500,000 in a commercial bank in the country for a minimum of six months**.
5. **Rwanda is a member of the East African Community (EAC**), and participates in a customs union that helps facilitate **the movement of goods produced in the region and allows EAC citizens with certain skills to work in any member state.**
6. Rwanda has also established **a free trade zone outside the capital**, **Kigali**, which includes current and planned future communications infrastructure
7. **RDB offers one of the fastest business registration processes in Africa**: new investors can register online at RDB's website and receive approval to operate in less than 24 hours, and the agency's "one-stop shop" helps foreign investors secure required approvals, certificates, and work permits.
8. The Government of Rwanda established the **Privatization Secretariat and the Rwanda Public Procurement Agency to ensure transparency in government tenders** and divestment of state-owned enterprises
9. **The government reserves the right to expropriate property "in the public interest" and "for qualified private investment**" under the expropriation law of 2007.
10. Rwanda is a signatory to the **Convention on the Settlement of Investment Disputes (ICSID) and African Trade Insurance Agency (ATI**). ICSID seeks to remove

impediments to private investment posed by non-commercial risks, while ATI covers risk against restrictions on import and export activities, inconvertibility, expropriation, war, and civil disturbances.

11. **Investors who demonstrate capacity to add value and invest in priority sectors have generally enjoyed more tax and investment incentives**, including Value Added Tax (VAT) exemptions on all imported raw materials
12. RDB has been successful in **developing investment incentives and publicizing investment opportunities abroad.** Protection of Property Rights; the law protects and facilitates acquisition and disposition of all property rights.
13. The Government of Rwanda has **implemented transparency of the regulatory system**; the government generally employs transparent policies and effective laws to foster clear rules consistent with international norms.
14. Rwandan law allows **private enterprises to compete with public enterprises under the same terms and conditions** with respect to access to markets, credit, and other business operations.
15. There is a **growing awareness of corporate social responsibility (CSR**), but only a few companies, chiefly foreign-owned have implemented sustainable programs.
16. Rwanda is eligible for trade preferences under the **African Growth and Opportunity Act (AGOA),** which the United States enacted to extend duty-free and quota-free access to the U.S. market for nearly all textile and handicraft goods produced in eligible beneficiary countries.
17. Rwanda is a member of the **Multilateral Investment Guarantee Agency (MIGA)** which issues guarantees against non-commercial risks to enterprises that invest in member countries and the African Trade Insurance Agency (ATI).
18. Rwanda attempts to adhere to **International Labor Organization (ILO) conventions protecting worker rights**. Policies to protect workers in special labor conditions exist, but enforcement remains inconsistent.

7.4.0: Global financial systems (GFS) and international financial institutions (IFI)

The **global financial system** is the worldwide framework of legal agreements, institutions, and both formal and informal economic actors that together facilitate international flows of financial capital for purposes of investment and trade financing.

Main functional components:

- The global capital market.
- The foreign exchange market.

There are two global institutions (Bretton woods institutions).

- The world Bank.
- The international monetary fund. (IMF)

The global financial system main components

An international financial institution (IFI) is a financial institution that has been established (or chartered) by more than one country, and hence are subjects of international law.

7.4.2: International Monetary Fund (IMF) and World Bank (WB)

7.4.2.1: International monetary fund (IMF):

The International Monetary Fund (IMF) is an organization of 189 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty around the world.
Created in 1945, the IMF is governed by and accountable to the 189 countries that make up its near-global membership. The IMF's primary purpose is to ensure the stability of the international monetary system; the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. IMF is headquartered in Washington, D.C.

A) Objectives of IMF.

1. **Establish International Monetary Co-Operation amongst the various member countries** through a permanent institution that provides the machinery for consultation and collaborations in various international monetary problems and issues.
2. **Ensure stability in the foreign exchange rates** by maintaining orderly exchange arrangement among members and also to rule out unnecessary competitive exchange depreciations/ devaluation.
3. **Promote international trade so as to achieve its required expansion** and balanced growth**.** This
4. **Eliminate or relax exchange controls imposed** by almost each and every country before
5. **To establish a multilateral trade and payment system** in respect to current transactions between members in place of the old system of bilateral trade agreements was another important objective of IMF.
6. **Help the member countries, especially the backward countries, to attain balanced economic growth** by exchange the level of employment.
7. Help the member countries in **eliminating or reducing the disequilibrium or maladjustments in balance of payments**.
8. **Promote Investment and flow of Capital** from richer to poorer or backward countries so as to help the backward countries to develop their own economic resources for attaining higher standard of living for its people, in general.
9. To ensure there is **sufficient international liquidity** and total means of payment acceptable for international payment.
10. **To stabilize prices** so as to increase the rates of economic growth and development among poor countries.
11. **To harmonize policies pursued by different countries** so as to create peace among member nations.

B) Functions of the International Monetary Fund

1. **Maintains Exchange Stability** thereby discouraging any fluctuations in the rate of exchange.
2. The Fund is **helping the member countries in eliminating or minimizing the short-period equilibrium of balance of payments** either by selling or lending foreign currencies to the members.
3. IMF enforces the system of **determination of par values** of the currencies of the members countries.
4. **IMF is exercising surveillance** to ensure proper working and balance in the international monetary system.
5. The IMF has an important function **to advise the member countries on various economic and monetary matters** and thereby to help stabilize their economies.
6. IMF is maintaining various borrowing and credit facilities so as to help the member countries in **correcting disequilibrium in their balance of payments.**
7. IMF maintains balance between **demand and supply of various currencies**.
8. **Maintenance of Liquidity of its resources** by providing for the member countries to borrow from IMF by surrendering their own currencies in exchange.
9. **Providing Technical Assistance to the member countries** by granting the member countries the services of its specialists and experts and also by sending the outside experts.
10. **Reducing tariffs and other restrictions imposed on international trade** by the member countries so as to cease restrictions of remittance of funds or to avoid discriminating practices.
11. The IMF is also keeping a general watch **on the monetary and fiscal policies** followed by the member countries to ensure no flouting of the provisions of the charter.
12. **Buying and selling currency** of the member countries and this assists debtor countries to purchase forex or to use SDRs in order to pay its debts. (SDRs are international reserve assets created by the IMF to supplement its member countries official reserves.).
13. **It is a reservoir of the currencies of all the member countries** from which a borrower nation can borrow the currency of other nations.
14. It is a sort **of lending institution in foreign exchange**.
15. The Fund contributes to the promotion and maintenance of high levels **of employment and real income and to the development of the productive resources** of all member nations.
16. Assist countries **to restructure their economies** through SAPs facility.
17. **The IMF works with governments** around the world to modernize their economic policies and institutions, and train their people.
18. **The IMF provides loans to member countries** experiencing actual or potential balance of payments problems to help them rebuild their international reserves.
19. The IMF oversees **the international monetary system and monitors the economic and financial policies** of its 189 member countries.

The World Bank is an international organization dedicated to provide financing, advice, and research to developing nations to aid their economic advancement. The bank predominantly acts as an organization that attempts to fight poverty by offering developmental assistance to middle- and low-income countries.

The World Bank is headquartered in **Washington, D.C.** Currently it has more than 10,000 employees in more than 120 offices worldwide.

A) Objectives of World Bank:

1. **To help in the reconstruction and development of member countries** by facilitating the investment of capital for the productive purposes, including the restoration and reconstruction of economies devastated by war.
2. **To encourage the development of productive resources in developing countries** by supplying them investment capital.
3. **To promote private foreign investment** through guarantees and participation in loans and other investment made by private investors.
4. **To supplement private foreign investments** by direct loans out of its own capital for productive purposes.
5. **To promote long term balances growth of international trade** and the maintenance of equilibrium in the balance payments of member countries by encouraging long term international investments.
6. **To bring about an easy transition** from a war economy to a peace time economy.
7. **To help in raising productivity**, the standard of living and the conditions of labour in member countries.

b) Functions of World Bank (IBRD)

1. **To assist in the reconstruction and development of the territories of its members** by facilitating the investment of capital for productive purposes.
2. **To promote private foreign investment** by means of guarantee of participation in loans and other investments made by private investors and when private capital is not available on reasonable terms to make loans for productive purposes out of its own resources from funds borrowed by it.
3. **To promote the long-term balance growth of international trade** and the maintenance of equilibrium in balances of payments by encouraging international investments for development of productive resources of members.
4. **To arrange loans made guaranteed by it in relation to international loans** through other channels so that more useful projects, large and small alike, will be dealt with first.

7.4.2.3: Structural Adjustment Programs (SAPs) / IMF Conditionalities.

Structural Adjustment Programs (SAPs) sometimes labeled as **the Washington Consensus** refers to a set of economic policies often introduced as a condition for gaining a loan from the IMF. SAPs are created with the goal of reducing the borrowing country's fiscal imbalances in the short and medium term or in order to adjust the economy to long-term growth.

Structural Adjustment Policies

To be eligible for a loan from IMF, developing countries often have to implement some or all of the following policies.

1. **Cutting Government Spending** to reduce the budget deficit. Also known as 'fiscal austerity' e.g. reducing on government expenditure on education and health in order to reduce the size of the work force to reduce on government expenditure hence a balanced budget.
2. **Raising tax revenues and trying to improve tax collection** by clamping down on tax avoidance.
3. **Control of Inflation**. Usually through Monetary policy (higher interest rates) and fiscal austerity which have the effect of depressing aggregate demand.
4. **Privatisation of state-owned industries**. This raises money for the government, but also, in theory, can help improve efficiency and productivity because private firms have a profit incentive to be more efficient.
5. **De-regulation of markets** to encourage competition and more firms to enter the industry. Opening the economy to free trade by removing tariff barriers which protect domestic industries. i.e. avoid government control of prices which lead to inefficiency and to allow private producers to compete.
6. **Ending food subsidies**. i.e. Raising food and petroleum prices to cut the burden of subsidies. This, can distort the market and lead to over-supply and hold back diversification of the economy to a more industrial based economy.
7. **Devaluation of currencies** to restore competitiveness, increase forex and reduce current account deficit. This usually leads to higher import prices.
8. **Retrenchment of the civil servants and demobilization of the army** in order to reduce on the size of the work force and government expenditure as well as ensure efficiency.
9. **Introduction of policies** that attract both foreign and domestic investors. For example, reduction in borrowing rates and having an open economy.
10. **Infrastructural development** in order to improve productivity thus promoting economic growth and development.
11. **Emphasize on the improvement of productivity** through research and adoption of modern technology.
12. **Market expansion** through economic integration in order to increase export earnings.
13. **Ensure political stability** and security in the economy.
14. **Forex liberalization and granting autonomy** to the central bank to pursue on appropriate monetary policy.

15. **Focusing economic output** on direct export and resource extraction.
16. **Improving governance** and **fighting corruption**
17. **Enhancing the rights of foreign investors** vis-à-vis national laws
18. **Increasing the stability of investment** (by supplementing foreign direct investment with the opening of domestic stock markets)
19. Creating **new financial institutions**

UNIT ASSESSMENT

1. a) What role has the IMF played in economic development of your country

   b) What structural adjustment programs have been implemented in your country?

2. a) Giving examples in Rwanda, analyse the role played by FDI's in Rwanda's development struggle.

b) Although Rwanda has tried her level best to attract Foreign Direct Investments, their inflow is still low. Why?

3. a) Explain the roles of World Bank.

   b) Identify different sectors supported by World bank in Rwanda.

UNI 8. ECONOMIC GROWTH AND ECONOMIC DEVELOPMENT:

Economic growth refers to the persistent quantitative increase in the volume of goods and services produced in a country. Or the persistent increase in the volume of goods and services over a period of time.

Economic growth is a material concept ie concerns itself with the growth of physical output and does not take into account non-material factors like stress, happiness, etc.

Economic growth trends

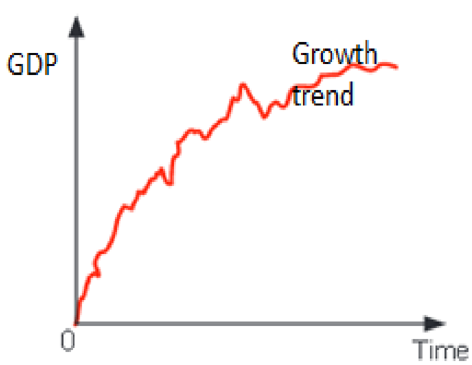

Fig. A

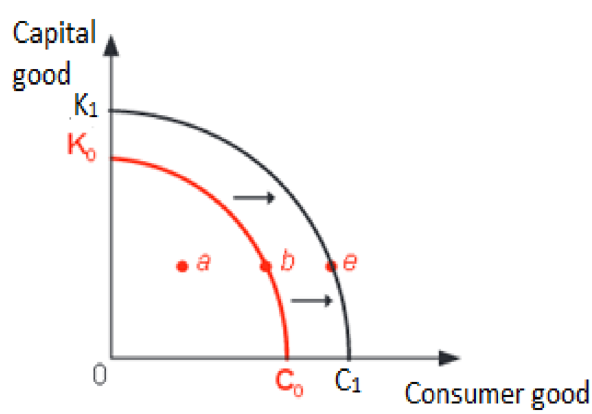

Fig. B.

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The curve **K0C0** shows all possible combinations of capital and consumer goods available to a nation when all resources are fully employed.

Point **a** represents unemployment of some resources, under-utilization or excess capacity. Point **b** indicates full employment of all resources, while **e** represents economic growth. A movement from **a** to **b** or any other point on the curve represents an increase in real income. An outward shift of the Production Possibility Frontier (PPF) from $\mathbf{K_0C_0}$ to $\mathbf{K_1C_1}$ illustrates economic growth. While a backward shift of the production possibility frontier from $\mathbf{K_1K_2}$ to $\mathbf{K_0C_0}$ - illustrates economic decline.

8.1.1.2: Factors that determine economic growth

1. **Political situation.** When there is good political climate that builds investor confidence, there will be increase in the volume of goods and services while political instability will lead to low production of goods and services.
2. **Technological development:** Technological development helps in increasing productivity with the limited amount of resources. Countries that have worked in the field of technological development grow rapidly as compared to countries that have less focus on technological development.
3. **Level of capital**. When capital is available and in plenty, there will be increased production of goods and services while absence of capital leads to low production low economic growth.
4. **Level of Market.** Presence of a large market will encourage producers to produce more goods and services while absence of market will lead to low production
5. **Size of population.** A large population will make a big labour force that will produce more goods and services while a smaller population will imply low output.
6. **Level of investment.** The rate at which an economy comes up with new investment determines economic growth.
7. **Level of entrepreneur development**. Presence of large number of entrepreneurs will lead to invention of new methods of production which will increase output but when the level of entrepreneur development is low, production and economic growth will be low
8. **Levels of infrastructure**. Investment in roads, transport and communication can help firms reduce costs and expand production. Without the necessary infrastructure, it can be difficult for firms to be competitive in the international markets. This lack of infrastructure is often a factor holding back some developing economies.
9. **Human resource:** The quality of human resource is dependent on its skills, creative abilities, training, and education. If the human resource of a country is well skilled and trained then the output would also be of high quality. On the other hand, a shortage of skilled labor hampers the growth of an economy, whereas surplus of labor is of lesser significance to economic growth. Therefore, the human resources of a country should be adequate in number with required skills and abilities, so that economic growth can be achieved.

10. **Natural Resources:** The natural resources of a country depend on the climatic and environmental conditions. Countries having plenty of natural resources enjoy good growth than countries with small amount of natural resources.
11. **Government policy of subsidization and taxation**. When the government gives producers subsidies like loans, seeds etc, there will be increase in the volume of goods while if the government over taxes the people, production will be low.
12. **Capital formation:** Capital formation increases the availability of capital per worker, which further increases capital/labor ratio. Consequently, the productivity of labor increases, which ultimately results in the increase in output and growth of the economy.
13. **Social and Political Factors:** Social factors involve customs, traditions, values and beliefs, which contribute to the growth of an economy to a considerable extent. Apart from this, political factors, such as participation of government in formulating and implementing various policies, have a major part in economic growth.
14. **Consumer confidence.** Consumer and business confidence are very important for determining economic growth. If consumers are confident about the future they will be encouraged to borrow and spend thus encouraging production which spearheads economic growth. If they are pessimistic, they will save and reduce spending hence discouraging production and economic growth.
15. **Interest rates.** Lower interest rates would make borrowing cheaper and should encourage firms to invest and consumers to spend. People with mortgages will have lower monthly mortgage payments so more disposable income to spend thus encouraging economic growth and the reverse is true when interest rates are high.
16. **Value of exchange rate.** If a country's currency devalued, exports would become more competitive and imports more expensive. This would help to increase demand for domestic goods and services hence economic growth. A depreciation could cause inflation, but in the short term at least it can provide a boost to growth and vice versa.
17. **Banking sector**. The banking sector is very influential in determining investment and growth. If the banks lose money and no longer want to lend, it can make it very difficult for firms and consumers leading to a decline in investment and thus economic growth and vice versa.
18. **The strength of labour markets.** If labour markets are flexible, then firms will find it easier to hire the workers they need. This will make expansion easier. Highly regulated markets could discourage firms from hiring in the first place, hence slowing down production and economic growth.

8.1.2.1 Benefits of economic growth.

1. There is **increased production of goods and services** which are vital to society and help to reduce malnutrition and other related diseases.

2. **Widens the tax base of the country** through taxing the different economic activities hence increasing revenue to the government that can be used for development.

3. **Economic independence** is attained since the country produces a lot of goods and services and this reduces relying on other countries for assistance.

4. **Leads to increase in infrastructure development** such as roads, hospitals and schools among others which lead to the development of the country.

5. **Urbanization and industrialization** are achieved because of construction of many industries to produce goods

6. **General price level of goods and services will reduce** because of the increase in output

7. **Reduction in balance of payment problems** in the country because the exports increase due to increased production and this improves the balance of payment position

8. **Political stability** because people are well off and have a variety therefore there are no food conflicts which is a major cause of Insecurities.

9. **Higher average incomes**. Economic growth enables consumers to consume more goods and services and enjoy better standards of living. This will reduce absolute levels of poverty and thus enabling a rise in life expectancy.

10. **Lower unemployment**. With higher output and positive economic growth, firms tend to employ more workers creating more employment. Employment opportunities come up because of the increase in economic activities and this reduces the rates of poverty and its related problems.

11. **Lower government borrowing.** Economic growth creates higher tax revenues, and there is less need to spend money on benefits such as unemployment benefit. Therefore, economic growth helps to reduce government borrowing. Economic growth also plays a role in reducing debt to GDP ratios.

12. **Improved public services.** With increased tax revenues the government can spend more on public services, such as health and education etc. This can enable higher living standards, such as increased life expectancy, higher rates of literacy and a greater understanding of civic and political issues.

13. **Money can be spent on protecting the environment.** With higher economic growth a society can devote more resources to promoting recycling and the use of renewable resources.

14. **Investment.** Economic growth encourages firms to invest, in order to meet future demand. Higher investment increases the scope for future economic growth – creating a virtuous cycle of economic growth/investment.

15. **Increased research and development.** High economic growth leads to increased profitability for firms, enabling more spending on research and development. Also, sustained economic growth increases confidence and encourages firms to take risks and innovate.

16. **Economic development**. The biggest factor for promoting economic development is sustained economic growth. Economic growth plays a major role in reducing absolute levels of poverty, increasing life expectancy thus promoting development.

17. **More choice.** In less developed economies, a large proportion of the population work in agriculture/subsistence farming, economic growth enables a more diverse economy with people able to work in service sector, manufacturing and having a greater choice of lifestyles.

18. **Enhanced business confidence:** Economic growth creates positive effect as encourage people running their businesses. As profits of small firms and business increase with economic growth, their business confidence and will to grow up to meet more challenges.

8.1.2.2: Costs of economic growth.

1. **Pollution of air, sound and water.** The industries set up to produce and persistently increase output level may produce fumes that pollute the environment and pour waste in air and water bodies. Noise from industrial machines may also make the environment unsuitable for human living.
2. **Environmental degradation.** The ecosystem is normally tempered with in order to increase the volume of goods and services produced. Swamps are reclaimed, deforestation occur so as to give room to industries that produce and persistently increase output level to attain economic growth.
3. **Erosion of cultural values.** In order to attain faster rates of economic growth, nationals tend to adopt foreign ways of consumption, behavior and general ways of living. This costs the nation of the discipline and order that had been maintained for long.
4. **Current consumption is normally foregone** so as to save enough, create capital assets that produce output to attain economic growth.
5. **People forego leisure** which is an important aspect of improved standard of living. They work so hard to increase output and attain economic growth.
6. **Increased indebtedness of developing countries**. In order to attain economic growth, most developing countries borrow to set up production ventures that produce and persistently increase the level of economic growth.
7. **Industrial/occupational hazards.** Several upcoming industries set up to attain economic growth do not provide protective gadgets to the workers, consequently, workers inhale poisonous fumes causing them chronic diseases and death, and they sometimes lose body party to the machines they are not oriented to.
8. **The dangers of rural urban migration** like slum development, unemployment and overcrowdings arise. This is mainly because people leave villages for urban settings where they expect to find jobs and better social living standards.
9. **Inflation.** If Aggregate Demand (AD) increases faster than Aggregate Supply (AS), then economic growth will lead to higher inflation as firms put up prices
10. **Boom and bust economic cycles**. If economic growth is unsustainable then high inflationary growth may be followed by a recession.
11. Increased economic growth tends to cause an **increase in spending on imports**, therefore, causing a deterioration on the current account.
12. **Environmental costs:** Increased economic growth will lead to increased output and consumption. This causes an increase in **pollution.** Increased pollution from economic

growth will cause health problems such as asthma and therefore will reduce the quality of life.

13. Connected to the above, economic growth also leads to **over exploitation of the natural resources** that leads to their quick depletion. This means greater use of raw materials and can speed up **depletion of non-renewable resources.**

14. It also can also lead to problems of **congestion of traffic and houses** as more people can afford to buy a car, but it is hard to increase the supply of roads to meet demand. This leads to delays and easy disease spread; traffic congestion occurs as vehicles are ever flowing in and out of the industrial place causing unnecessary delays, workers in the industrial place tend to be accommodated near industries causing slum areas around and poor sanitation.

15. **Inequality:** Higher rates of economic growth have often resulted in increased inequality because growth can benefit a small section of society more than others. For example, those with assets and wealth will see a proportionally bigger rise in the market value of rents and their wealth. Those unskilled without wealth may benefit much less from growth.

16. **Regional disparities:** In connection to the above, although average living standards may be rising, there is a gap between rich and poor. It can widen the issues of poverty and make a wide gap between different regions, and this hinders economic development.

17. **Diseases/problems of affluence:** With rising living standards it can cause unintended consequences. For example, with rising incomes, there are more goods to steal. Also, high growth can make people more materialistic which encourages crime. Also, higher incomes enable people to afford more food; this is a factor behind rise in obesity and health related problems.

8.1.3: THEORIES OF GROWTH

- Balanced growth theory
- Un balanced growth theory
- Big push theory
- Rostow's stages of growth

8.1.3.1: BALANCED GROWTH THEORY.

Balanced growth theory of economic growth advocates for a simultaneous upbringing of all sectors in an economy so that **sectors grow together in harmony and complement each other**.

The theory advocates for a **critical minimum effort** which is the minimum level of investment in all the sectors of the economy to ensure interdependence and self-sustaining growth.

Arguments in favour of balanced growth strategy

1. Encourages **resource exploitation and utilization** because it creates high demand for these resources by the many sectors in operation

2. **Widens the tax base** of the country because all the developed sectors are taxed by the government
3. Encourages **forward and backward linkages** in the economy since some sectors provide raw materials while others provide market for those raw materials
4. **Employment is created** because of the increased demand for labour to work in the different developed sectors.
5. **Balanced of payment position may be improved** especially when production is for export.
6. **Development in technology** is undertaken because of the need to produce good quality goods and services.
7. **Self-reliance is created** since all sectors are developed at the same time and there are a variety of goods and services needed in the society.
8. **Reduced income inequality** because most of the people are engaged in the production of goods and services.
9. **Brain drain is reduced** because the people are able to find employment in the country.
10. **Foreign exchange is saved** because there is little to import since the economy is self-sustaining.

Disadvantages of the theory

1. May lead to **sectors being developed without quality** since it calls for a critical minimum effort.
2. **Requires a lot of capital** which may be lacking in developing countries. This is because developing all sectors requires a lot on capital.
3. It may lead to **over exploitation of resources**. This is because all sectors have to be developed.
4. May lead to **uncoordinated plans and sectors** which may not lead to the development of the economy. The sectors may turn out to be without linkages
5. **Over ambitiousness** may at times lead to inferior work since the expected results cannot be achieved.

Limitations of balanced growth

1. A balanced growth strategy requires **a lot of capital funds which are not yet available** in developing economies.
2. Developing countries **do not have adequate skilled manpower** to scatter in all sectors being developed at the same time.
3. A balanced growth strategy **requires proper planning and implementation of plans** so as to coordinate the different projects running at the same time, developing countries are not blessed with such planning skills.
4. A balanced growth strategy **requires developed infrastructure in terms of transport and telecommunication network**, hydroelectric power, among others, such

developed infrastructure **is still inadequate in developing economies**, and so they cannot sustain a balanced growth strategy.

5. Developing countries have **under developed technology**; it is still traditional and sometimes just intermediate that cannot support the growth of a balanced growth strategy.
6. Developing economies have **inadequate local and foreign market**, such a market cannot support the much output from all sectors of the economy, thus it goes to wastage hence losses.

8.1.3.2: UNBALANCED GROWTH STRATEGY.

Unbalanced growth strategy emphasizes the growth of a **few vital leading sectors in an economy** such that they expand and others are developed at a later stage. Here countries tend to concentrate so much on sectors like agriculture and industry since they employ a large number of people. Others like fishing, mining to mention but a few come at a later stage. The developed sectors will in turn pull others that were left behind.

Advantages of the theory

1. **It needs little capital and resources** which makes it possible in developing economies which have always dealt with deficit budgets
2. **Requires less expenditure**. This is because a few sectors are looked at first then others come in later.
3. **Easy to control and manage** because a few leading sectors can easily be coordinated compared to the balanced growth theory.
4. **Production can be controlled basing on demand forces** because the country will be producing according to available markets
5. **The theory reserves some resources for the future use** since some sectors are developed at a later stage.
6. **Specialization is possible** since the country concentrates on some sectors fast and others are developed later. This creates efficiency in production
7. **Requires micro-planning** since it involves a small number of sectors which makes planning and implementation easy.
8. **There will be less reliance on foreign loans and donations** leading to limited balance of payment problems.

c) Demerits of the theory

1. **Slows the rate of economic growth** since the output from the few sectors is low and may not serve the whole nation at large. This may lead to constant importation
2. **Regional inequalities come up** because some areas will develop at the expenses of others hence creating dualism with its associated problems.

3. **Unemployment** since there are a few sectors developed and worse still the sectors may resort to capital intensive technology to produce good quality.
4. **Encourages dependence** because the country cannot satisfy the needs of its people thus it keeps on importing what it cannot produce hence worsening the balance of payment position.
5. **Leading sectors may not be able to pull others** hence they will develop at the expense of others sine they may not be compatible.
6. **Less tax revenue** will be collected from the few sectors leading to constant borrowing with its associated problems.
7. **Some resources will remain idle** since the developed sectors cannot use them as resources hence under utilization
8. **A decline in one or two sectors will affect the economy drastically** since it has no alternative sectors to run to
9. **There will be brain drain** since few people will employed creating a vacuum in the country since the would be skilled people have fled in search for greener pastures

Limitations of the theory

1. The strategy emphasizes **specialization which has several weaknesses like limited varieties** which limits choice and development, total loss in case of failure among others.
2. The strategy **limits employment opportunities**, one or a few sectors promoted can employ only a few people and with special skills so limiting employment opportunities.
3. The strategy **denies the economy a chance to diversify** which is a great input to development.
4. Developing countries have a **limited size of the market** which cannot consume all the output from the sector being emphasizes all over the country, so it leads to wastage of resources.
5. The strategy **encourages dependency on other nations**, the output missed from the neglected sectors is to be imported which worsens the dependency problem and worsen the balance of payment problems of the country.
6. The leading sector **may fail to have a serious impact on the country.** Worse still, it may just make it under develop more.
7. The **strategy may lead to lagging behind sectors**, the neglected sectors lag so behind that uplifting them later may be so expensive or even hard, and this further widens the gap between the sectors of the country.

8.1.3.3: BIG PUSH THEORY

Big push theory was advanced by an economist called Paul Rosenstein Rodan and it is the reason why some economists prefer calling it the **Rodanian theory.**

The theory states that developing countries must massively invest in a variety of industries and economic infrastructure so as to transform a backward agricultural economy into a self-sustained dynamic economy."

The theory advocates for a massive investment program to promote rapid industrialization and huge economic infrastructure.

Arguments in favor of big push strategy

1. The theory advocates for setting up **complementary industries**. This rises the volume and variety of goods and services provided to the nationals giving them several to choose from so economic growth and development.
2. The massive investment program emphasized by the theory **accelerates a stagnant economy into high rates of economic growth.**
3. The theory advocates for industrial growth that **provides several employment opportunities to nationals**, this develops the nation further.
4. The industrial progress that Walt Rodan advocated for **provides forward and backward linkages to the agricultural sector** all of which are necessary for the rapid development of developing countries.
5. The theory calls for **maximum exploitation of resources of developing countries** and this reduces underutilization of resources
6. There is a high likelihood of having **a balanced development of the economy if the different varieties of industries** are scattered in different parts of the developing countries.
7. The theory encourages **self-sufficiency that is the major symptom of development**. The different varieties of industries produce different varieties of output, so reducing the need to import from other countries.

a) Disadvantages of the theory

1. The theory calls for massive expenditure, such **funds are not readily available in developing economies**. It calls for borrowing from other nations that increase the indebtedness of developing economies.
2. The big push theory **ignores the role of agriculture in development**. Agriculture is the major supplier of foodstuffs and raw materials to agro-based industries that developing countries can sustain.
3. The massive industrialization that Rodan advocates for **increases pollution that reduces the quality of life of the people.**
4. The theory calls **for over exploitation of the natural resources** due to the massive industrialization, this leads to their quick depletion.
5. The heavy industrialization and economic infrastructural **growth brings about the use of machines in production, these replace laborers** so causing technological unemployment.

6. The massive industrialization required by the theory **calls for the rich foreign investors to developing countries**. However these investors repatriate all profits to their home countries leaving developing economies in a worse state than they found them.

Limitations of the theory

1. **Inadequate funds and man power** in developing economies to invest in the economy as the theory suggests.
2. **Inadequate resources** to act as raw materials may be a hindrance to the development of industries
3. Developing countries **do not have adequate skilled manpower** to scatter in all sectors being developed at the same time.
4. Strategy requires proper planning and implementation of plans so as to coordinate the different projects running at the same time, **developing countries are not blessed with such planning skills.**
7. Strategy requires developed infrastructure in terms of transport and telecommunication network, hydroelectric power, among others, such **developed infrastructure is still inadequate in developing economies, and so they cannot sustain** a balanced growth strategy.
8. Developing countries have **under developed technology**; it is still traditional and sometimes just intermediate that cannot support the growth strategy.
9. Developing economie**s have inadequate local and foreign market** that cannot support the much output from all the industries of the economy.

8.1.3.4: ROSTOW'S STAGES OF GROWTH

a) Rostow's stages of growth.

Professor Walt Whitman Rostow described the following stages through which societies pass to attain higher rates of economic growth and development.

1. Traditional stage

This is the first stage in the development process where the economy is still in infancy and there is little progress taking place.

Features of Traditional stage

- **Subsistence production** where output is for home consumption
- No use of money as a medium of exchange
- There is **a high degree of communal organization** where people work together as a community
- **Traditional beliefs in culture** lead to a lot of conservatism
- There are cases of disease and the **nearest hospital is the bush**

- Production is **highly labour intensive**
- There is almost no **formal employment and organized income**
- There is **nothing like investment and savings** in the economy and the economy is closed from external world
- **High levels of resource wastage** through unproductive activities like funeral rites, birth cerebrations, marriage etc

2. **Transitional stage/ pre-condition to take off**

   In this stage there are signs that the economy is preparing to take off.

   Features of Transitional stage/ Pre-conditional to take off

- **Dualism arises at this stage**. Dualism is the co-existence of two contradicting sectors in an economy one developed and the other under developed. e.g. commercial agriculture versus subsistence agriculture, agriculture versus industry.
- The society starts moving away from **dominant subsistence sector and traditional methods of production are reduced.**
- **A market economy starts emerging** where people exchange their output for money.
- **Industrialization starts more so the processing industry**, these are normally agro-based industries processing agricultural output.
- **Entrepreneurs start** to emerge.
- **Saving and investment** start and rise up to 5% of the gross domestic product.
- **Development of a national identity** and shared economic interests.
- **Mobility** of labour begins.

3. **Take off stage**

   This is the stage that involves rapid transformation in the country's social, cultural, political and economic spheres. It has the following characteristics.

Features of take off stage

-Barriers to development are eliminated. Strong economic infrastructure like banks, hospitals, schools are set up.
-Savings and investment grow to between 5% and over 10% of the Gross Domestic Product, new industries are introduced and industrial growth takes faster rates.
-More employment opportunities are created; peoples' incomes rise because wages are higher.
-Idle resources are put to more efficient use through exploitation by the industries.
-Modern and advanced technology is introduced in all sectors of the economy.
-Skilled and qualified labour and entrepreneurs start coming up.
-Education and literacy rates increase at faster rates.
-Rate of urbanization increases faster.

4. **Drive to maturity stage** (**self-sustained growth**)
   This is the stage which follows the take off stage and it has the following features.

-The rate of saving and investment is between **10% and 20% of GDP.**
-The economy undergoes fundamental **political, social and economic advancements, technology progresses rapidly.**
-Production for export grows further and there is **limited importation of manufactured goods.**
-The industrial sector is transformed **from small scale to heavy industrialization.**
-Agricultural mechanization emerges and such heavy agricultural machines like tractors, combine harvesters, multi crop thresher are used to increase agricultural productivity.
-There is maximum utilization of the **country's resources**.
-Modernization of the economy is very high and traditional norms, beliefs and customs are kicked away.
-There are **high levels of employment opportunities** and white collar jobs increase in availability.

5. **Stage of high mass consumption**
   This is the last stage in growth where the economy has reached its climax. It has the following characteristics

- All resources in the country are **fully exploited and utilized**.
- **Consumer durables** like washing machines, cookers etc become necessities in every house hold.
- **Incomes of the people are extremely high** due to full employment conditions.
- **Industrial growth is at its peak and they start producing luxuries** like cosmetics, necklaces among others.
- **The rates of saving and investments are over 20%** of gross domestic product.
- There are high rates of exportation and the country's balance of payment position improves.
- **Urbanization increases** and there is an increase in the urban population.
- **Country starts lending** and donating to other nations.
- **People reduce working hours** and start enjoying leisure, they even start going abroad to tour and rest.

N.B It is important to note that some stages over lap into others, so it may be difficult to identify the exact stage at which a society lies according to the features stated by Professor Walt Whitman Rostow.

b) Applicability of the Rostow's theory in developing countries.

1. **Subsistence production** where output is for home consumption is very common in developing countries as a means for survival.

2. **No use of money as a medium of exchange**. In some areas, exchange is through barter system while generally money is used as a medium of exchange in all societies.
3. There is a high degree of **communal organization** where people work together as a community through cooperatives.
4. Traditional beliefs in culture lead to **a lot of conservatism**. This is very common in developing countries and it has led to low quality output
5. **Production is highly labour intensive** and this is because of the inadequacy in capital in developing countries
6. High levels of **resource wastage** through unproductive activities like funeral rites, birth cerebrations, marriage etc. are common practices in developing countries.
7. **Dualism is common**. Dualism is the co-existence of two contradicting sectors in an economy one developed and the other under developed. E.g. commercial agriculture versus subsistence agriculture, agriculture versus industry.
8. **Industrialization is common more so the processing industry**, these are normally agro-based industries processing agricultural output. As talked about in the pre-conditions to take off stage
9. Entrepreneurs are emerging and this has **increased saving and investment** leading to increase of the gross domestic product.
10. There are high cases of **labour mobility** in the developing countries both internal and external

c) Criticisms of Rostow's theory

1. Rostow talks about progressing from stage to stage but **does not show the mechanism of how it is done.**

2. Rostow bases his theory on American and European history and defines the American norm of high mass consumption as an integral to the economic development process to all industrial societies, **so his model has no impact on other nations especially the developing agricultural nations.**

3. Rostow fails to demarcate one stage from the other as the features of take off and transitional stage tend to overlap into each other.

5. Rostow bases his theory on savings, showing that growth occurs as the rate of savings increase with advancing stages **but savings do not show a picture of economic growth because they may be autonomous.**

6. Whitman Rostow gives rates of savings and investment at different stages **but does not show how the rates are determined, so they become unrealistic.**

8.2. ECONOMIC DEVELOPMENT

Economic development refers to the sustained quantitative and qualitative increase in the volume of goods and services produced over a period of time resulting into positive social, economic, and political institutional changes that may improve the quality of life of the population.

Or It is the process by which real GNP per-capita increases quantitatively and qualitatively over a very long period of time in the country.

Measurements of economic development

1. Increase in real per-capita income
2. Increase in things that improve the quality of life of man like food, housing, health care, security, leisure, freedom and others.

Objectives of economic development

1. **To reduce upon illiteracy rates** and improve upon literacy among the citizens in the country.
2. **To attain higher rates of economic growth** as shown by the increase in the gross domestic product
3. **To attain price stability/fight against inflationary tendencies** in an economy so as to create certainty in the markets
4. **To reduce economic dependency** or to attain self-reliance so as to reduce excess capital outflow and at the same time develop local production ventures
5. **To fight against unemployment** so as to reduce poverty and improve the standards of living.
6. **To attain even resource distribution** so as to reduce income inequalities among the people and regions.
7. **To improve upon skills** of the people through education to reduce dependence on foreign experts who seem expensive.
8. **To improve upon security** to life and property to ensure a good political atmosphere that will attract investors.
9. **To control population growth rates to desirable levels** so as to reduce its associated problems.
10. **To attain equilibrium of the balance of payment position** through increasing and improving upon the volume and value of exports and reducing spending on imports.

8.2.2: Comparison between economic growth and development.

1. Economic growth may involve the **increase in the volume GDP only** while economic development involves **both increase in the quality and quantity/volume of GDP.**
2. Economic growth may take place even with **uneven income distribution** while development involves **fair income distribution**
3. Growth can take place even with **poor quality of output produced** while economic development involves **improvement in quality of output**
4. Economic growth may take **a short period of time to achieve** while development may take **a long time to achieve**.

5. Economic growth may take place even **with low quality of life** of the people while development **involves change in the quality of life**
6. Economic growth is a **rapid process** while economic development is **a slow process**
7. Economic growth can be achieved **without integration of economic sectors** with economic dependence while development takes place when **there is integration of economic sectors and self-sustenance.**
8. Economic growth may take place **without change in economic institutions** like banks while development **takes place change with structural changes.**

8.2.3: Indicators of economic development.

1. **Increase in per capita income** since there is a high national income in the country.
2. **Better education and health services** as shown by the increase in the educational institutions as well as the health facilities.
3. **Increased life expectancy** i.e. number of years a person is expected to live increases because of the improved wellbeing.
4. **Improved technology** which produces good quality goods and services that the people consume excessively.
5. **High levels of employment** as showed by a fall in the unemployment rates.
6. **Goods and services** suit the tastes of the people where by production is based on consumer sovereignty.
7. **Improvement in human and labour rights** because of high rates of democracy practiced in the countries.
8. **Improved welfare** of the people because of the good quality of the goods that are produced in the country.

8.3.: UNDER DEVELOPMENT:

Economic underdevelopment is an economic situation where a society has resources but has failed to put them to maximum use or maximum exploitation so as to improve the welfare of individuals.

OR

Economic underdevelopment is an economic situation where there is persistently limited resource exploitation so as to satisfy nationals' welfare to desirable levels.

8.3.1.2: Indicators/ characteristics or indicators of underdevelopment.

1. Dualism. There is existence of two contrasting sectors one being developed while the other poor eg rich and poor, commercial agriculture and subsistence, educated and uneducated etc.

2. **High population growth rate.** People tend to produce more children due to cultural factors.

3. **High levels of dependence** since the country hasn't enough resources to cater for its citizens.
4. **Predominance of agriculture** and most of output is for home consumption. This is because the economies have little capital to invest in other sectors like industry.
5. **Weak and underdeveloped infrastructure** especially the roads are of poor quality and mainly are small feeder roads.
6. **Predominance of a large subsistence sector**. This is brought by the small market in the country and worse still the quality is low.
7. **Low level of productivity**. This is brought by poor technology that is rampant.
8. **High levels of illiteracy and low-quality education**. There are few schools and worse still the available ones are of poor quality.
9. **High levels of poverty among the people.** This is brought about by the high unemployment rates and still lack of capital to start up business**.**
10. **Production is at excess capacity** i.e. produce less than what is needed by the people because of the poor techniques.
11. **Political immaturity leading to instabilities** are a common characteristic because pf the constant struggle for power.

8.3.2.1: Causes of underdevelopment.

Internal causes

1. **Inadequate strategic raw materials** and industrial inputs like coal, gold which stimulate production, industrial growth and then production, this hinders industrialization causing under development.
2. **Political unrests**. Peace and security are vital elements in the running and functioning of any country.
3. **Capital Deficiency**: Capital is of crucial importance for economic growth and development.
4. **Limited Entrepreneurial and Managerial Talent.** This is responsible for missing available opportunities of profitable investment in most developing countries.
5. **Limited Skilled Personnel and Technical Know-how:** Another very important bottleneck in the way of economic development is the scarcity of technical know-how and skilled personnel in developing countries.
6. **Limited Size of the Market:** The purchasing power of the people of most people in developing countries is very low on account of their rampant poverty.
7. **Weak Infrastructure:** The developing countries lack an adequate and efficient means of transport and communications, a well-organized and developed banking system and adequate facilities for technical education.
8. **Social and Institutional Set-up:** Social customs and attitudes of the people of developing countries are a great bar to economic progress.

9. **Growing Population:** The explosive rate of population growth in the developing countries undoubtedly retards their economic development.
10. **Dependence on Agriculture:** The majority of the population is engaged in agriculture which is carried on in a primitive manner.

External causes include

1. **Profit repatriation.** Several of the investments in developing countries are owned by foreigners, these take back the benefits ploughed out of these investments back to their home countries leaving developing countries in a worse state than they were found.
2. **The debt servicing burden.** Developing countries contract loans to set up investments for development, all benefits obtained flow back to the lenders in servicing these debts and paying them back rather than re-investing them. These cause further under development of the developing countries.
3. **High levels of Brain drain**. Several of the educated and high skilled personnel in developing countries go abroad for greener pastures. This leaves LDCs with the weak, dull, lazy and the unskilled labour force that cannot aid further development.
4. **The unfavorable trade position.** Several LDCs produce and export primary products which are semi processed or not processed at all, consequently they fetch less revenue because of their low value causing under development.
5. **Alien Rule / Neocolonialism**: Most of these countries have been under foreign rule which has kept them down. The foreign rulers could not be expected to take any genuine interest in the economic regeneration of the people.

8.3.2.2: Policy measures to solve the problem of underdevelopment

1. Education reforms have been undertaken. This has helped many people to access education so that they can be prepared to get jobs and remove the people from poverty

2. **Land tenure reforms**. This is through land redistribution policies and making it accessible to all people in society so that they can be able to carry out agriculture.
3. Kick start funds like the **one cow per family** has helped people to access cows that can be used as source of income through selling the milk
4. **Progressive taxation**. This has reduced the gap between the rich and the poor people since the revenues collected are used to subsidize the poor and further infrastructure development
5. **Improving infrastructure** like roads which helps in the movement of people and goods from areas of production to markets helps people to increase their earnings
6. **Liberalization of the economy**. This has helped people to participate in economic activities and trade hence increasing their incomes and standards of living
7. **Controlling population growth**. This has helped to reduce the ratio of resources to the population and also dependence burden among the families.

8. **Modernizing agriculture**. This has helped reduce the level of poverty in rural areas where the activity is fully based. The people are able to increase the quality and quantity of their products hence receiving more incomes.
9. **Improvement of the investment climate**. This has been through giving tax holidays and free land like the free investment zone in Masoro. This has attracted more investors and hence creating employment opportunities
10. **Improvement of the political climate.** This has created good environment for production where by the people are not scared of carrying out any activity
11. **Encouraging development of small scale enterprises**. These have also created more employment for the people in Rwanda and hence improving their standard of living
12. **Formation of co-operatives**. This has been the basis for reducing income inequalities among the people. These include: Saccos like umurenge sacco, umwalimu sacco, producer co-operatives among others have encouraged micro savings and given small loans to the local people.

UNIT ASSESSMENT

1. Examine the factors that influence Rwanda's level of GDP growth rates.
2. What conditions are there to show that Rwanda's economy is an underdeveloped economy?
3. Suggest measures that can be used to reduce the level of underdevelopment in developing economies.

UNIT 9: AGRICULTURAL DEVELOPMENT

Agriculture is the growing of crops and rearing of animals. There are both food crops and cash crops involved together with a variety of animals.

Agriculture is basically the backbone of developing countries contributing wholesomely to their economies and thus its development is paramount.

Agriculture development therefore is the process of promoting proper conditions for farming so that the quantity and quality improve drastically. It can also be looked at in the perspective of providing assistance to crop producers with various agricultural resources for better output attainment**.**

9.1. 1 Arguments in favor of agriculture.

1. **Provides enough food necessary** to feed the population in both rural and urban areas.
2. **Provides raw materials for agro based industries** e.g sugar factories textile factories etc. which increases the rate of industrialization.
3. **Provides employment** to the people which enables earn income and improve their standard of living.
4. **Increased output for export and reduced expenditures on imported** agricultural goods which in turn increases the country foreign exchange.
5. **Source of medicine** to the people of the country especially through the herbs.
6. **Provides backward linkages** to the industrial sector where it acts as market for the industrial output such as the hoes, pangas etc.
7. **Reduces rural urban migration** because people are employed in the agriculture sector which is normally carried out in rural areas.
8. **Facilitates development of infrastructure** like roads because of the need to transport commodities from rural areas to the market.
9. **Leads to fair distribution of income** because of the employment provided to the people through agricultural activities.
10. **It is source of government revenue** through taxing commercial agricultural products which leads to the development.
11. **It acts as training ground to many people**, many people get skills from managing agricultural activities and apply them in other sectors which also lead to the development.

9.1. 2 Disadvantages of agriculture.

1. **Agriculture prices keep on fluctuating consistently** due to the differences between planned output and actual output together with poor climate conditions all which affect the supply and affect the producers
2. Agriculture development may **involve expansion of the firms among others** and this may affect the growing population in terms of settlements leading to fragmentations
3. **Products are perishable and difficult to store**. This is a big problem that affects developing countries and worse still they are bulk and may not be transported easily to other parts of the country
4. **Some crops have a long gestation period** and thus the farmer may take long to gain from them even if the prices increase at present, the farmer may not increase supply thus losing out.
5. **Agriculture mostly depends on nature**. If the rains fail to come, the farmers may fail to increase supply than what they may have anticipated and prices may go up. The inconsistencies in climate worsen the problem of price fluctuation of agricultural products.
6. **Most of the developing countries produce the same types of agricultural goods** and thus products flood at the world market causing prices to fall down.
7. Development **of synthetic fibres** which also have the same purpose with agricultural raw materials these reduces the demand for agricultural products.

8. **High rates of conservatism** among the many farmers who prefer quantity to quality leading to poor quality and low revenue to them as earnings and to the government as through taxation.

9.2.1 Agricultural mechanisation

Agriculture Mechanization is part of agriculture modernization that involves the use of capital intensive techniques such as tractors, harvesters, irrigation pumps, ploughs and milking machines among others in production process.

It is normally done to increase quality and quantity and also for time saving.

9.2.1.2. Arguments in favor of agriculture mechanization

1. Time saving especially during times of planting, ploughing among others. The machines do the work very quickly and save time that would have been used by the people

2. Encourages **large scale production** because machines use large pieces of land and this increases output that would be exported to earn the country foreign exchange.

3. Good quality output is produced because of constant use of machines which can be tuned and adjusted to produce good quality.

4.Reduces **the cost of production** because the expenditure to buy machines is not recurring but happens once compared to labour that has recurring expenditures i.e wages.

5.Encourages specialization depending on the machines which the farmers have and this increases the quality and quantity and time saving.

6. Easy management because the use of machines doesn't need close supervision than labour

7. Machines can act as **collateral security** when acquiring loans from financial institutions

8. Irrigation is possible which **reduces dependence** on nature and it may help increase output even when during dry periods

9.2.1.3 Disadvantages of mechanization

1. Capital intensive techniques cause **technological unemployment** where machines replace humans.

2. Rural urban migration may occur because mechanization requires large pieces of land and therefore the local people may lack for settlement

3. Requires large sums of capital to use because the machines such as tractors, sprinklers, harvesters, all have to be imported.

4. Machines destroy the ecology of the soil since they may not be appropriate to the soil.

5. Requires gently or flat large pieces of land yet most parts of the country are **hilly with steep slopes** thus being disadvantage.

6. Specialization as a result of mechanization may affect the country **export earning incase world market prices fall.**

7. Over production. This is because of the work easily done by machines during the process and this leads to surplus and resource wastage. This happens where the market is small.

8. Over exploitation of resources due to the desire for the high profits and excess production by the machines.

9.2.1.4 Limitations of mechanization

1. Requires high skills to operate the machines which are inadequate in the developing countries due to limited trainings.

2. Existence of inadequate capital, most people in agricultural sector cannot afford buying agricultural machines like tractors hence limiting the strategy.

3. Requires large pieces of land which is scarce in LDCs where the land is divided into small pieces called fragments due to high population growth rates.

4. Existence of poor topography in some parts of country where the land is surrounded by many hills. This limits the use of modern machines like tractors in the agricultural sector.

5. High degree of conservatism in the agricultural sector especially in rural areas. Here most farmers still have poor attitudes towards mechanization where by most of them prefer traditional methods to modern ones hence being a big limitation.

6. Requires a good and efficient agricultural planning which is not possible in terms of costs and management in developing countries.

7.Underdeveloped **infrastructure and technology** limits the use of machines since they require a well-developed road network.

8. Existence of small market for the agricultural output discourages most farmers from using machines so as to increase output since it may lead to surplus and a fall in prices.

9. Price fluctuation in agricultural sector **also discourage many people from investing a lot of their money in buying machines** because they may fear to make loses when prices reduce hence being a limitation.

10. Land fragmentation in the country where land is divided into small pieces yet this strategy requires large pieces of land hence being a limitation.

11. Machines sometimes destroy the ecology of the soil sine they may not be appropriate to the structure**.**

9. 2.2 Commercialization of agriculture in Rwanda

Commercialization of agriculture is the type of production that is intended for sell with an aim of getting profits.

It normally involves large scale production with high technology most of the times. The quality tends to be better than that of subsistence production

Characteristics of commercialization of agriculture

1. Production is for **the market** either domestic or international
2. Use of **improved seeds and breeds** of cattle for better quality
3. **Use of modern tools like tractors**, harvesters, and sprinklers among others.
4. **Skilled workers are employed** compared to family labour used in subsistence production
5. **High levels of productivity** due to the need to serve a wide market and accumulate high profits
6. **Land improvements** through the use of fertilizers all in the need for high productivity.High quality is produced since the major aim is profit maximization.

9.2.2.2. Benefits of commercial agriculture

1. Develops skills of workers because of specialization and constant doing of the same work.

2. Increases the gross domestic product of the country because of the need for high profits and revenues.

3. Increases the incomes of the workers and the farmers at large. This is because production is for sale. This increases the standard of living of the workers.

4. Good quality products are produced since farmers produce purposely for sale which improves on standards of living of the people and their way of life.

5. Increases the exports of the country hence the increase in the foreign exchange earnings.

6. Increases the supply of food because in most cases it is carried out on large scales and this in turn reduces the price of food stuffs which increases people's standards of living.

7. Promotes industrialization because it involves production of raw materials on large scales in the country.

8. Capital accumulation may increase because of increased output for sell that will bring in revenues.

9. Sometimes it is done on a large scale so **it utilizes the idle land** that may be unproductive

10. Employment creation. The desire for too much profits make the owners of the farms to increase the number of workers hence creating employment.

9.2.2.3 Disadvantages of commercial agriculture.

1. Reduction in the food needed by the local people since production is mainly for sell and not home consumption.

2. Capital intensive techniques cause unemployment in the villages since mainly machines are used on the extensive land.

3. Requires large sums of capital to use because the machines such as tractors, sprinklers, harvesters, all have to be imported.

4. Requires large pieces of land and this is a problem in countries where land has rugged terrain with steep slopes in many parts of the country.

5. Specialization as a result of mechanization may affect the country incase world market prices fall.

6. Over production. This is because of the work easily done by machines during the process and this leads to surplus that may not be absorbed by the available market.

7. Over exploitation of resources due to the desire for the high profits and excess production by the machines.

9.2.2.4 Limitations of commercial agriculture

1. **Poor land tenure systems**. Some of the land is owned by absentee land lords and hence it is inactive.

2. **Narrow markets**. The market is low due to poverty among the people and the low quality that cannot yield much revenues.

3. **Poor infrastructure**. This limits the movement of goods from gardens to market and also from areas of low prices to areas of high prices

4**. Lack of skilled man power**. Most people have low skills and worse still they take long to adjust to the new techniques

5. **Conservatism of farmers**. Some farmers are very conservative and are not able to change to good quality output hence end up getting low revenue

6. **Inadequate capital**. This is still very low and many producers cannot access the improved equipment necessary to improve the quality and quantity.

7. **Competition from other countries** that produce the same at the world market. This leads to surplus and constant price fluctuation which affects the foreign exchange and incomes of the commercial farmers.

9.3 **Measures to improve agricultural productivity.**

1**. Encouraging security in the country**. This encourages many people both local and foreigners to invest in commercial agriculture which improves on agricultural productivity in the country.

2. **Establishment of credit schemes in the country** which support farmers with loans this can help to increase on farmers' capital which encourages them to produce on large scales.

3. **Encouraging agricultural diversification** where farmers are encouraged to carry out different activities in agricultural sector this increases their levels of income and output hence improving on agricultural productivity.

4. **Establishing and developing agro based industries in the country**. This increases the market for agricultural products and encourages many investors to invest in agricultural sector which in turn leads to increased agricultural productivity.

5. **Educating farmers about different modern methods of farming** this can help them on ways of improving their levels of output.

6. **Developing infrastructures** like roads which can easily help farmers to transport their products from rural areas to urban areas where the market is so big and this encourages many people to invest in the sector.

7. **Establishing many agricultural research centers** in which farmers can research and discover modern methods which can be used in the sector and also to provide improved seeds to them which in turn leads to increased outputs.

8**. Promoting agricultural cooperatives** in the country which extend agricultural services to farmers like storage services, improved seeds, transport services which all lead to the development of agricultural sector.

9**. Improving on land tenure system** where people are not allowed to divide their land into small plots this can help to encourage commercial agriculture which in turn leads to increased production.

10. **Encouraging farmers** to use pesticides which can help in fighting against pests and diseases, this in return can also help to increase on agricultural outputs.

11. **Encouraging agricultural commodity agreements** where the farmers of certain commodity come together and agree the price and the quality of their commodity this helps to reduce on price fluctuations hence leading to increased outputs.

UNIT ASSESSMENT

(ii) Explain the reasons why agriculture is referred to as the "back bone" of many developing countries.

(iii) In Rwanda using machines in agriculture sector has not been very common. Explain the reasons behind this scenario.

(iv) Mutoni is among the few farmers in Byumba district who has been producing beans, peas and ground nuts on large scale for commercial purposes.

(a). Which special name is given to the nature of agriculture Mutoni practices?

(b). Explain the advantages and disadvantages of Mutoni's agricultural practice.

(c) Explain the factors that hinders other people from joining the same agricultural practice like that of Mutoni.

4. Explain the measures taken by the government of Rwanda to improve agricultural productivity..

UNIT 10: INDUSTRIAL DEVELOPMENT

Industrial development is the building and growing of industries within an economy. An **industry** is a group of companies that are related based on their primary business activities (product produced or sold). These industries include mass production, technological advances and other services.

10.1.2: Advantages of industrial development:

1 .Industrial development provides **well-sustained economic growth that can transform an economy.**

2. Industrial development leads to an **increased demand for goods and services**, therefore promoting more innovation and more financial opportunity which profits the entire community.

3. Prices of industrial products tend to be stable for a long period. This price stability is a sign of development.

4. Industrial development **provides forward and backward linkages to agriculture, forward linkages** are provided by providing market to its produce by processing it, and backward linkages by providing it with tools to use.

5.Industrial development **requires relatively less land**, so, it is the most appropriate development strategy for developing countries whose land is reducing due to persistent increases in the population size.

6. Prices of industrial products are high, so the **industrial sector fetches more money** for the economy both locally and internationally.

7. Industrial development is necessary for **modernisation of agriculture**. To increase agriculture productivity, there is need of chemical fertilizers, pesticides and weedicides, tractors, threshers, pump sets harvesters etc.to modernize agriculture, of which are all industrial products

8. Industry **raises government tax revenue.** The industrial firms, labour, and output are all taxed to increase tax revenue.

9. Industrial development **encourages the development of science and technology**. The industrial enterprises conduct research and develop new products.

10. Industrial development facilitates **infrastructural growth**; industry requires hydroelectric power to run its machines and roads to transport its output and input to and from the industry.

11. Industrial development provides **more employment opportunities to all nationals**; the different linkages created by the industrial sector employ the almost all nationals i.e. educated, semi-skilled, and the unskilled.

12. Industrial development **increases the availability of foreign exchange and improves upon the balance of payment position of the country**.

13.Industrial development helps in **capital formation** because in large scale industries, the surplus is very high..

14.Industrial development **promotes Urbanization**. This is because industrialisation in a particular region brings growth of transport and communication, schools, colleges, technical institutions, banking and health facilities are established near industrial base.

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15. Industrial development **promotes self-reliance in different ways**. For example, during war and emergency or any other form of catastrophe and in case of any economic hardships, dependence on foreign countries for war weapons, food and medical relief may prove fatal.

16 .Industrial development plays an important role in the **promotion of international trade**. Industrial products command higher values & their demand is inelastic, thus making a country to gain from trade.

17. Industrial development plays important role in **proper utilisation of resources by a country.** It makes a country to properly utilize her resources to transform them into finished industrial products.

18. Rapid industrial development helps a country in **quick alleviation of Poverty and Unemployment.**

19. Industrial development helps in the **rapid growth of national and per capita income**.

20.Industrial development is a sign of **higher standard of living and social change**: This is because it helps a country to produce goods and services of high quality in order to attain decent living standard.

10.1.3: Disadvantages of industrial development

1.Industrial development **pollutes the environment**. The fumes from machines spoil the atmosphere, industrial waste is poured in the waters, and there is noise. All these endanger the lives of the people so worsening their welfare and delaying development.

2. It worsens rural-urban migration and its side effects like slum development in urban centers, congestion of traffic and under development of rural areas. This is mainly because industries are set up in urban centers.

3. It increases capital flight; the foreign industrialists who are the majority in the sector take back all the benefits from the sector rather than re investing it in developing countries. This further under develops the country.

4. It increases technological unemployment in LDCs. This is mainly because of the high use of capital-intensive techniques of production in the industrial sector.

5. It strains the government budget. Expensive infrastructure must be set up for industry to develop, this sometimes necessitates borrowing which increases the indebtedness of the country.

6. It leads to environmental degradation; sometimes swamps are reclaimed, forests cut down to give room to industrial growth, extinction of species etc. This under develops the economy since they tend to impose a major negative externality on human society.

7. Financially, industrial development results in a **wide gap between the rich and poor** due to a division of labor and capital. Those who own capital tend to accumulate excessive profits derived from their economic activities, resulting in a high disparity of income and wealth.

8. Rapid urbanization brought on by industrial development typically leads to the general deterioration of workers' quality of life and many other problems for society, such as crime, stress, and psychological disorders.

10.1.4: Problems faced by the industrial sector in developing nations

1. Difficulty in **disposing off industrial waste**; the environment laws normally prohibit industrialists from polluting the environment; they find a challenge in finding where to divert the fumes or pour solid waste.
2. **A narrow supply of quality raw materials**; most industries in developing countries are agro-based, the base on agriculture which is under developed and produces poor quality output. This on several occasions gives rise to poor quality industrial output whose marketability is hard. It sometimes necessitates importing raw materials that makes output too expensive and fails to compete on the world market.
3. **A limited supply of skilled personnel**. Developing countries have a limited supply of qualified, skilled, and experienced personnel with industrial skills. This necessitates importing expatriates that increase the price of final goods and services since such people are expensive.
4. **Under developed infrastructure**, industry requires well-developed road and telecommunication network to develop and a persistent supply of hydroelectric power. Their inadequacy is a great challenge to industrialist as they are forced to produce in excess capacity.
5. **Limited capital funds**; since most people in developing countries are poor, they do not have adequate funds to expand their industries or even purchase more efficient and advanced machines.
6. **Heavy taxes levied by government**. Governments of developing countries tend to tax industries heavily; this increases their costs of production and sometimes totally fail and close up the industrial plant.
7. **Competition from abroad**; industrial products from LDCs are normally out competed by those from developed nations which are of good quality and low priced because such firms are already enjoying the economies of large scale.
8. **Political instabilities and unrests from developing countries**. Industrialists in developing countries live in fear of having their entire plant destroyed by an insurgency that can erupt anytime in LDCS. Developing countries are politically insecure.
9. **A small size of the market;** people in developing countries are poor, they cannot afford the prices of quality industrial output. This forces industrialists to produce in excess capacity.
10. **Conservatism of the people in developing countries**. People in developing countries are rigid; they are not yet free with manufactured industrial goods. Consequently, several of industrial output is wasted if not exported.

10.2.0: INDUSTRIAL DEVELOPMENT APPROACHES.

Industrial development is one of the development goals in Rwanda**.** Production techniques as one of the approaches any economy can undertake for their industrial development process so as to achieve her goals of economic development

10.2.1: Technology:

Technology is a body of knowledge devoted to creating tools, processing actions and the extracting of materials. We apply technology in almost everything we do in our daily lives; e.g. at work, for communication, transportation, learning, manufacturing, securing data, scaling businesses and so much more.

OR

Technology is human knowledge which involves tools, materials, and systems. We can therefore, describe technology as products and processes used to simplify our daily lives.

A technique is any alternative method of production available to produce goods and services.

There is a great controversy on the question of choosing the technique of production i.e. between labour intensive and capital-intensive technique in less developed countries.

Criteria for choosing a technique

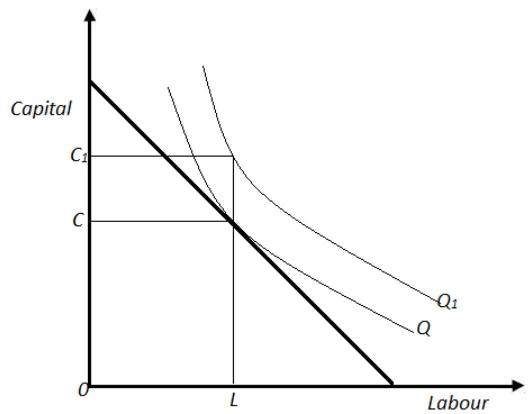
1. Benefit of the technique to the user.
2. Efficiency of the technique.
3. Prevailing economic conditions in the area or country.
4. The cost of the technique.
5. The advantages and disadvantages of the technique compared to others.

10.2.1.2: CAPITAL INTENSIVE TECHNOLOGY:

Capital intensive technique is technique that uses more proportion of machines than other factors of production like labour. It can also be called **labour saving technique**. Capital-intensive production represents the proportion of capital (machinery, equipment, inventories) relative to labour, measured by the capital–labour ratio.

(e.g. railways and airlines). All these industries require massive amounts of capital expenditures.

Figure: Capital intensive technique



In the diagram above, isoquant Q represents the initial level of output, using OL amount of labour and OC amount of capital. With the introduction of new technique, a higher level of output is shown by labour (OL) but with greater dose of capital (OC1). Therefore, capital intensive technique is using more capital with the same amount of labour.

Advantages of capital-intensive technique

1. Production of **better-quality commodities**. This is because there are more machines used that can produce better goods.
2. **Reduces the cost of supervision**. This is because machines are more than the people thus no need for a lot of supervision.
3. **Encourages and promotes better and efficient methods and inputs** that can lead to high output
4. **Promotes proper utilization of resources**. The machines tend to produce more hence reduce tendencies of excess capacity
5. **Encourages technology transfer** from developed nations to developing nations and this leads to technology development in the recipient countries
6. **Relatively cheap** since it does not associate with capital outlay like housing, medical care etc
7. **Reduces industrial strike cases** because it uses more machines than labour
8. **Increase labour mobility** from one place to another to acquire job opportunities

Disadvantages of capital-intensive technique

1. **Leads to technological unemployment**. This is because more proportions of machines are used in relation to the labour
2. **Expensive to install and maintain**. The machines that are employed are expensive to install and still maintenance is recurring in terms of costs
3. **Requires skilled man power** which is scarce in low developing countries. This calls for acquisition of imported labour which may lead to profit repatriation.
4. **Promotes capital outflow** when buying the machines and repairs. The machines have their repairs bought from outside countries and thus continuous outflow

5. **Worsens the balance of payment position** when acquiring the machines since they are expensive
6. **Promotes income inequality** because it creates technological unemployment when people are replaced with machines
7. **High social costs** like pollution from the machines and this leads to environmental degradation that may be harmful to the people
8. **High rates of resource exhaustion**. This is because the machines tend to produce a lot since there is no human judgment.
9. **Promotes dependence on other countries** for machines and expatriates and this may limit the country to be self-reliant.

Limitations of capital-intensive technique

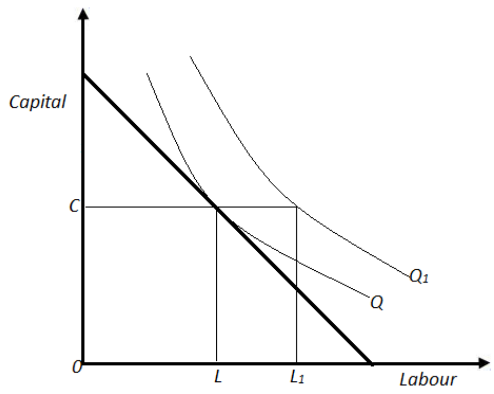
1. **Inadequate capital** by the people limits them to acquire the machines hence they resort to labour intensive technique.
2. **High tax charged on the importation of the machines** makes people to shun away from them and they retain the labour
3. **Inadequate market** both internal and external discourages people to use the capital-intensive technique since the excess supply will not have the market to use it.
4. **Inadequate raw materials** leading to constant importation creating constant balance of payment problems
5. **High operation costs** due to large scale production. This affects the operations of the business and it may result into increase in prices
6. **Under developed infrastructure like roads limit the movement of the machines** and it may affect the development of the technique of production
7. **Requires developed technology which still lacks**. In developing countries, technology is still intermediate which is still low and cannot produce the large quantities.

10.2.2: LABOUR INTENSIVE TECHNOLOGY.

Labour intensive technique is that technique which uses comparatively larger amount of labour and small doses of capital. It is that technique by which more of labour and less of capital is required for the process of production. It is sometimes called **capital saving or one-pound technique.**

Labour-intensive industries include **restaurants, hotels, agriculture, and mining**.

Figure: Labour intensive technique illustration.



In the diagram above, isoquant *Q* shows the initial level of output which is being produced by using *OL* labour and *OC* amount of capital. With the adoption of new technology, a higher level of output is represented by the isoquant Q_1; can be produced by the same amount of capital i.e. *OC*. In this case, greater amount of labour is OL_1. This shows that the technique is labour intensive.

Advantages of labour intensive technique.

1. **Cheap and easily afforded** since it uses mostly labour as compared to the machines and labour is cheap.

2. Source of employment to the people and hence reduces the unemployment problem in the country.

3. Helps in income distribution since the number of the unemployed is low since the technique employs more labour.

4. Requires little/ limited skills. The techniques may not need complicated skills compared to the capital-intensive technique

5. Reduces social costs such as pollution. The technique does not involve extrusion of fumes on land, water and atmosphere hence it does not degrade the atmosphere.

6. Increased employment **increases aggregate demand and investment**

7. Needed in agriculture where human judgment is paramount. Some decisions in agriculture cannot be done by machines hence labour is the best option.

8. Helps control **over exploitation of resources**. Production can be controlled when using labour through reducing on the areas that are being used. This helps o reduce exploitation.

9. No need to **import expatriates** since the technique can be operated by the labour which is available

Disadvantages of labour intensive technique

1. Low productivity compared to capital intensive technique. This is because the labour cannot do the work as quick as the machines

2. Costly in the long run in terms of feeding, med-care among others and this increases the cost of production compared to when machines are used.

3. Produces low quality output because of the low skills possessed by the workers

4. Underutilization of resources is common since the labour cannot cover wide areas during the production process

5. It does not encourage technology development because it uses more labour compared to machines. This further leads to under development.

6. Labour unrests and strikes are common when using this method and this leads to production stopping for some time hence no output and earnings.

7. It is hard to standardize output using the technique. Labour may not be able to produce good standard output because it may not have a standard measure.

Limitations of labour intensive technique

1. Inadequate labour due to rural urban migration and younger and elder leaving industries with no option but capital-intensive techniques

2. Need to produce good quality output calls for capital intensive technique so as to get output that can compete at the bigger stage in the market.

3. Increase in demand calls for **increased supply which can only be done by capital intensive techniques**

4. Specialization requires more use of machines since it requires use of expansive land or covers wide industrial areas.

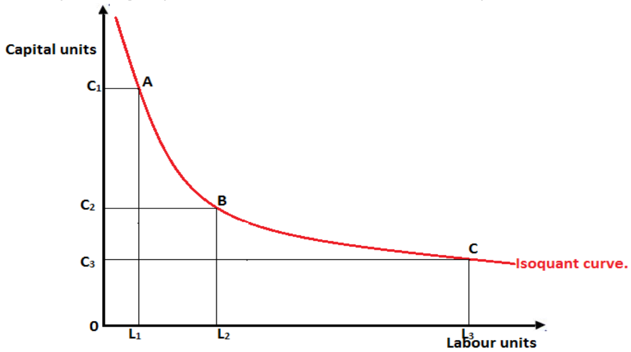
5. Production where human judgment is not needed can be easily done by machines compared to labour when the major aim is to maximize output

6. In the long run it may be costly when the expenditures on medication, housing allowance among others set in.

7. Government policy of standardization may not be put into consideration by labour intensive techniques but rather capital-intensive techniques.

Activity

Study the graph below and answer the question that follow.



a) What is an isoquant curve?
b) What technique of production is portrayed at points A, B & C respectively? Give supporting reasons for your answers.
c) Which production technique would you recommend for your economy to apply and why?

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10.2.3: INTERMEDIATE TECHNOLOGY

Intermediate technology is the type of technology which is midway between the modern technology and the traditional- primitive technology.

Features of intermediate technology

- The technology is fairly simple to use.
- The technology uses the local materials.
- It is cheap and affordable.
- It should be manageable by the majority of the people.
- It is user friendly meaning it may not affect the environment.
- It contains elements of both the traditional and modern technology

END OF UNIT ASSESSMENT

1. The development of Masoro area in Gasabo district has got many benefits to the people and economy at large. Examine the benefits talked about above.
2. Using more machines is more advantageous than using more workers. Discuss.
3. a) What is meant by appropriate technique of production?
   b) Identify the features of appropriate technology.
   c) Describe the advantages and limitations of the use of appropriate technology.
4. Rwanda, just like any other country, has always transferred technology from other countries to improve her productive capacity in the country. Analyse the impact of technological transfer in Rwanda.

UNIT 11. DEVELOPMENT STRATEGIES:

11.1.0: EDUCATION.

Education refers to the process of acquiring worthwhile knowledge, skills and values that aid an individual to engage in development activities of his/her country. Education is both formal and informal.

Formal education; This is a set of worthwhile knowledge, skills and values obtained from organized institutions, monitored by qualified personnel and following a well-made curriculum. These institutions from which it is acquired may be schools, universities and other training institutions.

Informal education is a set of worthwhile knowledge, skills and values obtained from outside the formal set up i.e it can be got from anywhere or anyone and any time. There is no organized curriculum to be followed.

11.1.2: Role of education to development.

1. **Increases technological knowledge** of labour and this can help in skill development necessary for development
2. **Encourages innovation and invention** which may lead to development of technology in the country
3. **Encourages people to acquire good standard of living**. This is because the people get exposed to different ways of life
4. **Breaks cultural rigidities** since people have knowledge about the outside world hence they can implement what they study about the outside world.
5. **Saves foreign exchange** spent on expatriates since the country is able to produce its own citizens that can do the work of the expatriates.
6. **It helps to reduce the rate of population growth**. The educated tend to like smaller families because they understand the dangers related to bigger families.. They also understand well the use of population control methods.
7. **Reduces the subsistence sector** since the educated will be in search for money therefore they will engage in commercialized agriculture.
8. **Widens the tax base** since it provides employment to the people after studying and still in the education sector employment opportunities are created.
9. **May lead to reduction in the population growth rate** since the educated knowledge about the control measures and the dangers of population explosion

Disadvantages of education

1. May cause balance of payment problem because the educated tend to copy and buy expensive things from abroad (high rates of demonstration)

2. **Causes unemployment** especially when theoretical and creates job seekers than creators.

3. **Causes rural urban migration** as the educated seek better opportunities in the urban centers leading to open urban unemployment

4. **Social discrimination** among the educated and the uneducated as the educated see themselves as superior

5. **Accelerates income inequality** since the educated will acquire better paying jobs than the uneducated

6. **May lead to brain drain** in search for employment opportunities abroad after failing to get employment home.

11.1.3: Problems faced by education sector in developing countries

1. Lack of expertise: An increasingly technological world requires an effort in terms of specialisation and professional training. However, there are limited skilled and specialized personnel at all levels in the education sector in most developing countries. Most qualified instructors move to other sectors and even abroad where they can have better remuneration.

2. Limited motivation to teachers has led to limited teaching staff: A lack of economic resources goes hand in hand with a lack of a greater number of teachers in most developing countries. Currently, there is a wave of teacher migration, ending up emigrating and together with the lack of educational resources for the training of new professionals, most developing countries have been deprived of the would-be potential teachers. Those who try to persevere, end up bringing up half-baked products since they are under paid thus their morale down.

3. Non-compulsory education: Many countries do not value the obligation of school attendances within their laws. Parents are not obliged to educate their children and therefore the children may not be registered at school or only attend classes on the days they wish. This leads to absenteeism and poor quality education output.

4. There are **limited teaching/learning materials**, most of the subjects are theoretically taught, and this keeps the education sector backward.

5. The education curriculum in developing countries is **still colonial based**. Most of the subjects taught and their content is no longer relevant, they train learners for white collar jobs, they make more job seekers than job makers so accounting for the rampant unemployment in the country.

6. Inequality: The world's illiterate population consists of 780 million people. Two thirds of these are women. The need for the inclusion of girls, right from primary school to university education, is essential to achieve the goal of universal education, but unfortunately, male prejudice is still something that is present which makes education difficult to attain for many women. Some parents prefer to educate boys compared to girls and this has accelerated gender inequality and income inequality among the males and females.

7. Inefficient and ineffective school networks like use of digital education and better schools to take on more students hampers education in developing countries. Digital education as a technological aid, helps teachers and students by making an infinite stream of knowledge available, which can be renewed and updated without increased costs in school materials. However, this is lacking in most developing countries, making children who attend school, to leave the education system without gaining basic reading and mathematics skills.

8. High school dropout rate: Many children leave school before completing their education due to family pressures like to look after the home while parents are working, taking care of younger siblings or being sent directly to work or marry before they are legally of age in order to contribute financially to the family, hence leading to many drop outs. This deprives the economy of a big number of future skilled labour force and entrepreneurs.

9. The economic crisis that has been felt in most developing countries has resulted into reduced **education budgets**, leading to inadequate funds for the education sector. This leaves some areas and schools in the rural areas with lack of equipment to use hence hindering the development.

10. Rampant poverty in developing countries: Education in most developing countries is expensive, thus making it costly. Due to poverty, many parents in developing countries are unable to send their children to school or even buy for them scholastic materials. Many countries in developing economies uphold mandatory payment rates for all students, regardless of family income. This means that many children stop attending school because their parents cannot afford these payments.

11.1.4: Measures of promoting education.

1. A New Educational Model: Investing in test scores and achievement is no longer a useful way to focus on education, therefore, a new educational model combining traditional content with important financial, health and administrative skills has been put in place through curriculum revision from knowledge based to competence-based curriculum (from KBC to CBC). Students are now made to practice teamwork, leadership and critical thinking. They also gain exposure to entrepreneurship projects such as identifying and exploiting market opportunities through business ideas such as community recycling. This shift away from standardized learning is preparing Rwandan students to make a positive impact on the social and economic wellbeing of their communities.

2. Improved Resources for Teachers: Computer-assisted learning is inevitably improving education in Rwanda and has enhanced the educational experience of both teachers and students. The computers that have age-appropriate learning software and a technically educated staff that knows how to maintain them has been implemented in most schools in Rwanda. These methods to improve education in Rwanda, will continue to encourage student enrollment, and most importantly, will ensure that children stay in school and learn more while they are there.

3.The Ministry of Education (MINEDUC) has been active in promoting the **use of ICT in schools** and coordinating the One Laptop per Child project in the country. ICT education is extending from tertiary institutions to all primary and secondary schools.

4. Promoted vocational education so as to produce students that have practical skills and can start their own businesses instead of waiting for employment.

5.There are regular inspections of all learning institutions to assess the quality of education, infrastructures, human resources, student recruitment and curriculum. Education being a shared responsibility between parents, teachers and policymakers, Rwanda saw it necessary to keep evaluating the progress in education by taking stock of what has worked, what has not worked and the gaps so as to improve the quality of education.

6. Increased teacher remuneration and motivation so as to increase their performance and achievement. For example, the recently announced 10 percent salary increment for teachers in state schools and government subsidized schools is expected to create a solid foundation for retaining and attracting the former and new teachers respectively. This will Increase the motivation of the teachers so that they can carry out their activities genuinely and professionally.

7. Provided parents with information on the value of education: This is aimed at increasing and maintaining school enrollment. Most adults in Rwanda are illiterate and do not have the awareness necessary to improve both their living conditions and those of their children. Responsible leaders at local levels in all parts of the country have been tasked to educate parents about the value of educating their children and to make them aware that a parent's investment in education is crucial for the success of their children.

8. Reduced the cost of Education through cost sharing: Rwanda has abolished school fees in primary schools, while in secondary schools through the 9- and 12-years basic education the government has undertaken paying part of the students' tuition and the students pay a smaller part and applied cost sharing especially in high institutions of learning. The move has triggered a large increase enrollment especially in primary level and thus has reduced the rate of school dropouts.

9. Policies for girl child have been embarked on through reducing their entry points at the higher institutions of learning and also when recruiting for secondary schools. Organizations such as Imbuto Foundation in Rwanda has had a major role in girl child education.

10. Encouraged active participation of the private sector in the education system through taking up government educational programs as well as setting up new schools at affordable fees structures.

11. Educational loans to help the students at higher levels. This is common in Rwanda under the government fees/ tuition structure where the students in the higher institutions are given educational loans and they pay back in installments on completion of the studies when they get jobs.

12. Expanded access to pre-school, including better nutrition to reduce malnutrition among young children through tightening school and district-level management of the early grade.

13. Capped class size at no more than 50 students per class by hiring new staff, and expanding affordable, proven models of early grade instruction.

14. Location of the schools close to rural habitations, pro-poor conditional cash transfers and related publicity campaigns on the benefits of schooling.

15. Strengthened professionalism of teachers to improve outcomes. Recently, it has been proposed that low-performing teachers should have options for improvement and exit for those falling short of minimum professional standards. There is recent move by the government to only recruit education professionals because, with teachers being a major factor in quality of education and progression of students, the task of educating Rwandan children should be entrusted to highly trained, well skilled and passionate people right from nursery to higher institutions of learning. Therefore, serving educators need to be subjected to structured guides and competency-based training options, along with career progression pathways through CPD courses like the recently graduated primary and secondary headteachers, deputy head teachers, teachers and TTC tutors.

16.Government implemented a school feeding programme that is partially subsidized but involves a compulsory cost-share with parents.

11.2. FOREIGN AID AND ECONOMIC DEVELOPMENT:

Foreign Aid is the international transfer of resources either on loan or grant from one country to another.

Or it can be defined as any form of assistance given by one country to another so as to achieve its intended objective. It can either be economic, technical, military among others.

11.2.1.2: Forms of foreign aid.

- **Capital** which may include money and machines.
- **Consumer goods** like clothes, food among others that are needed in times of disaster.
- **Military aid** i.e. military hardware.
- **Education facilities** like text books and scholarships.
- **Grants,** these are resource transfers that do not require any repayment.
- **Loans.** These are resource transfers that must be paid back with or without interest. There are two types of loans.
  - **a. Soft loans.** These are given with a long grace period, long repayment period and a very low or no interest at all.
  - **b. Hard loan.** This type of a loan attracts a high interest rate, a very short or no grace period and a very short repayment period.
  - **Direct foreign investment.** These are resource transfers by foreign business people in form of business companies or investments.
  - **Man power aid.** These are resource transfers to developing countries in form of high-level qualified personnel like teachers, economists, technicians, doctors, researchers etc.
  - **Medical aid.** This is extended to developing countries in form of drugs, medical research, and construction of health centers to improve upon the health of people.
  - **Tied aid.** This is extended to the recipient country with strings attached. It is sent to serve a specified purse and sometimes in a specified place.
  - **Multilateral aid.** This is aid from multilateral companies and international agencies. Major multilateral donors are; USAID, UN, I.M.F, world bank among others
  - **Bilateral aid.** This is a government to government aid. One country giving aid to the other, major bilateral donors are; Great Britain, U.S.A, China.

11.2.2: NEED FOR FOREIGN AID.

1. **To close the domestic savings-investment gap** due to lower savings relative to desired investment.

2. **To reduce the tax burden on their citizens**, this keeps them with enough disposable income, increase their purchasing power hence improved living standards in the economy generally.
3. **To increase domestic productivity** through growth of skills and provision of high wages.
4. **To accelerate industrial growth** by providing both initial and running capital
5. **To close the forex gap** due to low export base.
6. **To facilitate development and expansion of domestic infrastructure** e.g. transport and communication facilities, power projects etc.
7. **To fund the budget deficits** e.g. seeking for soft loans and grants to supplement domestic revenue. This increases a country's resources and helps in meeting its deficits especially in the national budget.
8. **To relieve the country of effects of disasters** by seeking for relief materials for the people displaced or affected by such disasters / calamities like famine, landslides earth quakes and floods which normally leave nations in a helpless state. Thus, countries seek foreign aid to help regain their stand.
9. **To close the skilled manpower gap** because of the low education and training through aid in form of technical assistance. The skilled manpower that is inadequate in developing countries alongside its need is covered by the manpower aid from developed nations.
10. **To close the technology gap** in developing countries through technological transfer; aid in form of machines and other equipment to developing countries improves upon quality of output and production methods so developing countries.
11. **To provide employment opportunities to people in developing countries**. If aid is directly invested, it employs people of developing countries and indirectly to people who supply to the investments put up.
12. **To close the foreign exchange gap in developing countries**. Financial aid extended to developing countries in form of foreign currencies increases foreign exchange reserves in developing countries hence developing theireconomies.
13. **To increase availability of commodities to the citizens of their country**. E.g. aid in form of consumer and capital goods.
14. **To strengthen international relations** since foreign aid may help keep good political ties with others.

11.2.3: Problems of relying on foreign aid.

1. It worsens the debt servicing problem; loans contracted must be paid back and on several occasions with interest, this drains the national resources and denies nationals essentials.
2. There is high balance of payment deficit. The high out flow of resources to pay back loans and service them worsens the balance of payment position of the country.
3. Sometimes the technological aid given is inappropriate, it may be too under developed or beyond the standards of developing countries, so it may just be wasted.

4. Sometimes the pre-conditions set for foreign aid are disastrous for the country. Countries may be forced to devalue their currency, retrench workers or even accept anti-social inhuman acts like homosexuality in order to receive their aid.

5. Tied foreign aid is sometimes tied to unproductive projects like digging boreholes in rural areas, financing wars. This brings difficulty in paying back since such projects do not bring monetary returns.

6. The political strings tied to the aid sent ruins the country its independence. Sometimes nations are forced to vote democratically which they are not ready for or even change leaders.

7. Foreign aid slows down initiative and hard work. Citizens of developing countries become lazy expecting to live on aid.

8. Foreign aid erodes the social and cultural values of nationals. They tend to adopt the cultures of the donor whom they normally take as their role model.

9. Foreign aid distorts planning of developing countries. This is because it normally comes in bits and normally it's not completed or even sent as promised.

10. Foreign aid reduces local production as people expect to live on foreign sent goods. This retard economic growth of nations.

11.3.0: Infrastructure and economic development.

Infrastructure can broadly be defined as long-term physical and structural elements/assets of the economy that facilitate the provision of goods and services that are geared towards development of the country.

Social Infrastructure is a subset of the infrastructure sector that includes assets that accommodate social services and improve the welfare of the population.

Or

It is the combination of basic facilities which are necessary for human development. Examples of social infrastructure assets include schools, universities, hospitals, prisons and community housing.

Economic infrastructure refer to internal facilities of a country that make business activity possible, such as communication, transportation, and distribution networks, financial institutions and markets, and energy supply.

Examples of infrastructure by sector

Sector	Examples
Health	• Medical facilities • Ancillary infrastructure eg offices, car parks, training facilities
Education	• Schools ie primary and secondary • Tertiary facilities • Residential student accommodation

Housing	• State or council housing • Defense force housing
Civil and utilities	• Community and sport facilities • Local government facilities • Water and waste water treatment plants
Transport	- Bus stations - Parks and rides. - Roads , airports etc
Corrections and justice	- Prisons

11.3.2: Role of infrastructure in economic development

1. It provides services that are part of the **consumption bundle** of residents.

2. Roads and other transport infrastructures **facilitate production** by easing the movement of inputs from their sources to the firms and output from the firms to the market.

3. Large - scale expenditures for public works **increase aggregate demand** and provide short-run stimulus to the economy

4. **It serves as an input into private sector production**, thus augmenting output and productivity

5. Education is a very important **source of economic growth** as the Denison study shows. Even though education may be a social investment, it is also an economic investment since it enhances the stock of human capital.

6. Health, like education, is a very important argument in the socio- economic production function. A popular saying is that '**a sound mind usually resides in a healthy body'**. Health is one of the major determinants of **labour productivity and efficiency**.

7. Investment in infrastructure is often considered as one of the **most effective tools for fighting poverty.**

8. Access to infrastructure is essential for **improving economic opportunities and decreasing inequality**. For example, adequate transportation networks in developing countries could give the poor better access to schools, hospitals, and centers of commerce, which in turn would improve the education, health, and entrepreneurial opportunities that strengthen a country's economic potential.

9. Housing enables people to have **a peace mind and thus also improves their standards of living and livelihoods.**

10. Sport facilities are used for co-curricular activities that enable to have a disease free body. A healthy body is a health mind as the saying goes, these facilities improve on the life expectancy of the people

11. Prisons as part of correction centers and the justice help to educate and bring right the people who may have created offences. They also educate the prisoners and they come out changed

12. Bus stations, car parks, rides and communication centers help to **connect people through transit.** They aid in communication and linking of the people to other areas

END OF UNIT ASSESSMENT:

1. a) Describe why education is regarded as:
   i) An investment
   ii) A consumer good.
   b) How has education solved the problem of underdevelopment in Rwanda?
2. Explain why countries find it beneficial to give assistance to other?
3. "Without infrastructure in a country like Rwanda, there is no development" support the above statement.

UNIT 12: ECONOMIC PLANNING

12.1.1 Economic planning refers to government attempt to direct, influence and control economic activities and resource allocation to achieve economic objectives such as; increasing the level of employment opportunities**,** increasing production**,** increasing investments.

Development planning refers to government attempt to influence and direct activities and choices to achieve economic, social and political objectives such as; reducing poverty levels, reducing income inequalities, maintaining sustainable growth and ensuring good and stable governance.

12.1.2. Rationale for planning.

1. For optimum allocation of resources in the economy so as to eliminate imbalances in resource allocation.

2. Helps the economy in **mobilizing funds from international organizations** like IMF, World bank etc since they give funds according to the plans made.
3. Helps to **remove price instabilities** and attain a favorable balance of payment equilibrium
4. **To eradicate the defects of price mechanism**; the automatic forces of demand and supply sometimes show weaknesses in efficiently allocating resources in an economy; these weaknesses are ironed out by development planning.
5. Plans are needed to bring up a **balance between the private and the public sector**, plans show the relative importance of each sector and so appropriate measures are taken to support the more desired sector.
6. To attain **a higher level of economic growth and development**, plans are made to set up the required infrastructure to attain and increase the rate of economic growth and development.
7. **Plans are a pre-requisite for getting foreign assistance**. Developing countries persistently draw deficit budgets, the deficit is to be obtained from donors, and these require well-made plans to release resources.
8. **To reduce dependence on other nations**, plans are drawn to for developing countries to move away from dependence to self-sustenance.
9. **To fight hyper rated of inflation**; developing nations draw plans to devise means to moderate the rate inflation and attain economic stability.
10. **To eradicate the unemployment problem** this is so rampant in developing countries.

12.2.1. Principles of planning.

1. **Consistence.** A good plan must be consistent and avoid any contradictions in the economy. The techniques and the objectives to be achieved must be followed.

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2. **Proportionality**. A good plan must be proportional whereby it must be on regional level than concentrating on a small area.
3. **Compatibility**. A good plan should be able to use the available raw materials. Planners should base on the available resources.
4. **Sequencing**. This principle involves putting in place minor projects to facilitate the major ones.
5. **Relevance**. A good plan should be in line to achieve the intended goals and objectives because this makes it socially important.
6. **Feasibility**. A good plan should be politically and administratively achievable so as to make its implementation easy.
7. **Optimality**. Planners should take into account the resources available and plan to exploit them in the most efficient way.
8. **Comprehensiveness**. A good plan should cover the whole economy because of the linkages among the sectors. This is because a partial plan may bring about imbalances in economy that may retard development.

12.2.2: Qualities of a good development plan

A good plan is characterized by the following:

4. It should be as **comprehensive** as possible. It should cover practically all the sectors of the economy. It should cover both the rural and urban areas.
5. It should combine **top-down and bottom-up planning approaches** through an intensive dialogue between the national,regional and local development agencies between the various levels of planning — national, regional, district and lower local governments.
6. A development plan should be **socially relevant,** and it must involve the people in a development effort.
7. A development plan must be **economically feasible.** The resources to implement the plan must be available.

8. A development plan must be **politically and administratively possible**. It must be accepted by political leaders otherwise it might never be implemented.

12.3: CLASSIFICATION OF PLANS

12.3.1 Classification of plans according to time element:

(a) Short term planning

This is when plans are made to cover a short period of time between 1-3 years.

(b) Medium term planning

This is when plans are made to cover a period of about 5-7years.

(b) Long term planning (perspective planning).

This is when plans are made to cover a long period of time beyond 10 years and can even be over tens of years

12.3.2 Classification of according to coverage.

(a) Comprehensive planning (macroeconomic planning)

This is when plans are made to cover **all sectors** of the economy like Agricultural sector, Industrial sector, Service sector, Public sector, Private sector etc

Merits of comprehensive planning

1. It **allows economic growth to move hand in hand with economic development** since plans are for the development of the economy as a whole.
2. **It Caters for the problems that may be going on in the economy at a particular** period of time such as unemployment, poverty, and inflation among others.
3. **It Leads to full utilization of resources** because the government plans for all sectors.
4. **It Increases government revenue** because when all sectors are planned for the government revenue increase through taxes.
5. **It reduces balance of payment problems** because when all sectors are planned for, exports may increase and imports will reduce.
6. **It reduces regional inequality** when all sectors are planned for; they all develop at the same level.
7. **It encourages economic growth** to move hand in hand with economic development when all sectors are developed. i.e. there is improvement in people's standards of living.
8. **It Encourages inter dependence** between different sectors when they are all planned for and developed which later increases the rate of economic growth.

Demerits of comprehensive planning

1. **They are expensive to administer and monitor**; it requires adequate amount of funds to scatter in all sectors being developed at the same time which funds are not readily available in developing countries.
2. **Developing countries have a limited supply** of the skilled personnel that can be everywhere at the same time to monitor the different sectors growing at the same time.
3. **Comprehensive plans give rise to inflation in short run**. This is because much money is set into circulation at the same time to see a comprehensive plan succeed.
4. **Comprehensive planning may bring distortions in the major national objectives** since a single plan covering the whole country may be hard to implement.
5. **It is hard to give rise to a single plan** that answers the needs of different groups and regions of people at different development levels. This makes comprehensive planning hard.

(b) Partial planning/fragmentary plan/micro plan:

These are plans drawn to cover only part of the economy. It may be only a region or may be drawn just for a sector.

Advantages of partial planning

1. **Cheap and easy to administer** because it economizes the use of skilled man power which is a problem in LDCs.

2. **Allows planners to concentrate on a few vital sectors** which they can develop successfully and achieve economic growth.

3. **Develops skills of planners** which they can use to take more comprehensive plans.

4. **Cheap to manage,** it doesn't require a lot of capital. Therefore, it is easy to manage and implement because it is in the financial reach of the country.

5**. Requires less data** which can be got easily since it covers a small sector.

6. **Suitable** because of wide difference in the level of development between regions

7. Helps in development of the leading sectors first and then other sectors follow because it covers only few or one sector and in case of Political instabilities in some countries make it a good idea to develop some areas first and others follow later.

Disadvantages of partial planning

1. Leads to wastage of resources because of many un coordinated plan

2. Leads to unbalanced development in the economy when the government plans only one or few sectors.

3. **Leads to underutilization of resources** when the government plans to develop few or one sector since some area are not planed and catered for.

4. **Leads to unemployment** when only one or few sectors are developed which inurn reduces people's standards of living.

5**. Leads to balance of payment problems** because if only one or few sectors are developed export will be less and more will be imported.

6. **Causes inflation** because when the government plans to develop one or few sectors this leads to low production output.

7. **Leads to wastage of resources** because the government may use a lot of resources to plan for only few sectors yet the same resources can be used for many other sectors.

12.3.3 Classification according to hierarchy of planning

1. Project plan. This is a plan designed to guide the control and execution of a given project in a particular sector.

2. Sectoral plan. This is when plans are made to cover **one sector** of the economy e.g if plans are made to cover the agricultural sector alone. An example can be **Plan for** Modernization of Agriculture - PMA

3. National economic plan. This is a plan for the whole nation which has to be consistent with the national resources.

4. Regional plan. This is a plan which integrates all activities, programs and projects within the region aimed at attaining national objectives.

12.3.4. Classification according to system of implementation..

(a) Indicative planning

This is where the government indirectly influences economic activities and choices through a set of fiscal and monetary policies. Its used in market economies.

Or

It is a situation where the government prepares a plan and provides information to the private sector (communities) to implement it without influencing their decisions directly.

(b) **Imperative plan**. This is a plan prepared and implemented by the central authority in consultation with various organs, offices and agencies.

12.3.5. Classification according to economic systems.

(a) Decentralised planning (Bottom-to-Top)

This is when plans are made from the lower level administrative units ie from grassroots following national objectives e.g each district makes its own development plan depending on its resources and requirements.

Merits of Decentralized planning

1. It **favours local priorities and interests**. Each regional has its own resources, requirements and priorities. Thus plans will be made according to each region's individual requirements.
2. It **takes care of and utilizes local resources**. This make it consistent with each region's resources.
3. It encourages **people participation**. The lower level administrative units are involved in plan formulation. This creates a sense of ownership and makes implementation easier.
4. It gives the **local people a chance to manage their destiny** using local resources.
5. It is suitable where the country is **geographically so large.**
6. It is **cheap, quick and direct to addressing people's needs**. This is because people are involved in addressing their problems using their resources.
7. It **reduces the responsibility of the central government**. This gives it ample time and resources to attend to other crucial services.

Demerits of Decentralized planning

1. Lack of planning skills at local levels. Most regions may not have the necessary skills required to design good economic plans.

2. It may lead to **duplication of services** and activities in different areas

3. Local objectives may **diverge from national objectives**

3. Uneven distribution of resources in different areas may lead to imbalances

4. The **central government may relax** knowing local areas cater for themselves

5. It puts **more pressure** on local governments

(b) **Centralized planning (Top-to-Bottom).**

This is when plans are made at the national level and the lower level administrative units implement them.

Advantages of centralized planning

1. **Leads to balanced regional development** because when the government plans all regions are considered.
2. **Helps to solve the problems of inflation** because when the government plans for all sectors; the levels of production increase which reduces inflation levels.

3. **The plans drawn are for high-level development of the nation**. So it collects all the skilled labour in the nation for its formulation and implementation.
4. **They are always consistent with national development objectives**. They are consciously drawn and cannot divert from national set targets.
5. They are flexible; they can be changes according to variations in national goals.

Disadvantages of centralized planning

1. The interests of some areas **may not be considered when the government plans** for the economy at once.
2. **Leads urbanization plus its negative effects** because in most government plans more emphasis is put on urban areas and then neglect rural areas.
3. **Expensive in terms of data collection and also implementation** because for the government to plan for all sectors require a lot of capital which is always lacking in most LDCs
4. **Discourages self-initiatives** i.e. people may ignore the plan since they know that all responsibilities are in hands of the government.
5. A wide distance between the **planning body and the source of finances makes centralized planning hard.**
6. Developing countries have **a limited supply of skilled personnel** needed to implement such plans.

12.4 Obstacles faced in formulation and implementation of development plans

1. Over ambitious plans. Most of the plans try to achieve many objectives at once and in the end they fail to accomplish them.

2. Insufficient and unreliable data. Data in some countries is difficult to get and sometimes unreliable and this makes planning difficult.

3. Unexpected social and economic disturbances. These may be internal such as agricultural hazards like pests or external instabilities all making the planning and implementation difficult.

4. Institutional weaknesses. The planning machinery may be separated from day to day decision making, inadequate communication about the goals and objectives may hinder implementation.

5. Lack of political will. Most people lack commitment and a sense of nationalism which hinders the national planning system of the country.

6. Inadequate resources. Plans always remain on paper because of failure to mobilize resources both from within and outside.

7. Inadequate qualified man power. Most developing countries lack qualified man power and most of their plans are made by outsiders who know little about the economic situations in these countries.

8. Political instabilities and constant change of governments. These affect the already made plans because each new government has got its own plan for development. Still the funds which would be for plan implementation are directed towards buying military hard ware.

9. Poor sequencing. In LDCs there is lack of funds to put up micro/ small projects which can lead to bigger plans. This leads to failure of the bigger plans.

10.Corruption and embezzlement. Most plans have failed because of high levels of corruption in which most of the funds are directed to peoples' selfish interest.

UNIT 13: SECTORS OF THE RWANDAN ECONOMY:

Structure of an economy is a range of characteristics or features that describe the economy of a country. These features range all the way from agriculture, industry, service that may be private or public. These sectors have each contributed the gross domestic product and greatly contributed towards the development of the country.

Sectors of the Rwandan economy

(i) The informal sector.

(ii) The public sector.

(iii)The private sector.

13.1.1 Informal sector

Informal sector is an intermediate sector existing between the traditional and the modern sector comprised of the self-employed. Informal sector is part of the economy which is not accounted for through payment of taxes and also is not monitored through any form of government and authority.

In Rwanda, people employed in the local informal sector include street vendors, hawkers, street vendors, hawkers, taxi operators, tax washers, bicycle riders and motorcyclists, charcoal sellers, domestic workers, carpenters, ironsmiths, hairdressers and barbers, brick layers, restaurants, and workers in tea plantations and mines, unregistered service providers, among others.

Characteristics of informal sector

1. Mainly produce on **small scale** because of the low capital employed.

2. Mainly **use poor or simple technology** since they cannot acquire modern developed machines

3. Produce mainly **low-quality goods** since the machines they possess cannot produce good quality output

4. Keep poor or no records mainly because they are done on small scale

5. Basically, **sole proprietorship** meaning they are owned by single individuals and most owned by families

6. Dominated by **semi-skilled or unskilled personnel**

7.Use basically **local resources** that are provided naturally

8. Basically, produce for the **local market** since they cannot produce to feed the entire external market.

9. Business operated in **open and semi-permanent structures** that can easily be demolished and the business transferred to another location.

13.1.1.2. Advantages of informal sector

1. Creates employment opportunities since it is labour intensive and this promotes income distribution.

2. Produce essential goods that are beneficial to low income earners.

3. Provide training grounds for growth of entrepreneurs.

4. Provide revenue to the government through taxation of the business activities.

5. Their growth paves way for transformation into a modern dynamic sector.

6. Promotes development of appropriate technology which suits the resources of the country.

7. Promotes linkages in production i.e. forward and backward and this leads to achievement of an integrated economy.

8. Promotes the spirit of self-sustenance there by reducing the prevailing dependence on simple consumer products.

9. Paves way for the development of small-scale industries through innovation and invention carried out.

10. Widens consumer choice since it produces a variety. This is because there are many producers working under the informal sector.

11. Promotes both local and international trade since they too, participate in productive activities alongside formal sector. For example, A survey commissioned by Trade Mark East Africa, Pro-femmes Twese Hamwe and International Alert on cross-border trade, shows that 82 per cent of the cross-border traders come from informal sector.

13.1.1.3. Disadvantages of informal sector.

1. Unexpected growth of the informal sector **would risk the stability of fiscal policy that depends on government revenue.** i.e. it Leads to public revenue instabilities since production cannot be relied upon and also high rate of tax avoidance and evasion.

2. Continuing growth of the informal sector **threatens the private sector that operates formally**. When the informal sector grows, it is a burden for firms in the formal private sector and they are the ones paying taxes providing government revenue.

3. Informal sector **distorts the natural competitive process** as firms operating in that sector enjoy an unfair cost advantage through tax avoidance.

4. Some informal firms **reduce their scale of operation** in order to remain undetected by the government which makes them less efficient.

5. Informal sector **drags the development process of a country** because it subsidizes employment in less productive activities.

6. Wasteful competition leading to **duplication of goods and services and wastage of resources.**

7. Pollution and its effects to the environment leading to degradation and hindering development.

8. Causes **congestion in the semi-urban areas** with its associated problems like prostitution, slums, theft etc

9. Leads to **underemployment and unemployment** hence labour capacity to produce goods is not fully put to use.

10. Produces at **excess capacity and end up exploiting consumers** through high prices.
11. Informal sector **limits informal employment, productivity**, and as consequence, economic growth is retarded.
12. Produce low quality goods and this leads to low standard of living of the people and low-income earnings
13. High administrative costs on the side of the government and this leads to increased government expenditure.

13.2: Public sector:

Public sector is part of the economy that is owned and operated by the government. The government owns and carries out the major economic decisions. Government enterprises include public corporations/enterprises which provide specific services for free or reduced prices, government parastatals which are nonprofit making and local authorities which provide essential services..

Rwanda, through *Rwanda Public Sector Law 19th October 2000***,** enacted a new law on public sector creating an independent body to regulate competition in the sector particularly telecommunications, water and electricity.

13.2.2: Characteristics of the public sector

1. Development oriented i.e. aims at developing the nation
2. Characterized by bureaucracy and red tape. This involves arrange of procedures so as to achieve what someone wants
3. Normally takes on projects which require large capital that cannot be taken up by the private sector
4.Medium and large-scale industries **dominate.**
5. Employs a large size of the population however with the present trend, its contribution is reducing
6. Normally organized on monopoly basis as it provides services which are vital to the people
7. High levels of external influence in decision making and implementation of the plans since foreigners fund the projects
8. Limited flexibility as it is for private sector in the production of goods and services

13.2.3. Advantages and disadvantages of the public sector.

Advantages of public sector.

1. The public sector **controls major and essential sectors of the economy** which are risky to put into private hands e.g power production, water and sanitation.
2. The public sector **mobilise finance to start large enterprises** that the private sector firms may not easily manage e.g construction of dams.
3. The public sector is essential in **establishing natural and state monopolies** that provide essential services that cannot be left under the private sector.
4. The public sector **controls strategic industries that are risky to be handled by the public sector**. For instance the security related industries.

5. Public sector firms **create employment opportunities in all regions and sectors**. This helps to reduce the level of inequalities in incomes, sectors and regions. Thus the public sector brings about a balance in regional and sectorial development.
6. Public sector **firms earn revenue for the government**. Some of them are profit making and so bring in income for the government.
7. The public sector **caters for long term need of the country**. It aims at national interest and development but not private interest.
8. The public sector **starts enterprises and sells them to the private sector**. This usually happens in areas where the private sector is slow to invest either because of the risks involved or less profitable.
9. The public sector **provides public goods/services like roads and street lighting** most which are non-profitable but essential to the population.
10. The public sector **caters for the future generations** by ensuring sustainable use of the available resources. It minimizes over exploitation of the country's resources. For instance REMA ensures the protection of the environment during the production process.
11.The public sector **regulates the production of commodities** that are taken to be vital to the society for instance medicine.

Disadvantages of the public sector.

1. Under the public sector there is **no consumer sovereignty**. Consumers do not have the power to determine what to producer i.e they can only purchase what is brought on the market.
2. There is **no variety of commodities** on the market. This is because resource allocation is in the hands of government organs only implying one or few producers.
3. There is an **element of monopoly**. This creates scarcity of commodities in the markets, leads to increase in prices, reduces competition and efficiency in production..
4. There is **production of low quality** output because of lack of competition due to monopoly tendencies in the public sector.
5.The public sector increases the **government responsibilities and expenditures.** This may become a burden to the government.
6. It is usually inefficient. This is because of lack of the profit motive in production to drive stimulate efficiency.
7. The public sector is usually dominated by **corrupt and embezzlement practices**. This is because of lack of close supervision.
8. Because of high government interference through selecting top management and constant change of officials among others management **may be inactive.**
9. The public sector is always **influenced by bureaucratic red tape** which slows down decision making and implementation.

13.2.4. Problems faced by the public sector.

1. Limited finance due to narrow tax base and this limits expansion
2. Corruption and embezzlement which has depleted funds which would be invested

3. Persistent inflation in the country increases the cost of production and amount of risks

4. Inadequate skilled man power due to poor man power training policy and this has led to dependence on foreign labour which is expensive

5. Foreign influence by external organizations like IMF and World Bank into the activities and dictating policies to be followed by the country

6. Poor management because of heavy government intervention through selecting top management and constant change of officials among others

7. Inadequate infrastructural facilities needed for development like road facilities, telecommunication among others limits coordination of different sectors

8. Bureaucratic red tape which slows down decision making and implementation

9. Sector runs a lot of objectives which conflict and in the end there is poor performance due to involvement in un productive enterprises

10. Limited market both domestic and foreign explains the poor performance of the manufacturing establishment

13.3: Private sector

13.3.1. Meaning of the private sector and its characteristics:

Private sector is an area of production activities that are not mainly owned by the government. It may include the informal sector, farmers, self-employed among others. The private is very active in a free market economy and mixed economic system as compared to the command economic system.

13.3.2. Characteristics of private sector.

1. It is mainly operated on a **small scale with some few large scale** but expanding enterprises.
2. The private sector is largely **dominated by individual producers** (sole traders) with some limited number of joint stock enterprises.
3. It is characterized by **high levels of competition** because of the large number of practitioners.
4. It is largely driven by the **profit motive**.
5. It mainly produces **consumer goods and a few producer goods**.
6. It largely uses **labour intensive techniques of production** in the small scale enterprises which dominates the sector.
7. It is mainly **active in urban centers than rural areas** because of the ready market.
8. The sector is still **small but expanding**.

13.3.3. Advantages of the private sector.

1. Employ majority of the people hence reduce unemployment and this increases incomes and standard of living

2. Produces goods and services hence contributing greatly to national income after the sale of the goods

3. Promotes gradual growth of the economy since it stimulates entrepreneurship which leads to discovery of new techniques of production

4. Contributes to growth and modernization of industry in the country through mobilizing of private savings, stimulating consumption and investment

5. Helps exploiting the local resources hence reducing excess capacity that exploits consumers through high prices

6. Uses local resources hence reducing foreign expenditure or resources and raw materials

7. Contributes to government revenue through taxation of the people, structures and also then profits of the business.

8. Sector re-invests (ploughs back) profits hence expanding the existing productive capacity which increases economic growth and the size of the national income.

9.Technological development is enhanced as the sector is innovative and adopts new techniques to suit the changing consumer tastes.

10. Helps to reduce the subsistence sector by monetarizing of majority of the economy.

11. Infrastructure development because of its tremendous expansion and this further leads to the development of the country.

Disadvantages of private sector.

1. Mostly located in urban centers hence cause rural urban migration with its associated problems like theft, prostitution and slum development among others which retards development

2. Tendency of using capital intensive techniques to increase production leads to unemployment with its associated problems like poor standards of living to mention but a few

3. Tends to specialize in few activities leading to consumer exploitation in form of high prices since sometimes they become monopolies with no competition

4. Concentrates on small scale production activities and this may not enable it to generate adequate economies of scale

5. The use of rudimentary/ outdated technology limits production hence little output for the growth of the growth of the country

6. The sector is profit motivated hence it may not provide services that are good for the society but nonprofit making

7. Capital outflow may occur if the productive ventures are owned by foreigners and thus the country may lose foreign exchange.

8. Limited levels of diversification due to production of similar commodities hence the consumers do not get a variety

9. Production of low quality goods which may fetch little when exported hence low foreign exchange

10. Income inequalities may arise where a few people get engaged in such activities and this may create tension in society and underdevelopment of some regions

13.3.4. Challenges of the private sector.

1. Under developed infrastructure like roads limits their movement of inputs and output from their production sites to the markets. This sometimes cause losses to them

2. Inadequate market both within and outside. This is because of the low quality of the goods that are produced and worse still they produce similar goods that create surplus at the markets

3. Poor technology. The technology is still low and this has continuously led to low output and low revenues.

4. Competition. Most of them produce similar products hence calling for high advertisement costs which lead to increased cost of production. The inefficient firms are sometimes driven out of the business leading to unemployment

5. Low prices paid by the consumers. This is sometimes due to price legislation by the government. The firms earn low profits that don't enable them to develop.

6. Under developed structure for production. Some of the firms under the private sector don't have permanent markets so they don't have a developed structure of production. This has sometimes led to over production and wastage of resources

7. Inadequate capital for production. This is the major problem that the private sector faces. Some have few equipment that cannot enable them to get loans from the banks hence their businesses have constantly not constantly not changed from small scale to large scale.

8. Low levels of skills of the entrepreneurs which has led to low innovations and invention leading to low quality outputs and low profit.

9. Undeveloped capital and money markets. This limits the rate of mobilization of capital.

13.4. Privatization

13.4.1.Privatisation of public enterprises refers to transfer of ownership and control of government or state assets, firms and operations to private investors.

Or **Privatization** is the reduction of the role of the state in the national economy while at the same time increasing private ownership and private sector both local and foreign.

Or it refers to the transfer of production assets from state ownership to private ownership.

13.4.2. Forms of privatization

1. De- nationalization (divestiture): This involves the sale of all or part of the enterprise owned by the government to private people or the public. It may also take the form of,

i. **Total sale**
ii. **Joint venture** where the government enters into agreement with private firms and individuals
iii. Abandonment, winding up or **liquidation**.

2. Liberalization (De-regulation): This involves opening up entry into activities which were previously restricted to the public sector enterprises only by allowing private sector participation. This is meant to increase competition and good quality output.

3. Contracting out: This is where the provision of the good or service is transferred from the public to the private sector while the government retains the responsibility to supply the good or service. It takes the following forms.

a. **Franchising.** This is the right to market on behalf of the government

b. **Contract management.** Here the government owns the property but gives out management like maintenance, providing goods and services among others

c. **Leasing or renting.** Here the government contracts the private sector to provide part of the service or to use/ rent its assets.

4. Cost sharing: This is where the government retains ownership of the enterprises but the beneficiaries contribute to the running costs e.g in schools and universities where the government pays part of the fees and the students pay the rest.

13.4.3. Advantages of privatization

1. Increased efficiency in the privatized firms leading to good quality goods and services.

2. Increased output from the privatized firms because of improved efficiency.

3. Reduced corruption and financial mismanagement of the enterprises. This is because of close supervision by the owners of the enterprises.

4. Reduced burden from the state to concentrate on the production of essential services. It reduces the responsibility of the government to only strategic functions.

5. Increased revenue to the government realized from the sold enterprises.

6. Increased competition resulting into emergence of several firms providing services which had been monopolized by the state enterprises

7. Increased private sector confidence in the country. This encourages private investments and so encourages further growth of the economy.

8. Reduced government budgetary deficits by reducing government expenditures.

Disadvantages of privatization.

1. Increased resource outflow by the new owners of the enterprises through profit repatriation. This occurs when the privatized enterprises are taken over by foreign firms.

2. The government loses property through transactions with **dubious businessmen who don't pay but spoil the property.**

3. Increased debts to the government because a lot of money is borrowed to fund the process yet little may be realized after selling.

4. Domination of foreign businesses in the economy as the domestic ones are reduced because of lack of enough funds to purchase the privatized firms.

5. Poor working conditions to the workers inform of low wages, longer hours of work, etc.

6. Environmental degradation through over exploitation of natural resources.

7. Associated with low levels of labour absorption in some sectors, underemployment and even reduction of local employment because they bring in foreign labour.

8. Over competition leads to use of non-price competition measures which include reduction in weight of goods like bread etc.

13.4.4: Limitations of privatization.

1. Corruption in the privatization unit i.e. some officials are not transparent and connive with prospective buyers

2. Opposition from the general public often delays the process of privatization.
3. Poor valuation of the enterprises leads to assets being sold at giveaway prices
4. Poor states of the enterprises due to poor maintenance making it hard to sale them
5. Political sabotage. Opposition leaders sometimes block the sale of enterprises just to frustrate the government and advance their causes
6. Poverty among the nationals makes the enterprises to be sold to foreigners leading to foreign domination in the country.
7. Small market discourages potential buyers due to limited potential for expansion
8. Political instability in some parts of the economy discourages potential investors from buying the enterprises.
9. Unscrupulous buyers. Some buyers who win the bids to buy the enterprises are not genuine and end up not paying after taking over the property.
10. Under developed capital markets. Government enterprises are sold under a capital market so its underdevelopment limits the potential buyers to access the enterprises.
11. Fear of nationalization

UNIT ASSESSMENT

1. Explain the role of the private sector in the growth of economies in developing countries.
2. (i) Distinguish between divestiture and cost sharing as forms of privatization.
   (ii) Describe the major problems faced by the government when transferring her enterprises to the private sector?
3. i) Under what sector of the economy do you classify charcoal sellers and salons?
   ii) Describe the contribution of the above sector to the development of the economy.

4.Explain the problems faced by the public sector in developing countries.

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