PUBLIC FINANCE AND FISCAL POLICY

Public finance is a branch of economics/macroeconomics concerned with raising of government revenue/income, its expenditure and the resultant effects on the economy.

It largely covers raising of public revenue through taxation, public borrowing etc, budgeting for the expenditure of the collected revenue, and expenditure of the revenue to achieve desired objectives in the economy.

The scope/branches of public finance.

1. Public revenue (especially taxation)

2. Public expenditure

3. Public debt/public borrowing

4. The national budget/financial administration

On the contrally, private finance is concerned with revenue/income and expenditure of private individuals and firms, or it is where private firms are contracted to provide funding, manage and complete projects for the major capital investments in an economy

Role of public finance in economic development

- It influences the level of investment; this is achieved by reducing indirect taxes which reduce cost of production and attract more investors.
- Raises public revenue; this is done by imposing various taxes, and non-tax sources of revenue.
- It controls the consumption of undesirable goods; this is achieved by raising taxes on such products to make them less affordable and thus discourage their consumption
- It controls inflation; this is achieved by increasing direct taxes to reduce disposable income and aggregate demand for goods and services in the economy

- Fights unemployment; this is achieved by providing incentives which lowers production costs and attracts investors, and thus create demand for labour in the economy
- Improves the balance of payment position; this is achieved by imposing high import duties to reduce importation and reduce the country's foreign exchange expenditure abroad
- It facilitates economic growth; this is achieved by lowering taxes which reduces production costs, encourages investment and hence higher levels of output.
- It protects infant domestic industries from foreign competition; this is achieved by imposing heavy taxes on imports to reduce their inflow.
- Controls monopoly power; this is achieved by increasing taxes on their abnormal profits.
- It reduces income inequality; this is achieved imposing progressive taxes where the rich are taxed at a higher rate than the poor.
- Promotes balanced regional development; this can be achieved by increasing public expenditure to set up infrastructure in the underdeveloped regions.
- Influences resource allocation. More and more resources tend to be allocated in sectors where lower taxes are imposed because of the reduced production costs

QUESTION

(a) What is meant by the term public finance? *(04 marks)*

(b) Explain the functions of public finance in an economy. *(16 marks)*

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FISCAL POLICY

This is a deliberate policy through which the government uses its revenue collection/taxation and expenditure programs to influence the level of economic activities in an economy

Types of fiscal policies

1. Expansionary fiscal policy; A policy through which government reduces taxes and increases its expenditure so as to increase the level of economic activities
2. Restrictive/contractionary fiscal policy; A policy through which government increases taxes and reduces its expenditure so as to reduce the level of economic activities

Tools/instruments of fiscal policy

These are the different measures related to revenue collection and spending that government uses to influence the level of economic activities in the economy
They include the following

- Taxation; Increase in taxes leads to an increase in the production costs which reduces investments and economic activities but a decrease in taxes increases economic activities
- Government expenditure; government increases its expenditure to encourage an activity and it reduces expenditure to discourage economic activity.
- Subsidisation; government offers subsidies to encourage activities through lowering the costs of production and denies subsidies to discourage economic activities
- Licensing; government restricts the issue of licences to discourage a certain economic activities and makes it easy to acquire licences for those activities it wants to encourage.
- Public borrowing; government borrows in order to support economic activities by injecting more money in the improvement of infrastructure which encourages investments and economic activities, while it reduce borrowing in case it wants to discourage economic activities.
- Debt repayment; government promotes economic activities by clearing internal debts because it increases the amount of money in circulation, which increases aggregate demand and investments.

Objectives of fiscal policy

- To promote economic growth; the government provides tax incentives to lower production costs and attract investors and hence increase output.
- To improve balance of payment position; the government will increase taxes on imports to reduce importation and thus reduce the country's foreign exchange expenditure abroad
- To protect infant domestic industries; the government can impose high import duties which reduce the inflow of imports and preserve the market for domestic firms.
- To reduce income inequality; the government introduces progressive taxation to redistribute incomes and wealth.
- To achieve balanced regional development; the government will increase public expenditure to set up infrastructure in the underdeveloped regions
- To create employment opportunities; the government will provide tax incentives to lower production costs and increase investment for employment creation
- To discourage consumption of harmful goods; government can impose high taxes on such goods to make them less affordable.
- To control inflation; government will increase direct taxes to lower disposable income and lower aggregate demand.
- To influence investment levels; the government can lower taxes on investments so as to reduce production costs and thus encourage more investments.
- To achieve desirable political objectives; the government will increase expenditure on social services in order to win public support.
- To raise public revenue; the government can introduce new taxes and non-tax sources of revenue to increase government revenue.
- To control monopoly; the government can impose higher taxes on the abnormal profits of the monopolists .
- To influence resource allocation, More and more resources tend to be allocated in sectors where lower taxes are imposed because of the reduced production costs
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Question

(a) Explain the tools of fiscal policy used in Uganda (08 marks)

(b) Discuss the factors that limit effectiveness of fiscal policy in Uganda

(12 marks)

Public revenue

This refers to the income of government from the different sources

The need for public revenue

- To provide security/maintain political stability
- To ensure balanced regional growth
- To finance public administration costs
- To improve infrastructure
- To alleviate the effects of disasters
- To service and repay public debts
- To promote economic growth
- To finance programs for creation of employment and poverty alleviation

Sources of public revenue

(a) Tax sources of revenue; These involve imposing of taxes by the government on incomes, property or goods and services

(b) Non-tax sources of revenue; These include all the other sources of government revenue other than the taxes

- *Taxes*; These are compulsory payments levied y a public authority on incomes, property, or goods and services irrespective of the amount of services to be rendered in return (thus they are non-quid-pro-quo payments)
- *Fees*; these are payments made by individuals to public authorities for services rendered to them by the state e.g. valuing property and passport fees.
- *Fines and penalties*; these are payments made by individuals for contravening the laws of a country e.g. fines for traffic offences.
- *Donations and grants*; these are voluntary contributions made to the government
- *Market dues*; these are payments made by individuals to public authorities so as to get permission to sell one's products in a market place.
- *Public borrowing*; the government acquires loans either internally or externally
- *Gambling*; the government organises national lotteries where the public buys tickets to win gifts
- *Privatisation*; the government earns revenue from selling public enterprises and assets

- *Rent;* this is collected from people who hire government property e.g. houses, public halls etc.
- *Rates*; this is money charged by the government for use public utilities e.g. piped water
- *Licences*; the government imposes licence fees to people who want to secure permission to do business.eg. trading licences
- *Printing and issuance of currency*
- *Road toll/Bridge toll*; the government imposes charges on motorists who use the road/bridge.
- Proceeds from public enterprises; these are profits made by the public enterprises which add to government consolidated fund
- *Forfeitures;* These are properties that owners have failed to legally claim for within the time period prescribed by the law. such goods are auctioned and the proceeds go government as revenue
- *Special assessments*; These are imposed on particular individuals in particular areas for specific services provided to them
- *Royalties*; These are paid by particular individuals or firms for exploiting a given resource in a country eg minerals, sand etc

TAXATION

Taxation is the compulsory transfer of money from individuals or business entities to the government
or the imposing of compulsory payments by a public authority on incomes, property, or goods and services in a country

PRINCIPLES OF TAXATION/CANONS OF TAXATION

These are the rules that guide the government in assessment, collection and administration of taxes.

- Principle of equity/fairness; All taxpayers should bear the same burden due to payment of the tax
  - (a) Vertical equity; high income earners should pay money as tax compared to the low income earners
  - (b) Horizontal equity; individuals in the same income bracket should pay the same amount of money as tax
- Principle of certainty; the taxpayer should know the amount to pay, the time and where to pay.
- Principle of convenience; the tax should be collected at the time most favourable for the tax payer
- Principle of economy/efficiency; the cost of assessment and collection of a

tax should be low i.e. not exceeding 5% of the revenue realised.

- Principle of productivity; the tax imposed should not discourage effort, or investments so as to raise adequate revenue
- Principle of elasticity/flexibility; the tax imposed should be able to change with the changes in income.
- Principle of simplicity; the tax imposed should be easy to understand and calculate by both the tax collector and the tax payer.
- Principle of neutrality/impartiality; the tax should not discriminate among tax payers.
- Principle of diversity/comprehensiveness; the tax should have a wide range of activities/entities/tax bases on which to be imposed
- Principle of consistency; The tax should align with the national economic policies and objectives by facilitating the achievement of such objectives

Adam smith referred to the principles of taxation as canons of taxation especially the first four i.e Equity, Certainty, Convenience, and Economy

CHARACTERISTICS OF A GOOD TAX SYSTEM

These are the qualities or attributes a good tax system should possess in order to yield adequate tax revenue, these include;

- It should be comprehensive; a good tax system should have a wide tax base
- It should be simple; it should be easy to understand by both the tax payer and the tax collector
- It should be impartial; it should not discriminate among the tax payers
- It should be flexible/elastic; it should be adjustable according to prevailing economic conditions.
- It should be productive; it should be able to yield adequate government revenue without causing harmful effects to the taxpayer
- It should be economical/cheap; the cost of administration of the tax should low
- It should avoid double taxation; tax payers should not be taxed more than once on the same tax base.
- It should be certain; a tax payer should know the amount of tax, the time and where to pay
- It should be convenient; a tax should be collected at the time when the tax payer is ready to pay.
- It should be equitable/fair; high income earners should pay more tax than the low income earners

- It should be consistent; should be in line with the national economic policies and objectives

Questions

1) *Describe the characteristics of a good tax*
2) *Explain the principles of taxation in an economy*

ROLE OF TAXATION IN ECONOMIC DEVELOPMENT

The positive role/merits/importance/positive effects

- Generates government revenue; through imposing the taxes on goods and services(indirect taxes) as well as on incomes and property (Direct taxes)
- Reduces income inequality; by taxing the high income earners at a higher rate than the low income earners (progressive taxation)
- Protects infant domestic industries from foreign competition; high taxes on imports (import duties) discourage importation and as a result the domestic industries sell their products with minimum competition
- Improves the balance of payment position; by imposing heavy taxes on imports to reduce their inflow and reduce import expenditure
- Discourages production and consumption of undesirable goods; by imposing high taxes on such goods to make them less affordable such that consumers abandon them.
- Controls monopoly power; high taxes on their abnormal profits reduce their ability to dominate the market which reduces exploitation of consumers
- Influences resource allocation; high taxes discourage investment and resource allocation in certain activities through increasing production costs while lower taxes encourage investment and allocation of resources in other activities which are essential.
- Controls inflation; increase in direct taxes leads to a reduction in the disposable income and thus reduce aggregate demand.
- Controls dumping; high taxes on dumped goods lead to an increase their prices and make them less affordable and thus discourage the buying of such goods
- Encourages hard work; increase in taxes on goods and services (indirect taxes), lead to an increase in their prices and thus compel people to work harder to earn more money in order to cope with the rising cost of living.

Negative role of taxation/demerits/negative effects

- Discourages saving; this is because direct taxes reduce people's disposable

incomes which reduces their capacity to save.

- Encourages trade malpractices; high import duties encourage smuggling as importers avoid going through the proper customs posts so as to dodge paying high taxes.
- Leads to inflation; indirect taxes increase costs of production which compels producers to increase prices of goods.
- Discourages hard work; this is because as people work harder and earn more, the tax rate also increases in case of progressive taxes.
- Makes the government unpopular; this is because high taxes on income reduce people's welfare and thus they resent the government.
- Limits the volume and benefits of trade; high taxes reduce the profits of traders and some drop out of business.
- Leads to diversion of resources/misallocation of resources; this is because producers shift their capital from highly taxed activities which are more productive to less productive activities or non-productive activities which are less taxed.
- Reduces consumer welfare; high taxes on consumer goods increase their prices which discourage people from consuming goods and services
- Discourages investment; this is because indirect taxes increase the costs of production and reduce the profits which discourages the investors.

NB*;(i) for effects/merits and demerits "leads" can be used*

(ii) for importance/significance/uses, "used to" "helps" can be used

(iii) take note of when to use" it" or "they"

QUESTIONS

(1) How is taxation used as an instrument of economic control in Uganda?

(2) Assess the impact of taxation in an economy

(3) Explain the importance of taxes in an economy

(4) Why is there a need to impose taxes in an economy?

CLASSIFICATION OF TAXES/Types of taxes

There are two major classifications of taxes, and hence the types of taxes

(a) According to the proportion/percentage of income paid as tax (tax rate).Under this classification we have the following types of taxes
   - (i) Progressive taxes
   - (ii) Regressive taxes
   - (iii) Proportional taxes
   - (iv) Digressive taxes

(b) According to whether the incidence of the tax can be shifted or not,

under this classification we have

(i) Direct taxes
(ii) Indirect taxes

Other classifications are;

(c) According to how the tax is imposed (basing on the value or per unit of the commodity)
    (i) Advalorem taxes
    (ii) Specific taxes
(d) According to the boundary;
    (i) Domestic taxes (VAT, rental income tax, corporation tax, individual income tax etc)
    (ii) International taxes/customs taxes (VAT, excise duty, import duty, environmental levy etc)
(e) According to the authority of administration;
    (i) Taxes administered by the central government-URA(income tax, VAT, excise duty, import duty, export duty, environmental levy, infrastructural levy, rental income tax, etc in Uganda)
    (ii) Taxes administered by the local governments (property tax, local hotel tax, and local service tax, in Uganda)

Types of taxes according to the tax rate(proportion of income paid as tax)

(a) Proportional tax; this is tax whose rate remains constant for all levels of income

Proportional taxes are rarely imposed in both developing and developed countries because they limit government revenue, don't reduce income inequality and do not promote hard work.

(b) **Progressive tax**; this is a tax whose rate increases as the taxpayer's income increases e.g. PAYE

Effects of progressive tax

- It yields high tax revenue to the government.
- It promotes equitable distribution of income
- Improves the welfare of low income earners.
- It controls demand-pull inflation
- It discourages hard work

- Discourages investment (by the rich)
- Leads to resentment towards government by the rich
- Discourages savings (by the rich)
- Leads to tax evasion and avoidance by the rich

(c) Regressive tax; this is a tax whose rate reduces as the income of the tax payer increases.

Effects of a regressive tax

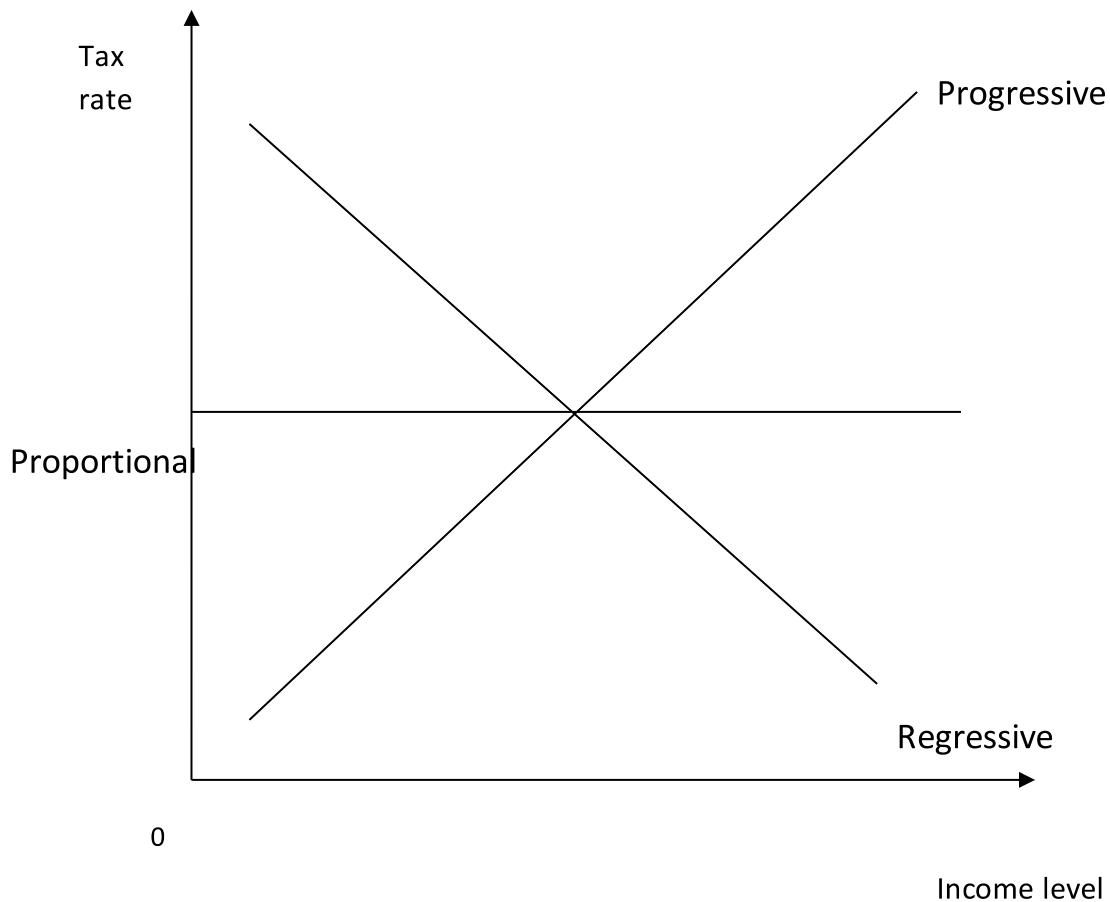
- Encourages hard work
- Encourages saving by the rich
- Encourages investment by the rich
- Widens income inequality
- Reduces welfare of the low income earners
- Limits government revenue
- Encourages tax evasion and tax avoidance(by the poor) (d**)Digressive**

tax; A tax whose rate increases as the income of the taxpayer increases up to a certain income level beyond which the rate remains constant despite increase in the income

Table showing proportional, progressive and regressive taxes

Income level (shs)	Tax rate (%)		
	Progressive tax	Proportional tax	Regressive tax
10,000	10	15	20
20,000	15	15	15
30,000	20	15	12
40,000	25	15	8

Illustration of progressive, proportional and regressive tax



Questions

(1) *Due to an increase in Okello's income from shillings 500,000 to shillings 800,000 , his tax liability increased from shillings 500 to shillings 800 Determine the nature of the tax and give a reason for your answer*
(show all working by first calculating the tax rates for before and after the increase in income)

(2) *(a)What is a progressive taxation system?*
(b)Determine the nature of the tax illustrated in the table below

INCOME(SHS)	*TAX RATE(%)*
100,000	*2*
200,000	*4*
300,000	*6*
400,000	*8*
500,000	*8*
600,000	*8*

Types of taxes according to whether the incidence of the tax can be shifted or not

(a) Direct taxes;

These are taxes levied on incomes and property of individuals and enterprises and their incidence cannot be shifted to another tax payer

Such taxes are always paid by the individuals or firms on which they are officially imposed

Examples of direct taxes

- Capital gains tax; this a tax levied on the earnings from financial assets whose values have increased from the time of their purchase to the time of sale.
- Corporation tax/company tax; this is a tax levied on profits of corporations/ companies.
- Income tax; this is tax imposed on the earnings of individual or business entities
- Pay as you earn; a tax imposed on employment income/salaries of individuals
- Inheritance tax; this is a tax imposed on individuals that have taken over ownership of the property of a deceased person
- Death/estate duty; a tax imposed on property of a deceased person before it is distributed
- Property tax; this a tax imposed on income derived from provision or use of a given fixed asset eg buildings, land (administered by local authorities in Uganda)
- Rental income tax; A tax imposed on earnings from letting out immovable property eg land, buildings etc (collected by URA in Uganda)
- Stamp duty; this is a tax imposed when there is transfer of property from one person to another.
- Local hotel tax; a tax imposed earnings of local hotel owners and paid to local authorities in Uganda
- Local service tax; a tax imposed on earnings or wealth of individuals in gainful employment
- Withholding tax; a tax deducted at the source of income by the person/entity effecting the payment eg for services of hired lawyers, auditors etc
- Surtax; a tax imposed on very high income levels that exceed a given level

- Capital level; a tax levied on individuals with wealth/resources that exceed a given minimum usually in national emergency situations
- Graduated tax; a tax imposed on members of the adult population basing on their incomes from employment and property. It excludes house wives and the armed personel.

Merits of direct taxes in the economy

- They generate public revenue.
- They promote equitable distribution of income.
- They control inflation.
- They control monopoly power
- They influence resource allocation/ investment

Demerits of direct taxes in the economy:

- They discourage investment
- They reduce the welfare of the people.
- They discourage hard work and effort
- They lead to resource diversion
- They make government unpopular/lead to resentment towards government
- They discourage savings
- They involve high costs of administration/collection
- They are inconvenient
- They are discriminative
- They are easy to evade

Question;(1) *Examine the effects of imposing direct taxes in an economy*

(2*) Outline for effects of corporation taxes in an economy*

(b)Indirect taxes

These are taxes that are levied on goods and services and their incidence can be shifted to another tax payer. They can also be referred to as outlays, hidden taxes, Consumption taxes, Expenditure taxes, commodity taxes. They are normally collected by the business people or intermediaries that remit them to the tax authorities

Indirect taxes can be imposed as

(i) Specific taxes; per unit of the tax base/commodity

(ii) Advalorem taxes; basing on the value/as a percentage of the value of the tax base/commodity

Examples of indirect taxes:

- Customs duty; this is a tax imposed on either imports (import duty) or exports (export duty)
- Excise duty; this is a tax imposed on locally produced goods.
- Octoroi tax; this is a tax imposed on goods in transit from one country to another.
- Sumptuary tax; this is a tax imposed to discourage consumption of some particular goods
- Sales tax; this is a tax imposed on the sale of goods and services
- Turn over tax; a tax imposed on the total sales made by a firm in a year
- Expenditure tax; a tax imposed on money spent on purchase of goods and services e,g commercial transactions levy (CTL) which is a tax imposed on money spent on services
- Environmental levy; A tax imposed on used imported motor vehicles, motor cycles, spare parts etc
- Infrastructural levy; a tax imposed on goods imported from countries outside the east African region aimed at maintaining infrastructure in the region
- Gaming and pool betting tax; a tax imposed on gaming and pool betting activities
- Over the top tax (OTT); a tax imposed on over the top services e.g air time, internet data e.t.c
- Value added tax; this is a tax imposed on the amount by which the value of an article has been increased at each stage of production

Merits of indirect taxes:

- They protect domestic infant industries
- They encourage hard work
- They discourage production and consumption of undesirable goods
- They influence resource allocation
- They improve balance of payments position.
- They contribute to public revenue.
- They control dumping
- They reduce dependence on other countries
- They protect the environment
- They are flexible

- They are comprehensive
- They are difficult to evade
- They are difficult to avoid
- They are convenient
- They are economical
- They are less resented
- They are neutral/don't discriminate among tax payers

Demerits of indirect taxes:

- They limit the volume and value of trade.
- They lead to income inequality.
- They reduce consumer welfare.
- They promote trade malpractices such as smuggling.
- They lead to cost-push inflation.
- They make government unpopular
- They discourage investment.
- They lead to misallocation of resources/ diversion of resources
- They lead to increase in costs of production
- They strain relationships between countries
- They lead to inefficiency within the domestic firms
- They result into traders unrests

Questions(1) Assess the implications of imposing indirect taxes in an economy

(N.B Not all merits and demerits are effects/implications)

(2) Explain why developing countries rely more on indirect taxes as a source of revenue

(3) Outline three effects of value added tax in Uganda

(4)(a)Distinguish between a specific and an advalorem tax

(b)Outline the demerits of levying a specific tax in Uganda

(c)Give two examples of specific taxes and two examples of advalorem taxes imposed in Uganda

THE IMPACT AND INCIDENCE OF A TAX

Impact of a tax refers to the person/firm on which the tax is officially imposed or the initial resting place of a tax

Incidence of a tax refers to the person who finally pays the tax or the final resting place of a tax

The impact and incidence of an indirect tax may fall on different entities because it is possible to shift the tax to another entity e.g from the seller to the buyer depending on (i) price elasticity of demand for the commodity

(ii)Price elasticity of supply of the commodity

Tax shifting—refers to the transfer of part or the whole tax form the original taxpayer to another.

Forward shifting of a tax—is where the tax imposed on a producer or seller is transferred to the buyers of the firm's products, by making them pay higher prices for those products.

Back ward shifting of a tax—is where the tax imposed on a firm/producer is transferred to the suppliers of the firm's inputs through paying them lower prices for those inputs.

Questions

(1)Determine the incidence of the tax if the demand for the commodity is price inelastic while supply is price elastic (use illustrations)

(2)(a) Distinguish between the real burden and money burden of a tax

(b) Explain and illustrate the effect of price elasticity of demand on tax incidence

Solution(to part b)

- *If demand is price elastic, the producer/seller pays a bigger portion of the tax*
- *If demand is price inelastic, the consumer/buyer pays a bigger portion of the tax*
- *If demand for the commodity is unit elastic, the tax is shared equally between the producer and the consumer*
- *If demand for the commodity is perfectly elastic, all the tax is paid by the producer*
- *If demand for the commodity is perfectly inelastic, all the tax will be paid by the consumer*

  (Draw the corresponding diagrams for each of the above categories of PED)

SUBSIDIES

A Subsidy is a grant / financial assistance by the government to the producer/consumer of a given commodity aimed at encouraging the production or consumption of that commodity.
The effect of a subsidy is the opposite to that of a tax, and hence a subsidy is sometimes called a negative tax.
Effects of a subsidy include:

- Reduction in the cost of production
- Increases the level of output.
- Increase consumption of the commodity/improves welfare
- Reduction in the price of the commodity.
- Leads to increase in investments
- Protects domestic industries from foreign competition
- Leads to high government expenditure

Like a tax, a subsidy extended to a producer can be shared between the producer and the consumer depending on the price elasticity of demand (and price elasticity of supply)
Question; Apply the concept of price elasticity of demand
(i)to subsidies
(ii)to tax incidence

IMPORTANT CONCEPTS RELATED TO TAXATION

Taxable capacity.
Refers to the extent to which a tax payer can pay the tax assessed on him and yet remain with enough disposable income to sustain the standard of living he/she is accustomed to.(taxable capacity of an individual)
or refers to the ability of a nation to raise the expected revenue through taxation without resulting into socially, economically and politically harmful effects (taxable capacity of a nation).

<u>Determinants of the taxable capacity in an economy</u>

- Political climate
- Level of development of infrastructure
- The rate of inflation

- Level of accountability among revenue officers
- Level of tax evasion and tax avoidance
- The popularity of government
- The population growth rate
- The degree of income inequality
- Level of monetisation
- Level of effectiveness of methods of tax collection used.
- Level of unemployment

Question; *(a) Account for the low taxable capacity in developing countries*
(b)suggest measures for increasing the taxable capacity in developing countries

Taxable income
Refers to the amount of income which is subject to taxation.
Taxable income = Gross income – allowable deductions

Disposable income; amount of income people are left with for consumption or saving after direct taxes and other compulsory contributions have been deducted

Tax base.
Refers to all items or entities on which a tax can be imposed /levied to raise revenue. It includes goods and services, incomes, investments, firms, economic activities e.t.c

<u>Determinants of the size of the tax base in an economy</u>

- The political climate
- Level of development of infrastructure
- Size of the subsistence sector
- Size of the industrial sector
- Level of diversification in the economy
- Level of tax concessions to investors
- Level of accountability
- Size of the informal/formal sector
- Income levels

- Level of investments
- Level of unemployment

Question; (a)Account for the narrow tax base in Uganda
(b)suggest measures that can be used to expand the tax base in Uganda

Tax avoidance.
This is where the tax payer exploits the loopholes or weaknesses in the tax system (or tax laws) and uses them not to pay tax or to pay less. Tax avoidance is legal and allowed e.g. refusing to buy a commodity on which a tax has been imposed , using of the profits made to buy more/better capital equipment so that there are less profits to tax

Question*;(1) Outline the causes of tax avoidance in Uganda*
(2)Outline the measures that can be used to reduce tax avoidance in Uganda

Tax evasion.
Refers to the deliberate refusal of a tax payer to pay the tax assessed/imposed on him/her (by use of illegal means). The tax payer uses illegal means of dodging or reducing the tax payable such as under-declaring the value of his goods, hiding from the tax collectors, and smuggling goods to avoid check points.

<u>Causes of tax evasion</u>

- Ignorance about the importance of paying taxes
- Corruption in the taxation system
- Inadequate services provided for the tax payers by government
- Desire to retain all incomes
- Weak tax administration(laxity, ineffective)
- Unfair tax assessment
- High tax rates
- Unpopularity of government/political sabotage
- Low incomes

<u>Measures for reducing tax evasion</u>

- Encourage fair tax assessment
- Sensitise the population about importance of paying taxes
- Fight corruption
- Encourage provision of services for the tax payers
- Strengthen the tax administration
- Strengthen/implement the tax laws

Tax rebate.
Refers to the amount refunded to a tax payer by the tax authority, if the tax payer had paid more than he was supposed to pay. OR refers to a tax reduction under special considerations.

Tax threshold
Refers to the minimum amount of money income that is subject to taxation

Taxation potential.
Refers to the measure of the nation's ability to raise revenue through taxation as determined by the country's productive resources and productive economic activities

Tax holiday. Refers to a period of time of non tax payment given by the government to investors

Average rate of a tax./tax rate
Refers to the proportion of income which is paid as tax.

Marginal rate of a tax.
Refers to the rate of taxation on extra unit of income earned.

Causes of low tax revenue

- High level of tax evasion; many tax payers out rightly dodge tax payment.
- High level of tax avoidance; the tax payers use loopholes in the tax law and they avoid buying taxed commodities.
- Limited skilled labour; this leads to poor identification of taxes and collection
- Low taxable capacity; majority of the people earn very low incomes and thus cannot pay taxes or contribute very little tax revenue
- Poor infrastructure; this limits accessibility to some areas by the tax authorities.

- Corruption; this leads to loss of revenue because tax collectors connive with the tax payers to under declare the goods for taxation
- Political instability; tax collectors cannot go to certain areas to assess and collect the tax for fear of losing their lives
- Resistance from the public against tax payer payment; potential tax payers organise demonstrations against certain taxes which intimidate the tax authorities and thus reduce the tax rates or even abandon some taxes.
- Narrow tax base; there are a limited range of items to tax due a large subsistence sector and other factors
- High costs of tax administration in form of paying salaries, allowances e.t.c to the tax officials which take a substantial portion of the collected revenue
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Question*; Examine the factors that influence the level of tax revenue in developing countries*

Measures being used to increase tax revenue

- Ensuring political stability
- Developing infrastructure
- Sensitising the population about importance of paying taxes
- Encouraging fair assessment in taxation
- Encouraging training off tax officials to equip them with skills
- Encouraging proper accountability among the tax officials
- Increasing provision of services for the tax payers/effective use of the tax revenue
- Developing a tax payer friendly system of taxation
- Encouraging strengthening and implementation of the tax laws
- Introducing new taxes
- Increasing the tax rates
- Widening the tax base

Challenges faced by tax authorities in Uganda

- High level of tax evasion. Many tax payers out rightly dodge tax payment and this limits tax revenue realised by the government.
- Limited skilled tax administrators/ Limited skilled manpower. Most tax officials are not properly trained on how to collect revenue without using brutal means. This makes tax payers to hate tax payments.

- Low taxable capacity. Many people have extremely low level of incomes that cannot be subjected to taxation while others due to their low level of incomes cannot pay taxes at all, this leads to low tax revenue collected.
- Poor infrastructure. Economic infrastructures in some parts of developing countries are very poor such as roads thereby limiting accessibility to tax sources hence low revenue collected.
- Corruption/low levels of accountability among officials of the tax authorities. This leads to high loss of revenue through poor assessment and misappropriation of funds hence limited revenue.
- Political instability in some parts of the country. Political instabilities scare tax collectors from collecting taxes and assessors due to fear of losing their lives which leads to low revenue..
- Narrow tax base. There are limited entities that are subject to taxation due to limited diversification of economic activities. Also the tax system isn't comprehensive to generate more revenue.
- Difficulty in identifying taxable sources or limited information about peoples' earnings. This is due to the fact that people do not want to reveal information concerning economic activities they engage in for fear of high taxation.
- Frequent changes in employment, contracts, and areas of residence. These make work of tax assessors and tax collectors complicated hence less revenue is realised.
- High level of tax avoidance. The tax payers use a variety of loopholes in the tax law to avoid tax payment. This is done by substituting taxed activities by non-taxed ones or by declaring imported manufactured goods as intermediate products to be used in the production process thereby avoiding payment of taxes.
- Political interference in the operations of tax authorities in the country. Some tax payers use their political positions to escape payment of taxes or to help friends and relatives to do the same
- Conflicting government objectives/policies. The government wants more tax revenue collected but at the same time exempts some individuals/entities
- Resistance from the public against tax payment. Potential tax payer organise demonstrations against certain taxes which intimidate the tax authorities and thus reduce the tax rates or abandon some taxes which limit government revenue.

Question;*(a) Describe the structure of Uganda's taxation system*

(b)What measures should the government adopt to improve the structure of Uganda's taxation system

TAX ADMINISTRATION, COMPLIANCE, AND COMPUTATIONS

(a)Tax administration

Tax administration is a mechanism of assessment, collection, enforcement of taxes and accounting for the tax revenue collected. In Uganda tax administration is a responsibility of Uganda Revenue Authority (URA) as mandated by the 1991 act of parliament

<u>Key stakeholders in Uganda's tax administration</u>

- Ministry of finance, planning and economic development; which is responsible for policy changes in taxation in Uganda for example when it comes to tax incentives, new taxes, tax rates e.t.c
- Tax payers ;since they are the ones that register businesses, file returns and pay the taxes
- Parliament ;which makes the tax laws
- Local government authorities and local councils; which collect taxes at the district, city council, municipal and town council levels
- Courts of law; such as the Tax Appeal Tribunal which settles disputes between tax payers and Uganda Revenue Authority
- Tax agents; which help taxpayers in filing returns, making declarations, tax accounting and auditing e.t.c
- Financial institutions; such as banks which collect, receive and account for the taxes from the tax payers
- Insurance companies; which provide guarantee for compensation to importers, clearing agents, bond operators for the goods I transit or compensation
- The central bank ;which safe keeps the revenue collected in the consolidated fund
- Government agencies such as the Uganda Registration Services bureau(URSB) and National Identification Registration Authority (NIRA) ;that manage the registration process of the tax payers
- International organisations such as the World Customs organisation (WCO) and World Trade Organisation (WTO) ;which issue guidelines taxation in international trade business

Role of Uganda Revenue Authority in tax administration

- It assess taxes to be paid
- Collects the taxes
- Accounts for the revenue collected
- Registers the taxpayers (by issuing tax identification numbers)
- Advises the Minister of finance, Planning and Economic Development on policy matters related to taxation
- Provides tax advisory services to enable tax payers comply through its contact centres, web portal, community outreach e.t.c
- Facilitates trade and investment through issuing tax clearance certificates, registration of tax agents, providing quality services that reduce the costs of doing business
- Provides relevant and accurate data to the different government agencies such as Uganda Bureau of Statistics (UBOS), Bank of Uganda and Uganda Investment Authority (UIA) for policy formulation and planning
- Provides tax education aimed at promoting tax compliance through stake holder engagements, the media, tax clinics, workshops, school interactions e.t.c

(b) Tax compliance

Tax compliance is defined as the degree to which the tax paying community meets its tax obligations in accordance with the legal and regulatory provisions Or the extent to which the tax payer conforms to the tax rules of the country e.g by declaring income, filing returns, paying the taxes due in a timely manner.

Elements of tax compliance

- *Registration*. This should be done in time and accurate information provided to the tax authorities (URA), After registration the tax payer/business is issued with a Tax Identification Number (TIN) which is a key identifier of the tax payer. A TIN is a unique ten degit identifying number allocated by URA to prospective tax payers to enable them meet their tax obligation
- *Filing returns*. This involves submitting of information about the business for the respective period on a prescribed form to URA for purposes of determining the tax payable
- *Declaration*. Correct and accurate information about the transactions should be provided and submitted to URA for further processing
- *Timely payment*. The correct amount of taxes should be paid in time

- *Record keeping*. Tax payers are required by law to keep records about their business transactions (e.g income and expenditure) for taxation purposes

Determinants of tax compliance

- *Level of the actual income*. Tax compliance increases with income because high income earner can afford to hire tax consultants to do for them the declaration, filing returns e.t.c
- *Nature of employment.* Tax payers employed by other firms/companies tend to be more compliant because for them the taxes are deducted at source unlike those that are self employed
- *The tax rates*. High tax rates lead to a low level of tax compliance and vice versa. Tax avoidance tends to increase as the tax rates increase
- *Availability of tax audit*. Absence of tax audit breeds non compliance but presence of tax audit increases the probability of detection which forces the tax payers to declare information about their transactions as required
- *Level of the fines for non- compliance*. A high level of fines force the tax payers to comply because the fear of the consequences but low level of fines lead to a low level of tax compliance
- *Availability of informants/informers*. Presence of motivated informants leads to a high level of tax compliance since the tax evaders fear to be caught but their absence leads to a low level of tax compliance
- *Level of tax education*. A high level of tax education leads to a high level of tax compliance as it creates awareness about the importance of paying taxes and the possible consequences of non- tax compliance
- *Degree of fairness of the tax system*. A low level of fairness in the tax system leads to a low level of tax compliance because some tax payers perceive that they bear a bigger tax burden than others
- *Level of customer care to the tax payers*. A high level of customer care leads to a high level of tax compliance eg where the taxpayers are treated in a respectful and responsible way
- *The degree of simplicity of the tax system*. The greater the degree of simplicity of the tax system the higher the level of tax compliance because its easy for the tax payers to understand the computations and the procedure to follow so as to be compliant
- *Level of motivation and rewards for those that are tax compliant*
- *Level of consistency in application of the tax laws*
- *Attitude towards taxation/tax payment*

Question;(a) Account for the low level of tax compliance in Uganda

(c)Suggest measures that can be adopted to increase the level of tax compliance in Uganda

Benefits of tax compliance

- Increases government revenue, people pay taxes willingly which reduces tax evasion
- Reduces the costs of tax administration, Due to reduction in the need for conducting audits, looking for tax defaulters, and prosecuting them
- Promotes continuity in business, due to reduction in instances of penalties on defaulters ,fines in the courts of law, imprisonment, all of which would otherwise bring the business to a stand still
- Eases facilitation of the business, compliant tax payers benefit from participating in bidding for contracts in government ministries and departments, getting work permit s ,accessing loans which are easily obtained when the business has a valid Tax Clearance Certificate

Forms of non-tax compliance

- *Smuggling*, this is the exportation or importation of goods through unofficial and illegal channels so as to dodge payment of the duties imposed
- *Under declaration*, this is where the business people deliberately understate the incomes/profits or goods so as to pay less or no taxes
- *Under valuation*, this is where trader assign lower values to the goods imported or exported in order to defraud government revenue
- *Falsification of documents*, this is the deliberate alteration of information on the prescribed documents for purposes of dodging taxes, e.g altering the year of manufacture of a vehicle
- *Non –filing of returns*
- *Failure to register for taxation*
- *Diversion of the transit of goods and export market of goods for purposes of not paying taxes*

Measures suggested to enhance tax compliance

- Use border controls, e.g surveillance and patrols, joint verification between countries e.t.c
- Make the tax system equitable/fair. E.g through adopting progressive taxation to ensure that the tax burden is equitably distributed to the tax payers

- Improve the quality of business management in terms of record keeping
- Popularise government/improve quality of governance in terms of accountability to encourage people to pay taxes
- Simplify the tax laws for the tax payers to understand them
- Ensure consistence in the way taxes are implemented
- Strengthen the tax administration
- Carry out regular audits
- Provide tax incentives
- Apply automation in tax assessment and collection
- Apply strict enforcement
- Encourage self- assessment, so as to encourage to enable the tax payers voluntarily comply as opposed to estimated assessment by the tax authorities
- License clearing and tax agents, to handle the affairs of the tax payers
- Recognise and reward the best tax payers
- Give amnesty/pardon the tax payers to enable them comply through voluntary declaration
- Interface with stake holders, through various engagements to share information
- Arrange instalment schemes, through signing memorandum of understanding with tax payers that have large outstanding tax liabilities to enable convenient settlement of tax arrears
- Encourage the whistle blower’s policy, which involves encouraging the public to provide information to URA regarding non-tax compliance for which they are rewarded and protected
- Encourage use of advanced technology e.g the surveillance cameras, electronic cargo tracking systems such as the GPS (Global positioning system)

Rights of the tax payer

These are the protections available to all tax payers

- The right to *equity*, in terms of the tax laws and procedures
- *Confidentiality*, information about the tax payers possessions shall be kept secret
- *Facilitation of tax compliance*, tax payers or their authorised agents shall be provided with clear and timely information to their enquiries and complaints
- *Attention to their objections and appeals*

- *The right to prior notices,* whenever their premises are to subjected to routine inspection and audit
- *Accountability*, URA shall maintain an updated data base of the tax payer's tax records
- *Tax refunds,* where they are due, URA shall process them within the prescribed time limits
- *Processing returns, customs entries and other documents*
- *Customer care*, URA always be courteous, accepting constructive criticism, complaints and advice from the taxpayer, and responding promptly

Obligations of the tax payer

- *Registration*, Tax payer should ensure that he/she voluntarily register with URA the obtain a Tax Identification Number (TIN) which is the transactions account with URA
- *Filing returns and entries*
- *Tax payment*
- *Cooperation with the authority*
- *Declaration/disclosure*, of all information eg the correct TIN, details of the transactions
- *Ensure that you complete all the necessary forms when travelling* such that the forms are ready on reaching the departure/processing point
- *Use services of licenced customs agents to complete customs entries and related clearance formalities when importing or exporting cargo*

TAX COMPUTATIONS

Important terms in computation of taxes

1)Taxable income (Chargeable income) for a person for a year of income;

this is the income of the person for the year less tax deductions allowed and any assessed losses carried forward from earlier income years.

)Gross income of a person for a year of income;

this is the total amount of business income, employment income and property income other than exempt income

3)Exempt income;

This is income not taxed by law

Chargeable income=Gross income –total deductions

Total deductions are the sum of expenditures and losses incurred by the taxpayer and allowed to be deducted from the taxpayer's gross income.

COMPUTATION OF DOMESTIC TAXES

Domestic taxes are those taxes imposed on activities or trade carried out internally such taxes include corporation tax, individual income tax, individual rental tax, withholding tax, individual presumptive tax etc.

a) Corporation tax;

This is a tax paid by companies and the rate applied is 30% for Uganda on chargeable income on both resident and non-resident companies.

Example 1:

Rk limited gross income for the year 2017 was shs 95,000,000 and his allowable expenses amounted to shs 60,000,000. Calculate his chargeable income and determine the amount of tax payable.

Solution:

Step 1 Determine the chargeable income

Chargeable income=Gross income-allowable expenses

Chargeable income=95,000,000-60,000,000=shs 35,000,000

Step 2 Compute tax payable

Tax payable=Chargeable income x corporation tax rate of 30%

Tax payable=35,000,000 x 30%=shs 10,500,000.

Therefore, RK is required to pay a corporation tax of shs 10,500,000 in the year of 2017

b) Individual income tax;

It is a tax paid by individuals on their incomes, this can be from business or employment. The rates applicable for business income are described below

Annual chargeable income	Tax Rate(bracket)
1. Not exceeding shs 2,820,000	Nil
2. Exceeding shs 2,820,000 but not exceeding shs 4,020,000	10% of the amount by which chargeable income exceeds shs 2,020,000.
3. Exceeding shs 4,020,000 but not exceeding 4,920,000	Shs 12,000 plus 20% of the amount by which chargeable income exceeds shs 4,020,000
4.Exceeding shs 4,920,000	(a)shs 300,000 plus 30% of the amount by which chargeable income exceeds shs 4,920,000 (b) Where the chargeable income of an individual exceeds shs 120,000,000 an additional 10% charged on the amount by which chargeable income exceeds shs 120,000,000.

Example 2.

Mr. Oakum's gross income for the year 2017 was UGX 75,000,000 and his allowable expenses amounted to UGX 50,000,000. Calculate his chargeable income.

Solution;

Step 1; determine chargeable income

chargeable income = Gross income- allowable expenses

Chargeable income = 75,000,000- 50,000,000

Shs. 25, 000, 000

Step 2: compute individual income tax payable

Tax payable = chargeable income X applicable tax rate

Note: Oakum's chargeable falls in the fourth category exceeding Shs. 4,920,000 and the applicable rate is 30% of the amount by which chargeable income exceeds Shs. 4,920,000 plus 300,000.

Tax payable=300,000+(25,000,000-4,920,000) x30%.

= 300,000+6,024,000= 6,324,000 shillings

c) **Employment income Tax (Pay As You Earn);**

It is collected on a monthly basis. It is paid at the time the employment income is being earned. The employers are required by law while making payment of the income in any month to withhold tax at the prescribed PAYE rates and pay the tax withheld by the 15Th day of the following month to URA.The tax is paid on both wages and allowances.

COMPUTATION of PAYE

Monthly Emoluments	Tax rate(Bracket)
1.Not exceeding shs.235,000	Nil
2.Exceeding shs.235,000 but not exceeding shs.335,000	10% of the amount by which chargeable income exceeds shs.335,000
3.Exceeding shs.335,000 but not exceeding shs.410,000	shs.10000 plus 30% of the amount by which chargeable income exceeds shs.410,000
4.Exceeding shs.410,000	(a) Shs. 25,000 plus 30% of the amount by which chargeable income exceeds Shs 410,000. (b) Where the chargeable income of an individual exceeds shs.10,000,000 an additional 10% charged on the amount by which chargeable income exceeds Shs 10,000,000

Example 1:

Kapere is employed as a security guard in Kacumbala (U) Ltd. He earns a monthly salary of Shs. 200,000. Compute Kapere's monthly tax liability**.**

Solution: The tax is nil because the monthly salary is less than the threshold, so his salary doesn't attract PAYE.

Example 2: Ewogu is an employee of Kapir Ltd. He earns the following monthly income: a salary of Shs 700,000, travelling allowance of Shs 200,000 and medical allowance of Shs 300,000. Compute his monthly PAYE tax liability

Solution.

Total income=Salary +Travelling allowance + Medical allowance Total

income=700,000+120,000+300,000=1,120,000.

Use rates in the fourth bracket i.e. exceeding shs 410, 000. (Shs 25,000 plus 30% of the amount by which chargeable income exceeds shs. 410,000.)
Total income exceeds shs 410,000

Step 1
Shs 1,120,000-410,000=710,000

Step 2
30% x 710,000=213,000

Step 3

25,000 +213,000=238,000

Example 3: Bamu is an employee of Kavesh Ltd. He earns the following monthly income: a salary of shs 7, 000, 000, travelling allowance of shs 1,200,000 and medical allowance of shs 3, 000, 000, security shs 500,000. Compute his monthly PAYE tax liability.

Solution

Salary	7,000,000
Travelling allowance	1,200,000
Medical Allowance	3,000,000
Security	500,000
Total	11,700,000

Use rates in the fourth bracket, i.e. exceeding shs 410,000. (shs 25,000 plus 30% of the amount by which chargeable income exceeds shs 410,000) Total income exceeds shs 410,000. Where the chargeable income of an individual exceeds shs 10,000,000 an additional 10% is charged on the amount by which chargeable income exceeds shs 10,000,000.

Step1: To find taxable income
Shs 11,700,000-410,000=11,290,000

Step 2

30% x 11,290,000=3,387,000

Step 3

25,000+3,387,000=3,412,000

Sep 4 (Additional income)

11,290,000-10,000,000=1,290,000**.**

Sep 5

10% of excess income
1,290,000 x 10%=129,000

Therefore, PAYE tax is 3,412,000+129,000=shs 3,541,000

(d) Presumptive tax; this is an income tax levied on small business tax payers whose gross turnover from all businesses for the year is between shillings 10-150 million. The taxes payable vary according to turnover, business location and business trade

Note.
Turnover is one's total sales for the year

Business location refers to the area of operation and registration of business e.g. City, Municipality and town councils.

Business trade refers to the nature of business operated e.g. general trade, restaurant, bars, hair and beauty salons etc.

A small business taxpayer for income tax purposes is a resident taxpayer whose gross turnover from all businesses owned by such a person in a year is above 10m but less than 150m shillings.
In the case of a taxpayer whose gross turnover exceeds 50m but doesn't exceed 150m shillings pays tax as per the schedule below;

GROSS TURNOVER	TAX PAYABLE
Gross turnover exceeds 50m but doesn't exceed 75m	Shs.937,000 or 1.5%of gross turnover whichever is lower
Gross turnover exceeds 75m but not exceeding 100m shillings	Shs.1, 312,500 or 1.5% of gross turnover whichever is lower.
Gross turnover exceeds 100m but not exceeding 125m shillings	Shs 1,687,500 or 1.5% of gross turnover whichever is lower
Gross turnover exceeds 125m but not exceeding 150m shillings	Shs 2,062,500 or 1.5% of gross turnover whichever is lower

Example:
Akuwa`s gross turnover for the year 2017 was shillings 11om.Compute her presumptive tax payable.

Solution
Either
110m shillings falls in the bracket (Gross turnover exceeds 100m but not exceeding 125m) the tax payable is 1.5% of 110m which is shs 1,650,000 since its lower than shs 1,687,500.

Or
Presumptive tax=Tax rate x Chargeable income

= 1.5% x 110,000,000

= Shs 1,650,000

NOTE: A taxpayer whose turnover is below shs50m pays tax depending on their location and nature of business as illustrated in the table below.

Traders in Kampala city and divisions of Kampala whose turnover exceeds 10m but doesn't exceed 50m pay the following amounts as tax.

Business trade	With turnover btn(shs35,000,000-50,000,000)	With turnover btn (20,000,000-35,000,000)	With turnover btn (10,000,000-20,000,000)
General trade	500,000	400,000	250,000
Carpentry/metal workshops	500,000	400,000	250,000
Garages/motor vehicle repairs	550,000	450,000	300,000
Hair and beauty salons	550,000	450,000	300,000
Restaurants and bars	550,000	450,000	300,000
Drug shops	500,000	350,000	100,000
Others	450,000	300,000	200,000

Traders in Municipalities whose turnover exceeds 10m shillings but doesn't exceed 50m pay the following amounts of tax.

Business trade	With turnover btn (shs 35,000,000-50,000,000)	With turnover btn (shs 20,000,000-35,000,000)	With turnover btn (shs 10,000,000-20,000,000)
General trade	400,000	300,000	150,000
Carpentry/metal workshop	400,000	300,000	150,000
Garages(motor	450,000	350,000	200,000

vehicle repair)			
Hair and beauty salons	450,000	350,000	200,000
Restaurants and bars	450,000	350,000	200,000
Drug shops	400,000	300,000	150,000
Others	400,000	300,000	150,000

Traders in Towns and trading centers whose turnover exceeds 10m but not exceeding 50m shillings pay the following amounts of tax.

Business trade	With turnover btn(Shs35,000,000-Shs50,000,000)	With turnover btn (shs 20,000,000-shs 35,000,000)	With turnover btn (shs 10,000,000-shs 20,000,000)
General trade	300,000	200,000	100,000
Carpentry/metal workshop	300,000	200,000	100,000
Garages(motor vehicle repair	350,000	250,000	100,000
Hair and beauty salons	350,000	250,000	100,000
Restaurants and bars	350,000	250,000	100,000
Drug shops	300,000	200,000	100,000
Others	300,000	200,000	100,000

NOTE: The tax payable in this category varies based on locality e.g. given a turnover of shs 35m-50m a drug shop, in a given town say Katakwi pays shs.300, 000, Jinja Municipality a similar drug shop pays shs 400,000 and in Kampala is shs 500,000.

(e) Rental income tax.

Rental income is one earned by an individual from letting out immovable property in Uganda. Immovable property includes land and buildings. It doesn't matter whether the building is let out as a residence or commercial use.
The rental income of resident individual for the year of income is charged to tax at the rate of 20%of the chargeable income in excess of the tax free allowance or threshold of shs 2,820,000 per year.

The rental income of a non-resident individual for the year of income is charged to the tax at a rate of 15% on gross earnings from Uganda.

Computation of Rental income

The following is considered

- Gross of all income earned in the year.
- Deduct 20% statutory expenses on the gross rent (provision for expenditure and loss
- Deduct interest expenses if it was incurred in respect of the mortgage for acquiring constructing the building. Deduct tax free allowance of shs 2,820,000 to arrive at the chargeable income.
- Apply a rate of 20% on the chargeable income.

Example:

Jane earned annual rent of shs 2,500,000 from a house in Kisaasi, shs 900,000 from a house in Jinja and shs 600,000 from a house in Lyantonde.Calculate Jane's rental income tax.

Solution

Calculate the Gross rental income=2,500,000+900,000+600,000=4,000,000

Less provision for expenditure and loss 20% x 4,000,000=800,000 Chargeable

rental income=4,000,000-800,000=3,200,000

Less threshold 3,200,000-2,820,000=380,000(Net chargeable income)

Jane's rental income tax due=380,000 x 20%=76,000

(f) Value added tax (VAT); this is a broad based indirect tax on consumption, charged on value added to taxable goods and services at different stages in the chain of distribution. Its charged on local and imported goods

Features of VAT

- Its comprehensive since it's collected at all stages of distribution
- It's an indirect tax i.e. it's paid by a person who buys a good or service.
- Its payable on expenditure (consumption and not income)
- Its payable on value added in the production process.

Terms used in VAT

1. **Taxable person**; this is a person who is registered or required to be registered to pay VAT i.e. a person whose turnover exceeds shs 150m (VAT registration threshold) VAT charged on goods and services at different stages of consumption is accounted for by taxable persons.
2. **Persons**; this is any business entity that buys or sells goods or services and is required to be registered for VAT. These may include individual, partnership, company, trust, government and any public or local authority.
3. **Goods;** these include all kinds of movable and immovable property, but doesn't include money.
4. **Movable property**; this includes stock in trade and the capital goods of the business.
5. **Immovable property**; this includes land with developments on it and any real right to such property.
6. **Service**s; this is anything that's not a good or money. It includes intellectual and industrial property rights e.g. Copy rights, trade marks.
7. **Taxable supply**; this is supply of goods that is not an exempt supply made by a taxable person in Uganda for consideration as part of his /her business activities.

CATEGORIES OF TAXABLE SUPPLIES

Standard Rated Supplies; VAT is charged at 18%.

Zero Rated Supplies; VAT is charged at 0% e.g. Exports are zero rated.

Exempt Supply; An exempt supply is not charged to tax even if made by a taxable person. Exempt supplies are business supplies other than taxable supplies on which VAT is not charged e.g. supply of education services, agricultural products and financial services.

Input VAT; this is VAT payable in respect of a taxable supply.

OR: It is VAT payable on import/purchase of goods or services by a taxable person.

OR: VAT paid by a registered person as well as VAT on other business expenses as administrative expenses e.g. rent, electricity, water.

Output VAT; this is VAT on sales. i.e. it is a tax charged by a taxable person when selling to customers.

Tax period; this is a period of time covered by a VAT return, currently monthly in Uganda.

CALCULATION OF VAT PAYABLE AT A SINGLE STAGE

$$\text{VAT Fraction} = \frac{R}{R+100}$$

Where R is the rate of tax,
Given VAT standard rate of 18%,

$$\text{VAT fraction} = \frac{18}{18+100} = \frac{18}{118}$$

Note: Value Added Tax is computed by getting the difference between output VAT (VAT on sales) and input VAT (VAT on purchases)

EXAMPLE.

Nambasa is a taxable person, made taxable sales of shs.300, 000,000 and taxable Purchases of shs.250, 000,000(VAT inclusive). Determine Nambasa's VAT payable to URA

Solution.

	Amount inclusive of VAT	VAT fraction= 18/118	VAT exclusive amount
Sales	Shs.300,000,000	Shs.45,762,711(output)	300,000,000-45,762,711= 254,237,289
Purchases	Shs.250,000,000	Shs.38,135,593(input)	250,000,000-38,135,593= 211,864,407
VAT payable		Shs.7,627,118	

1) We get taxable sales which of shs.300, 000,000 and multiply by the VAT fraction to get VAT output. i.e. shs.300, 000,000×18/118= shs.45, 762,711.
2) We get taxable purchases which are 250,000,000 and multiply by the VAT fraction to get the VAT input.ie 250,000,000 x 18/118=38,135,593.
3) VAT payable = outputVAT - input VAT.
4) From the answer of 1 and 2 above we get 45,762,711-38,135,593=7,627,118.

Finally, VAT payable is Shs. 7,627,118.

(b) CALCULATING VAT PAYABLE AT DIFFERENT STAGES OF DISTRIBUTION/VAT TRAIL.

Example

Andruvule imported goods worth Shs. 60m and sold to Mutumba at Shs. 65m.Mutumba sold to Watua a wholesaler at Shs. 68m.Watua sold to Efrance a retailer at 70m.Efrance sols the goods to various customers at 72m.Given that all prices are inclusive of VAT and the VAT rate is 18% calculate VAT payable at each stage and total VAT payable to URA.

CHAIN OF DISTRIBUTION (VAT TRAIL)

Stage	Activity	Purchase price	VAT on purchase (input VAT) (18/118	Selling price	VAT on sales (output VAT(18/118)	VAT Payable to URA (output-input)
	Customs VAT on imports.	60,000,000	-	-	-	9,152,542
1	Importer Andruvule	60,00,000	9,152,542	65,000,000	9,915,254	762,712
II	Distributer Mutumba	65,000,000	9,915,254	68,000,000	10,372,881	457,627
III	Wholesaler Watau	68,000,000	10,372,881	70,000,000	10,677,966	296,085
IV	Retailer Efrance	70,000,000	10,677,966	72,000,000	10,983,050	305,085
V	Final consumer	72,000,000	10,983,050	-	-	10,983,050

From the illustration above it's indicated that the final consumer pays VAT of Shs. 10,983,050=9,152,542(VAT on imports) +762,712(stage I) +457,627(stage II) + 296,085(stage III) + 305,085 (stage IV)

The total price the final consumer pays would be Shs. 72m inclusive of VAT.

(g) Local Excise Tax/Duty; this is a tax on consumption of specified goods and services. Its imposed under the excise law on goods such as beer, soft drinks,

wines, alcoholic spirits, cigarettes, fuel, airtime on cellular phones, mobile money etc.

Taxable value for excise duty

- In respect of manufactured goods, Excise duty is payable on Ex-factory price. This includes: raw materials, manufacturing costs, bank charges, profits, charges, expenses incidental to the factory including the distribution costs.

- In respect of imported goods, it is charged on cost insurance and freight (CIF) plus import duty.

- In respect of services, it is imposed as a fixed fee or as a percentage of the charges imposed by the service provider.

The table below illustrates excise duty computations.

Product	Ex-Factory Price	Excise rate %	Excise Tax
Beer	2000 per 500ml	60	1200
Spirits	5000 per litre	60	3000
Soft drinks(sodas)	1000 per 300ml	12	120

(h) Withholding Tax; this is a form of income tax that is deducted at source by one person effecting a payment.
The person making payment is obliged to withhold tax and is referred to as withholding agent and the person receiving payment from which tax is required to be withheld is the payee.

Payments where withholding applies**.**

TAX BASE	RATE
Employment income(PAYE)	The rates are covered under

	(PAYE)
Goods and services	6%
Imports	6%
Professional fees(Resident)	6%
Dividends	15%
Rent(Resident)	6%
Rent(non-resident)	15%
Natural resource payments	15%
Royalty(Non-resident)	15%
Winnings(Sports or pool betting)	15%
Management charge(Non-resident)	15%
Ugandan –source services contract (nonresidents	15% to 10% should be withheld by resident persons who purchase assets from non-resident persons.

COMPUTATION OF CUSTOMS TAXES (INTERNATIONAL TRADE TAXES)

These are taxes collected from both imports and exports. Taxes on exports are levied occasionary for economic stabilization purposes, e.g. a coffee stabilization tax was introduced in Uganda in 1994/95 during a coffee export boom to help stabilise the foreign exchange rate.

Determinants of international taxes and duties

1. **Value of goods**; the higher the value, the higher the taxes payable to government.

Note: Customs value is the total value of all the items in your shipment. This determines the import duty the package recipient must pay. E.g. if you are shipping 10 dresses each valued at Us dollars 25.00(or local currency equivalent), then you would enter a customs value of Us dollars 250.

2. **Classification of goods**; using the harmonized system, it allows countries trading together to classify and name traded goods on a common basis for determining customs rates
3. **Origin of goods;** e.g. trade preferential areas like COMESA, SADC, EAC shown by the certificate of origin, the import duty of such items is zero.
4. **Nature of goods**; (Used goods and new products) e.g. environmental levy is imposed on used vehicles, motor vehicle and motor cycle spare parts, used bicycles.
5. **Monthly exchange rate prevailing;** the higher the exchange rate the higher the taxes charged.

Determination of duties/taxes under importation;

The import duty is paid at the rate in force at the time when the goods liable to such a duty are entered for home consumption.

Tax rates/bands on imports.

i)Zero rated; some imports are zero rated so as to encourage investments especially in agriculture and mining e.g. agricultural tractors, fertilizers, pure breeding animals raw materials capital goods computers and imported supplies by mining companies or their subcontractors up to the first year of production, inputs for horticulture and agriculture solar equipment and accessories.
ii) Ten Percent Rate (10%); these include fully processed inputs for industries and semi-produced inputs at the rate of 10% to encourage industrial development. These goods include motor vehicle spare parts, pen nibs, lubricating greases.
ii)Twenty-five percent Rate (25%); final consumer goods are imported at a rate of 25% so as to discourage importation of final consumer goods and thus promote local production/investment.
Note; some goods are charged at a higher rate than 25% so as to protect the environment as well as industries, these include all types of sacks, plastic bags and second hand (worn) clothes

Computation of Duty/Steps to determine tax liability

Step 1. Determine customs value
The customs value can be either be in foreign or local currency. This is done by the customs agent to establish the correct customs value for computing the correct amount of taxes and duties to minimise false declaration.

Step 2 Apply the current exchange rate to convert the customs value to local currency, if it's foreign currency

Example

If US dollars 1000 is the customs value and shs 3730.64 is the current exchange rate. The customs value is Us dollars 1000 x shs. 3730.64=Shs. 3,730,640.

Step 3 Compute the taxes and duties applicable for the consignment. These taxes may include import duty, excise duty, VAT, Infrastructural levy and environmental levy.

Given the correct customs value as cost insurance Freight (CIF) and harmonized code system (HS code) the taxes are calculated as follows:

Import duty (ID) =ID rate x customs value (CIF) Excise

Duty (ED) value=customs value + import duty Excise

duty (ED) =ED value x ED rate

VAT value=CIF+ID+ED

VAT=VAT value x VAT rate

The total tax liability is the sum of all taxes/duties above.ie import duty, excise duty and VAT; where the product in question doesn't attract excise duty then

VAT= (ID +CIF) x VAT rate i.e. (ID+ED (o) + CIF) x VAT rate.

In case ID is nil then,

VAT=CIF x VAT rate i.e. (CIF+0+0) x VAT rate.

Infrastructural Levy; this is a levy imposed by the East African community member states to finance and maintain infrastructural development. It's charged at a rate of 1.5% of CIF value.

Environmental Levy; this is a levy imposed to limit the importation of used cars as a way of protecting the environment. The rate varies depending on the years of manufacture. E.g.

- Below 5 years after manufacture no infrastructural levy
- Above 5 years but less than 10 years after date of manufacture, environmental levy is 35%.
- Above 10 years after manufacture, the environmental levy is 50%.

Example

If you imported a car worth 2,000 dollars, paid 200 dollars for insurance and 300 dollars as freight charges up to Mombasa and the exchange rate is 1 dollar= shs 3,700: Given the tax rates as import duty=25%, VAT=18%, withholding tax=6% determine the relevant customs tax.

Step 1

Customs value=Cost + Insurance +Freight
=2,000 +200+300
=shs 2,500

Step 2

Customs value=Customs value x exchange rate
=2,500 x 3,700
=shs.9. 250, 000

Step 3

Determine the taxes

IMPORT DUTY=25%of 9,250,000

=25/100 x 9,250,000

=shs.2, 312,500

VAT=18% of (customs valve + import Duty)

= 18% of (9,250,000 + 2,312,500)

= 18/100 x 11,562,500

= shs.2, 081,250

WHT= 6% of customs valve

= 6/100 x 9,250,000

= shs.555, 000

INFRASTRUCTURAL LEVY= 1.5% of customs value

= 1.5/100 x 9,250,000

= shs.138, 750

NB If the car is above 5 years but less than 10 years since the date of manufacture, you need to compute environmental levy at 35% and if the car is above 10 years you compute the environmental levy at 50%.

Passenger vehicles below 5 years do not pay environmental levy. All goods vehicles do not pay environmental levy.

Environmental Levy (5 to 10 years)

= 35% x 9,250,000

Total Taxes for the car 5 to 10 years old.

= import duty +VAT +WHT + infrastructural Levy + Environmental levy

= 2,312,500 + 2,081,250+ 555,000 + 138,750 + 3,237,500

= shs 8,325,000

OR

Total Taxes for used cars above 10 years old

Environmental Levy above 10 years = 50% of customs value

= 50% x 9,250,000

=Shs 4,625,000

= Import duty + VAT + WHT +Infrastructural levy + Environmental levy

= 2,312,500 + 2,081,250 + 555,000 + 138,750 +4,625,500

= Shs.9, 713,000

NB: please note that there is a value guideline for used cars. This means that customs value for a used car has already been determined. The value guideline disregards the invoice price. It is available on the URA web portal ;(http://ura.go.ug under motor Vehicle guidelines.

Domestic VAT;

this is for non VAT registered taxpayers that came into effect in Uganda on March 1, 2001. It is VAT charged on standard rated imports other than personal effects or motor vehicles whose value is 4million shillings and above, imported by Non VAT registered importers.

Domestic VAT = (CIF +ED) X 15%) X18%

NB; Motor vehicles manufactured 15 years ago are prohibited.

PUBLIC DEBT; this refers to the total borrowing by the central government, local authorities and public corporations.

NATIONAL DEBT; this refers to a debt incurred by the central government.

CLASSIFICATION OF PUBLIC DEBT:

Debts can be classified in the following ways;

1.Classification according to source:

(a) Internal/domestic debt; this is money borrowed by the government from within the country. This is mainly through selling securities to the public e.g. treasury bills and bonds.

(b) External debt; this is money borrowed by the government from foreign sources. e.g. donor agencies and other governments.

2. Classification according to purpose

(a)Reproductive /Productive/ Self -liquidating debt; this is a debt acquired to finance productive activities which generate income part of which can be used to repay a debt. e.g. money borrowed to build a factory.

(b)**Dead weight / Unproductive debt**; this is a debt incurred to finance unproductive projects. e.g. a debt incurred to pay salaries.

3.Classification according to the method of debt repayment

(a)**Funded debt**; this is a long term debt for which the there is no redemption date but the borrower keeps paying annual interest on the principle.

(b) **Unfunded/ Floating debt**; this is a short term debt whose repayment date is known.

Note; (i) Hard loan; this is a loan with a very short repayment period and very high interest rate

(ii) **Soft loans;** this is loan with a long repayment period and a very low interest rate

REASONS FOR INCURRING PUBLIC DEBTS IN DEVELOPING COUNTRIES:

1. **To ease the burden of taxation on citizens in the short run**; with increased borrowing, the government doesn't have to levy heavy taxes on the nationals.
2. **To fill the government-revenue expenditure gap;** the funds acquired through borrowing are used to finance recurrent expenditure
3. **To finance the balance of payment deficit in the short run**; the money borrowed comes in form of foreign exchange which increases its supply in the economy.
4. **To supplement tax revenue**; the funds borrowed are added to the little tax revenue to meet government expenditure.
5. **To control inflation**; internal borrowing reduces the amount of money in the hands of the people which reduces aggregate demand.
6. **To fill the saving investment gap**; borrowing enables government to acquire more funds to add to the little savings to finance investment.
7. **To sustain market**; this is because people are less taxed which leaves them with adequate disposable income to buy goods
8. **To increase employment level;** this is because the funds borrowed will invested to create jobs.

9. **To handle the effects of disasters**; this is because the government will borrow to buy basic necessities for the victims of the disasters.
10. **To effect debt repayment**; the government will borrow from cheaper sources to pay off expensive loans.

Merits of public debts

1. Eases the burden of taxation on the citizen
2. Fill the government revenue expenditure gap
3. Finances the balance of payment deficit in the short run
4. Supplements tax revenue
5. Controls inflation
6. Fills the saving-investment gap
7. Sustains market for the citizens
8. Increases employment opportunities
9. Helps to handle the effects of natural disasters
10. Helps to repay the loans

Demerits of public borrowing

1. **It worsens the balance of payment deficit**; this is becauses it increases the outflow of foreign currency through debt servicing and repayment.
2. **Denies nationals essential goods**; this is because much of the money is used to pay back the debts instead of proving essential goods.
3. **It encourages extravagance**; this is because government misuse government borrowed to buy luxury items like cars which limits funds for financing projects.
4. **Encourages foreign of domination the economy;** the foreign donors influence political, social and economic decisions in the country
5. **Shifts the burden of debt repayment to the future generation**; this is because the future generation is taxed to pay back the debts yet they may have never benefited.
6. **Limits the capacity to import**; this is because much of the foreign exchange is used to pay back the external debts instead of buying imports.
7. **Leads to high taxes;** this is because the government increases taxes on the citizens to raise funds for debt repayment.
8. **It encourages laziness**; this makes people to get used to easy acquisition of funds which make them reluctant to work.
9. **Undermines capital formation**; this is because much of the money is used to pay back the loans which reduces the country's capacity to save.

Public debt management; this refers to the process of **acquiring**, **utilising, servicing** and **repayment** of debts by the central authority, local authority or public corporation

Objectives of public debt management

i. To maintain price stability
ii. To reduce income inequality
iii. To influence interest rate
iv. To minimise corruption
v. To reduce the debt burden
vi. To mobilise financial resources.

Note: (a) **Debt servicing**; refers to the payment of interest and sometimes part of the loan acquired

(b) **Debt repayment/ redemption**; this refers to paying back the principle amount borrowed

METTHODS OF REDUCING THE PUBLIC DEBT:

1. D**ebt rescheduling**; this involves asking for an extension of the maturity date
2. **Debt conversion**; this involves borrowing from a cheaper source to pay a high interest debt.
3. **Drawing foreign reserves**; the central bank uses part of the foreign exchange kept to pay off the debt.
4. **Privatisation;** this involves selling public enterprises to raise funds necessary to pay back the debt.
5. **Soliciting for grants and donations**; the government acquires foreign exchange to pay the debt.
6. **Selling securities to the public**; the government borrows internally to pay off loans.
7. **Creating a sinking fund**; this involves putting aside some money in the national budget to pay off the debts in future
8. **Appealing for debt cancellation**; the government requests the donor to write off the outstanding debt.

Debt /deficit financing; this is where the government borrows money to finance its expenditure that may not be covered by the tax revenue.

Merits of debt/deficit financing:

1. It makes the government popular because it does not tax people heavily
2. It enables the government to realise a lump sum of money at once because borrowed funds are disbursed at once.
3. It is easy to get borrowed funds from various sources
4. It enables the country to supplement the local sources of revenue.
5. It sustains market for goods because people's incomes are less taxed which gives them adequate disposable income
6. It is easy and cheap to acquire borrowed funds
7. It promotes investment because it does not involve setting high taxes on producers which keeps the cost of production low.
8. It increases the foreign exchange reserves of the country because the funds borrowed are in foreign currency which are kept in the central bank
9. The burden of payment of the debt is shared between the current and future generation.
10. Controls inflation, this true with internal borrowing which reduces money in circulation
11. It is quicker to raise funds through borrowing because the government deals with few individuals when applying for loans.

Demerits of debt/deficit financing:

1. It leads to economic dependence because there is over borrowing which increases the debt burden
2. It discourages hard work because people expect get assistance in form of loans any time.
3. It worsens the balance of payment problem due to debt servicing obligation
4. It discourages the use of internal resources due to overreliance on foreign resources.

Taxation financing; this is where the government uses revenue from taxes to finance its expenditure.

Advantages of taxation financing

1. It reduces economic dependence because of reduced borrowing.
2. It encourages hard work as people struggle to earn more income to meet the high cost of living resulting from high indirect taxes
3. It improves on the balance of payment position because of limited borrowing which reduces expenditure on debt servicing.
4. It controls inflation because the high taxes reduce the disposable incomes of people which reduces aggregate demand
5. It encourages the use of internal resources because most of the external resources are stopped from coming into the country.

Disadvantages of taxation financing:

1. It discourages investment because high taxes increase the cost of production
2. It leads to cost push inflation because of the high indirect taxes which compels the producers to increase the prices of goods
3. It reduces consumer welfare because high direct taxes reduce people's disposable income
4. It limits public revenue because of the narrow tax base
5. It denies the country to have access to external resources because it relies mainly on taxes at home.
6. It is a slow means of raising revenue
7. It makes the government unpopular because people are made to pay high taxes.

NATIONAL BUDGET; this is a statement which shows the estimated government revenue and estimated government expenditure in a given financial year. A national budget caters for both recurrent and development expenditure

(i) Recurrent national budget; this is budget that caters for the day to day running of the state to maintain the existing production capacity in a financial year. e.g. salaries

(ii) **Development national budget;** this is a budget that caters for capital development in order to increase the production capacity of country in a financial year. e.g. construction of roads

Types of National Budget:

i) **Balanced National budget**; this is a budget where estimated government revenue is equal to estimated government expenditure in a financial year.

ii) **Unbalanced National Budget**; this is one where government estimated revenue is not equal to government estimated expenditure in a financial year. Therefore, unbalanced budget may be a surplus national budget or a deficit national budget.

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(a)Surplus National Budget; this is a budget where the estimated government expenditure is less than the estimated government revenue in a financial year.

Note: with the surplus budget the tax levels are very high and therefore its effects are the same as those of taxation financing covered earlier.

(b)Deficit National Budget; this is a budget where the estimated government expenditure is greater than the estimated government revenue in a financial year.

Note: with the deficit budget the level of borrowing is very high and therefore its effects are the same as those of debt/deficit financing.

THE OBJECTIVES OF A NATIONAL BUDGET:

1. **To control inflation**; taxes on incomes are increased to reduce disposable incomes which reduces aggregate demand
2. **To create employment opportunities**; incentives will be provided to investors which will lower the cost of production to stimulate investment.
3. **To improve the balance of payment position**; import duties will be increased to reduce importation and cut import expenditure
4. **To reduce income inequality**; progressive taxes will be increased so that the rich pay more than the poor.
5. **To protect domestic infant industries**; taxes on imports will be increased to reduce their inflow in order to preserve the market for local producers.
6. **To discourage consumption of undesirable products**; taxes on such goods will be increased to make them less affordable to consumers.
7. **To raise public revenue;** various tax and non-tax sources of revenue will be introduced.
8. **To influence investment;** high taxes will be imposed on non-priority activities to compel investors to commit their resources to priority activities which are less taxed
9. **To promote economic growth**; incentives will be provided to lower costs of production to attract investors and hence higher levels of output.
10. **To solicit for foreign aid**; the budget will be presented to donors showing expenditure gaps where assistance can be offered.
11. **To mobilise the public to participate in development**; more money will be injected in the construction of infrastructure which will stimulate private investment due to lower cost of production
12. **To reduce economic dependence**; the budget will increase domestic sources of public revenue so as to reduce external borrowing.
13. **To regulate government expenditure**; this will be ensured by maintaining budget allocations and minimise misallocation of funds
14. **To reduce regional imbalance in development;** the government will allocate more funds to under developed regions which will promote infrastructural development

BENEFITS A NATIONAL BUDGET

1. Regulates government expenditure
2. Helps in attraction of foreign aid
3. Promotes balanced regional development
4. Stimulates investment
5. Promotes economic growth
6. Enables the government to raise revenue
7. Discourages consumption and production of harmful products
8. Reduces income inequality
9. Corrects balance of payment deficits
10. Protects infant domestic industries
11. Controls inflation
12. Creates employment opportunities
13. Reduces economic dependence
14. Mobilises the public to participate in national development

CAUSES OF PERSISTENT BUDGET DEFICITS IN DEVELOPING COUNTRIES

1. **High costs of infrastructural development**; there are a number of infrastructural facilities that are being undertaken at the same time and they take a lot of money.
2. **Frequent occurrence natural disasters;** the government spends a lot of money to provide relief to the victims of the disasters

3. **Corruption**; project funds are stolen by government officials which requires the government to make supplementary budget.
4. **Heavy expenditure on defence**; the government spends a lot of money to buy military hard ware to fight political instability
5. **High administrative expenditure;** the government spends a lot of money on wages of public servants.
6. **Heavy debt servicing and repayment;** the government spends a lot of money to pay back debts.
7. **Heavy expenditure on external commitments;** the government spends a lot of money to maintain foreign missions as well as contributions in international organisations.
8. **Over ambitious planning;** government engages in very many projects at ago which call for borrowing
9. **High cost of employment creation campaigns;** the government allocates a lot of money to offer credit facilities to the disadvantaged groups to enhance employment creation.
10. **Narrow tax base;** there a few economic activities to be taxed which limits government revenue
11. **Weak tax administration**; this limits identification of tax sources thus low tax revenue.
12. **Low taxable capacity**; many people are very poor and therefore unable to pay taxes.
13. **Limited non- tax sources of revenue;** this leads to low government revenue
14. **High degree of tax avoidance and tax evasion;** many people doge paying taxes hence low revenue

MEASURES THAT CAN BE TAKEN TO MINIMISE BUDGETARY DEFICITS IN DEVELOPING COUNTRIES:

1. **Encourage cost sharing in the provision of services**; this will compel the public to meet part of the cost and reduce the burden on government.
2. **Ensure political stability**; this will reduce expenditure on purchase of military hardware.
3. **Reduce the size of public administration;** this will reduce the wage bill on public servants.
4. **Control population growth rate;** this will reduce public expenditure on provision of social services.
5. **Reduce acquisition of unproductive debts;** this will reduce expenditure on debt servicing and repayment.
6. **Restructure foreign missions;** this will reduce public expenditure on maintenance of foreign missions.
7. **Decentralise governmen**t; this will enable the local authorities to look for various sources of revenue which will reduce pressure on the central government.
8. **Privatise public enterprises**; this will reduce government on state enterprises since it will now be the responsibility of the new owners.
9. **Fight corruption**; this will minimise loss of project funds and reduce the need for supplementary budgets.
10. **Increase on non-tax sources of revenue;** this will increase public revenue.
11. **Liberalise the economy;** this will increase the number of economic activities and widen the tax base.
12. **Widen the tax base; this** will provide a variety of taxes and increase public revenue.
13. **Improve tax collection;** this will minimise loss of tax revenue.

PUBLIC EXPENDITURE; this refers to the expenditure made by the government to run the state and development.

Objectives of public expenditure:

1. To provide basic social services e.g. medical care and education.
2. To ensure internal security and defence.
3. To influence the level of economic activities.
4. To provide humanitarian assistance to victims of natural calamity.
5. To cater for debt repayments
6. To reduce income inequality.

Forms of Public expenditure:

- **Recurrent expenditure/consumption expenditure/operating expenditure;** this refers to the day-to-day spending of government aimed at maintaining existing capacities. e.g. wages of civils servants, rates on urban property, rent interest on the national debt, contribution to international organisations
- **Development expenditure/capital expenditure;** this refers to the expenditure by government on capital goods for purposes of creating capacities to generate more goods e.g. setting up infrastructure, establishment public enterprises.

CAUSES OF HIGH PUBLIC EXPENDITURE IN DEVELOPING COUNTRIES:

1. **High population growth rate**; this leads to high government expenditure on provision of social services
2. **Political instability;** this leads to high expenditure on the importation of military hardware
3. **Heavy debt burden;** this leads to high expenditure on debt servicing and repayment
4. **High rate of inflation**; this leads to high cost of project implementation by the government.
5. **Big public administration**; this leads to high expenditure by the government on wages of public servants.
6. **Frequent occurrence of natural disasters;** this leads to high government expenditure on provision of relief to the victims.
7. **Corruption;** government officials swindle money meant for projects and the government has to look for more money to fill the gaps.
8. **High expenditure on infrastructural development;** the government spends a lot of money to rehabilitate as well as construct new ones.
9. **High expenditure on international commitments;** the government spends a lot of money to subscribe to international organisations as well maintaining foreign missions.
10. **Over ambitious economic planning;** this means that the government tends to do too much in a so short time which calls for high expenditure.
11. **High expenditure on programmes to create employment;** the government spends a lot of money to subsidise potential investors so as to stimulate investment and create more jobs.

Measures that can be taken to reduce government expenditure:

1. **Appeal for debt relief**; this will reduce expenditure in form of debt servicing and repayment
2. **Acquire productive debts;** this will enable the government to generate revenue to pay back the debts.
3. **Fight corruption;** this will reduce loss of government funds and reduce the need for supplementary funding.
4. **Avoid overambitious planning;** this will ensure that the projects are financed by the resources available which does not strain the government financially.
5. **Encourage cost sharing in the provision of services;** this will enable the public to contribute part of the cost and lessen the burden on the government.

6. **Control population growth rate;** this will reduce government expenditure on provision of social services.
7. **Control inflation;** this will lower the cost of implementing projects by the government.
8. **Restructure public administration;** this will lower the wage bill on public servants.
9. **Restructure foreign missions;** this will reduce government expenditure on maintaining the missions in terms of paying rent and wages.
10. **Privatise public enterprises**; this will reduce expenditure on subsidisation of inefficient public enterprises.

INTERNATIONAL TRADE

This refers to the buying and selling of goods and services among nations. It is a trade that goes beyond the boundaries of a country. It involves exports and imports.

IMPORTS

These are goods and services that legally cross the borders from one country into another. There are both visible and invisible imports.

Visible imports

These are tangible goods that are brought into a country from another country.

Invisible imports

These are services that are brought into a country from another country e.g. insurance, banking, etc.

EXPORTS

These are goods and services that are locally produced and sold to other countries. They can also be visible and invisible. Visible exports are tangible goods while invisible exports are services that are produced locally and sold to other countries.

VISIBLE TRADE

Refers to the buying and selling of tangible goods among different countries

INVISIBLE TRADE

Refers to the exchange of services between countries

OR

Is the exchange of invisible exports and invisible imports of a country e.g. tourism, electricity.

International trade can also be bi-lateral or multi-lateral.

BI-LATERAL TRADE

This involves exchanging of goods and services between two countries.

MULTI-LATERAL TRADE

This involves exchanging of goods and services among more than two countries.

THE ROLE OF INTERNATIONAL TRADE IN THE DEVELOPMENT OF A COUNTRY

POSITIVE ROLES

1. Enables the country to get what it does not produce.
2. Provides a variety of goods hence widening the consumers' choice.
3. Increases the efficiency of domestic firms due to competition from imported goods hence lowering average production costs.
4. Enables the country to dispose of the surplus output that would otherwise be wasted due to widened markets beyond the country's boundaries.

5. Promotes specialization and its benefits since there is existence of comparative advantage among countries as each country specializes in the production of a commodity where it incurs the least opportunity cost.
6. Enables a country to acquire new ideas and values especially on better production techniques hence helping to transform the economies from subsistence to commercialized production.
7. Promotes international friendship and cooperation among countries participating in trade hence promoting peace and stability among countries.
8. Leads to utilization of resources hence avoiding wastage. This is due to widened markets beyond the country's boundaries.
9. Promotes technology transfer i.e. shifting of new and efficient production methods from one country to another especially from developed countries to underdeveloped countries. This leads to effective exploitation of resources and production of better quality products.
10. Enables countries to acquire skilled labour from other countries as they trade together hence leading to increased productive capacity among nations hence leading to higher economic growth rates.
11. Promotes capital inflow/ foreign exchange from foreign investors and from goods being exchanged hence helping to close the foreign exchange gap.
12. Provides revenue to the government. This is obtained mainly from taxes imposed on exports and imports hence enabling the government to meet its expenditure needs.
13. Increased output hence economic growth. International trade leads to production of more goods due to existence of a big market among different countries participating in trade hence economic growth.
14. Provision of employment opportunities. This is arises due to enlarged investments as markets expand calling for more workers. Also jobs are provided to those participating in importation and exportation of goods and services hence enabling people get incomes thereby improving their standards of living.
15. Increased quality of output due to competition. International trade leads to increased quality of output being produced due to competition for market among different countries.
16. Promotes infrastructural development especially railway networks, bridges and roads so as to allow easier and cheaper movement of goods and services being traded between countries thereby promoting increased economic/ productive activities between countries.
17. Promotes entrepreneurship as investors engage in various investment activities to earn more profits due to widened markets.
18. Enables countries to get supplies in times of emergencies e.g. natural calamities like droughts, earthquakes, landslides, etc which would not be possible in absence of international trade hence helping to save life.
19. Supplements domestic production (output) hence overcoming a problem of scarcity of goods.

NEGATIVE ROLES

1. Leads to exhaustion of non-renewable resources due to over exploitation as the market keeps on growing.
2. Leads to cultural and moral erosion especially among low developing countries as people tend to copy foreign cultures and lifestyles.
3. Leads to collapse of domestic firms as they find it difficult to compete with high quality goods being imported into the country and sometimes at lower prices than the domestically produced goods.
4. Leads to imported inflation which is as a result of importing goods from inflation prone countries. This increases the cost of living in the country hence lowering peoples' standards of living.
5. Leads to poor terms of trade. This is as a result of exporting low quality and semi-processed goods from low developing countries that command low prices in international markets while importing expensive manufactured goods from developed countries.
6. Leads to balance of payments problems. This is arises due to high capital outflow in form of profit and income repatriation by foreign investors working in the country and also due to expenditure abroad on expensive manufactured goods being imported into the country.
7. Promotes dependence/ reduces self-sufficiency. This arises as countries expect to rely on goods produced from other countries instead of surviving on their own. This erodes the political and economic dependence.
8. Leads to importation of undesirable products such as pornographic material, indecent attires, destructive drugs and other intoxicants. Such products negatively affect the health and morals of people.
9. Leads to unemployment. This is arises due to technology transfer that tends to be more capital intensive than labour intensive and due to collapse of domestic firms due to their out competition.
10. Retards development of local skills. This arises because instead of the country struggling to come up with its own technology, own products and training its own manpower; it hopes to rely on technology and goods produced by other countries.
11. Leads to dumping with its negative effects such as closure of local firms due to their out competition, underutilization of local resources among others.

BASIS OF INTERNATIONAL TRADE

1. Difference in resource endowment. Different countries have different natural resource endowments in form of minerals, forests, etc. therefore there is need for countries to specialize and exchange in order to get what they do not have through international trade.
2. Need to dispose of surplus output. Some countries produce more than what they can consume. Therefore, there is need to sell off the excess output to other countries in order to avoid resource wastage.
3. Difference in comparative advantage between countries. There is need for specialization among countries in the production and exportation of commodities that they can produce at lower costs than other countries and import commodities that they can produce at high cost hence international trade.

4. Lack of self-sufficiency in terms of goods and services. No country can produce all what it needs therefore countries trade together in order to get what they cannot produce locally.
5. The need to earn foreign exchange. There is need for international trade for countries to acquire foreign exchange which can be used for import purposes.
6. Need to promote international relations among countries through international trade. In addition, some countries need international trade in order to further their political and economic ideologies.
7. Etc.

LIMITATIONS OF INTERNATIONAL TRADE

1. Poor infrastructures.
2. Low quality of goods produced for international markets.
3. Protectionism policies of importing countries.
4. Tendency for most LDCs to have similar comparative advantage/ production of similar commodities.
5. Political instabilities in various countries e.g. Democratic Republic of Congo, Central African Republic, Southern Sudan.
6. Absence of uniform/ same currency to be used among different trading partners.
7. Differences in languages hence limiting effective communication.
8. Differences in political ideologies between countries/ conflicts among leaders of different countries.
9. High tariffs and non-tariff barriers on trading partners. This restricts the volume and direction of trade.

LIBERALISATION OF INTERNATIONAL TRADE (TRADE LIBERALISATION)

Trade liberalization refers to the removal of unnecessary restrictions on trade, hence giving people liberty to trade without undue government interference so as to increase the volume and benefits of trade.

OR

Trade liberalization refers to the removal of unnecessary restrictions on trade (so that trade can be carried out with more freedom).

WAYS OF LIBERALISING TRADE

£ Reduction of tariffs
£ Removal of unnecessary subsidies to domestic firms.
£ Abolition of quotas
£ Privatization of state owned trading enterprises.
£ Reduced bureaucratic/ administrative controls e.g. easing the process of acquisition of import licenses.

- £ Liberalizing the foreign exchange markets i.e. using floating exchange rate.

IMPLICATIONS OF TRADE LIBERALISATION IN AN ECONOMY

POSITIVE IMPLICATIONS

1. Increases employment opportunities.
2. Increases the level of output hence economic growth.
3. Controls structural inflation since participation in international trade controls scarcity of goods and services hence controlling structural inflation which arises as a result of supply rigidities.
4. Encourages resource utilization.
5. It encourages inventions and innovations/ leads to technological development.
6. Leads to efficiency of firms due to competition.
7. Leads to improved quality of goods being traded due to competition between local and foreign firms.
8. Increases tax revenue.
9. Upholds consumer sovereignty. Widens consumers' choices through increased variety of goods being traded.
10. Fights corruption in government departments due to abolition of unnecessary controls on trade.
11. Encourages foreign investment/ promotes resource inflows.
12. Stimulates development of infrastructures.
13. Improves balance of payment position through increased foreign exchange mainly from exports.
14. Reduces bureaucracy involved in trade due to reduced restrictions involved in international trade.
15. Improves relations between countries as countries continue to trade together hence improving peace and stability.
16. Promotes growth of entrepreneurship abilities due to widened markets hence leading to increased production capacity of nations leading to faster economic growth rates.

NEGATIVE IMPLICATIONS

1. Leads to imported inflation.
2. Competition pushes out inefficient firms leading to unemployment
3. Increases inflow of demerit goods due to absence of trade restrictions hence endangering peoples' health.
4. Technological development and technology transfer worsen the unemployment problem due to use of machines.
5. Promotes capital outflows in form of profit and income repatriation by foreign investors hence limiting capital accumulation.
6. Leads to environmental degradation due to desire for more output and profits both for domestic and foreign markets.

7. Leads to exhaustion of non-renewable resources due to their over exploitation.
8. Leads to dumping leading to suffocation of domestic industries.
9. Leads to economic dependence i.e. dependence on imported goods.
10. Leads to cultural and moral erosion.

GUIDING QUESTIONS

a) What is meant by **"trade liberalization"?** (1 mark)

b) State any **three** measures that have been taken to liberate trade in your country. (3 marks)

c) Examine the implications of trade liberalization on the economies of developing countries. (16 marks)

THEORIES OF INTERNATIONAL TRADE

1. THE PRINCIPLE OF ABSOLUTE ADVANTAGE

The principle of absolute advantage states that **"given two countries and two commodities with the same amount of resources, one country can produce both commodities more cheaply than the other."**

Study the table below showing output levels of two countries producing two countries with the same amount of resources and state the country with absolute advantage in the production of both commodities.

untry	mmodities	
	nerators	ffee
	0	0
	0	0

Country X has absolute advantage in the production of both commodities.

2. THE PRINCIPLE OF COMPARATIVE/ COMPETITIVE COST ADVANTAGE

The principle of comparative cost advantage states that **"given two countries and two commodities with a given amount of resources, a country should specialize in producing a commodity where it has the least opportunity cost than the other."**

Using the above table, calculate the opportunity cost of producing each commodity in each country. In which commodity should each country specialize?

Solution

$$Opportunity\ cost = \frac{Alternative\ forgone}{Actual\ production}$$

Country X

$$Opportunity\ \ cost\ (Generators) = \frac{600}{400} = 1.5$$

$$Opportunity\ cost\ (Coffee) = \frac{400}{600} = 0.67$$

Country Y

$$Oppotunity\ cost\ (Generators) = \frac{300}{100} = 3$$

$$Opportunity\ cost\ (Coffee) = \frac{100}{300} = 0.33$$

untry	mmodities	
	nerators	ffee
	5	57
		33

Country X should specialize in the production of generators while country Y should specialize in the production of coffee.

ASSUMPTIONS UNDERLYING THE PRINCIPLE OF COMPARATIVE ADVANTAGE

- Assumes two countries
- Assumes two commodities
- Assumes existence of free trade
- Assumes no transport costs
- It assumes full employment of resources in both countries
- Assumes demand is elastic.
- Assumes homogeneity of factors of production.
- Assumes constant returns to scale/ no diminishing returns
- Assumes existence of barter trade as a medium of exchange
- Assumes constant comparative advantage in both countries.
- Assumes constant technology
- Assumes perfect mobility of factors of production internally and immobility of factors externally

APPLICABILITY OF THE THEORY IN LDCS

1. Developing countries have tended to specialize in agriculture where they have the lowest comparative cost.
2. There are barter trade arrangements in low developing countries making the theory applicable.
3. There is use of labour intensive technology which is abundant in LDCs, which is more static.
4. There is some degree of mobility of factors of production within the region as assumed by the theory.
5. There are some cases of free trade in LDCs especially under common market arrangement.

INAPPLICABILITY/ LIMITATIONS OF THE COMPARATIVE COST THEORY

1. The simplicity of considering only two countries is unrealistic since trade is carried out by more than two countries.
2. The simplicity of considering only two commodities is unrealistic since trade between countries involves more than two commodities.
3. It assumes free trade yet in most countries there are trade barriers such as quotas, total ban, quality controls among others.
4. It ignores transport costs which cause differences in costs between countries.
5. It wrongly assumes the possibility of full employment of resources yet LDCs experience high levels of unemployment and underemployment.
6. It assumes that demand is elastic yet demand for agricultural products is inelastic.
7. It assumes homogeneity of factors of production yet these factors are heterogeneous.
8. It ignores the existence of diminishing returns as the principle assumes constant returns to scale.
9. It assumes barter trade only yet there is also monetary exchange.
10. It ignores the existence of different currencies used by different countries.
11. It assumes static comparative advantage among countries yet sometimes this advantage changes.
12. It ignores technological changes yet technology changes for example from labour intensive to capital intensive.
13. There can be international mobility of factors of production but the theory assumes perfect mobility of factors internally and immobility of factors externally.
14. It ignores the possibility of absolute advantage whereby a country can produce both commodities more cheaply than the other.
15. It ignores the need for self-reliance among countries as it puts emphasis on specialization between countries hence countries surviving on each other.

3. VENT FOR SURPLUS THEORY

The theory states that **"international trade provides opportunity for countries to utilize formerly idle resources to produce output for the export markets."**

GUIDING QUESTIONS

1. a) State the principle of comparative cost advantage. (1 mark)

b) Give any three limitations of the above theory. (3 marks)

2. a) What is meant by "vent for surplus theory" used in international trade? (4 marks)

b) Assess the role of international trade in the development of your country. (16 marks)

3. a) Distinguish between comparative advantage and the law of absolute advantage. (4 marks)

b) To what extent is the comparative cost theory applicable to developing countries?

(16 marks)

4. a) Study the table below.

untry	mmodity	
	ffee (Kg)	lk (Lr)
nya	)00	)00
;anda	)00	)00

i) Calculate the comparative cost advantage of producing each commodity in the two countries.

(4 marks)

ii) State a commodity in which each of the two countries should specialize.

(2 marks)

b) Explain the limitations of the theory of comparative cost advantage in developing countries.

(14 marks)

TERMS OF TRADE

Terms of trade refers to the ratio of price index of exports to the price index of imports.

OR

Terms of trade is the rate at which a country's exports are exchanged for imports.

OR

Terms of trade is the purchasing power of a country's exports in terms of imports.

Terms of trade can be expressed in two ways;

1. Barter terms of trade/ commodity terms of trade.

Is the ratio of the price index of exports to the price index of imports. It shows how much exports are required to purchase a unit imports.

$$Barter\ T.O.T = \frac{Price\ index\ of\ exports}{Price\ index\ of\ imports} = \frac{Px}{Pm}$$

If $\frac{Px}{Pm} > 1$, the country is said to be experiencing favourable terms of trade

If $\frac{Px}{Pm} < 1$, the country is said to be experiencing unfavourable terms of trade

Barter terms of trade can also be expressed as a percentage using the formula;

$$Barter\ T.O.T = \left(\frac{Px}{Pm}\right) \times 100$$

Barter terms of trade are favourable if $\left(\frac{Px}{Pm}\right) \times 100$ is greater than 100% and unfavourable if $\left(\frac{Px}{Pm}\right) \times 100$ is less than 100%.

2. Income (monetary) terms of trade.

Is the ratio of the <u>value of exports</u> to the price index of imports. It shows how much a country can import using the revenue from exports.

$$Income\ terms\ of\ trade = \left(\frac{Px}{Pm}\right) \times Qx$$

$$= Barter\ T.O.T \times Qx$$

Where;

Qx = Quantity of exports

Px = Price index of exports

Pm = Price index of imports

If Px > Pm, → favourable terms of trade.

If Px < Pm, → unfavourable terms of trade.

<u>Example</u>

Given that the price index of exports is 120 and the price index of imports is 130 and the quantity of exports is 200kgs. Calculate;

a) (i) The barter T.O.T

(ii) The income T.O.T

b) Comment on the country's terms of trade.

<u>Solution</u>

a) (i) $Barter\ T.O.T = \frac{Price\ index\ of\ exports}{Price\ index\ of\ imports} \times 100$

$$= \frac{120}{130} \times 100$$

$$= 92.3\%$$

(ii) $Income\ T.O.T = Barter\ T.O.T \times Quantity\ of\ exports$

$$= \frac{92.3}{100} \times 200$$

$$= 184.6$$

b) The country is experiencing unfavourable terms of trade because the barter terms of trade is less than 100%.

<u>CAUSES OF UNFAVOURABLE TERMS OF TRADE IN LDCs (UGANDA)</u>

1. Falling prices of exports.

2. Importation of expensive manufactured capital and consumer goods.

3. **Increasing substitution of exports with synthetics produced by developed countries.**
4. **Exportation of semi-processed agricultural and mineral products.** These have low value added on them therefore command low prices on the world market yet imported goods are highly manufactured and hence carry high prices.
5. **Market flooding of raw agricultural products leading to fall in export prices.** This is as a result of production and exportation of similar products by developing countries.
6. **Protectionist policies of developed countries in form of tariffs and non tariff barriers.** This is aimed at protecting their economies as a way of achieving self-sufficiency and self-reliance. This greatly reduces the demand for exports from developing countries leading to a fall in export prices.
7. **Weak bargaining power of LDCs.** In most cases, LDCs are price takers i.e. the prices of their exports in foreign markets are dictated by MDCs. MDCs dictate low prices for LDCs' products yet set high prices for their commodities causing unfavourable terms of trade.
8. **Invention of raw-material saving techniques of production by MDCs.** Developed countries have invented technology which uses less raw-materials from LDCs thereby leading to a reduction in demand for products from LDCs leading to low prices of LDCs' exports yet imported commodities are expensive causing unfavourable terms of trade.
9. **Low income elasticity of demand for LDCs' exports.** This implies that even when incomes increase worldwide, the demand for LDCs' exports remains low because they are mainly agricultural products thereby commanding low export prices yet import prices are high.
10. **Low quality of exports from LDCs.** This is partly due to limited skills and use of poor techniques of production therefore commanding low prices on the world market yet import prices are high.
11. **Rising prices of imports.** Generally, the rich in LDCs have a high marginal propensity to import especially due to the snob effect and the goods demanded include expensive wines, cars, mobile phones, jewelleries, etc. This enables developed countries to fix high prices on their products yet LDCs export semi-processed products whose prices are low causing unfavourable terms of trade.
12. **Unfavourable exchange rates.** This has resulted into undervaluation of LDCs' exports yet prices of imports remain higher causing unfavourable terms of trade.

NOTE

Emphasis should be on prices of exports being low or prices of imports being high, avoid "B.O.P".

EFFECTS OF DETERIORATING TERMS OF TRADE

1. **Leads to foreign exchange shortages** due to low prices of export commodities.
2. **Leads to imported inflation** due to rising prices of imported commodities.
3. **Worsens the country's B.O.P position and balance of trade position** since low prices of exports result into low earnings from abroad while rising prices of imports increase the country's expenditure abroad.

4. **Leads to low production** due to low prices of exported commodities limiting the rates of economic growth.
5. **Causes unemployment.** This is because low prices of export commodities discourage production and investments.
6. **Leads to reduction in level of investment** since low prices of export commodities are unattractive to investors.
7. **Causes currency depreciation** due to unfavorable exchange rates between the local currency and foreign currencies.

MEASURES THAT SHOULD BE TAKEN TO IMPROVE TERMS OF TRADE

1. **Process primary products** to add value on them thereby commanding high prices on the world market.
2. **Adopt import substitution industrial strategy.** This helps to produce formerly imported goods thereby reducing importation of expensive manufactured goods.
3. **Diversify export markets.** LDCs should look for different markets in various parts of the world for example through joining or strengthening regional cooperation. This increases the demand for exports hence raising the export prices.
4. **Strengthen commodity agreements.** LDCs should enter commodity agreements with other countries so that they can be offered fair and stable prices for the commodities they mainly import.
5. **Improve quality of exports** for example through research, adoption of better production techniques, training of labour to improve on its skills hence producing high quality exports that command high prices on the world market.
6. **Encourage importation from cheaper sources.** This helps to overcome importation of expensive manufactured goods thereby improving the country's terms of trade.
7. **Diversify products for export.** This helps to increase on the variety of goods for exportation so that when there is a fall in the price of some exports, other commodity prices remain high.
8. **Stabilize foreign exchange rates** for example through setting managed exchange rate to ensure fair competition between exports and imports.
9. **Negotiate for removal of trade barriers in export markets** such as tariffs, total ban, quality controls etc so as to raise demand for exports in the foreign markets which helps to raise prices for exported commodities.

GUIDING QUESTIONS

1. a) Distinguish between barter terms of trade and income terms of trade. (02 marks)

b) State any two effects of unfavourable terms of trade in your country. (02 marks)

2. a) Account for unfavourable terms of trade in your country. (10 marks)

   b. Discuss the measures that have been taken to improve terms of trade in your country.

(10 marks)

BALANCE OF TRADE

This is the difference between the value of a country's visible exports and visible imports.

BALANCE OF PAYMENTS

Refers to the difference between a country's receipts/ income from abroad and expenditure/ payments abroad during a given time

OR

It is a systematic record of a country's receipts and payments in international transactions in a given year.

OR

Refers to the difference between earnings/ incomes/ receipts from abroad and payments abroad (visible and invisible trade and not capital transfers) of a country during a given time.

If the country's receipts/ income from abroad exceed her expenditure/ payments abroad, the country is said to have a balance of payment surplus and therefore it experiences favourable balance of payments.

If the country's expenditure/ payments abroad exceeds her receipts/ income from abroad, the country is said to have a balance of payments deficit and therefore it experiences unfavourable balance of payments.

COMPONENTS OF THE BALANCE OF PAYMENTS ACCOUNT

1. **Current account.** This is a summary of all transactions which involves movement of goods and services between countries. The current account is divided into two i.e. the visible trade account and the invisible trade account.
2. **Capital account.** This records all transactions which involve movement of capital in and out of the country e.g. donations, grants, foreign investments, investments of nationals abroad, etc.
3. **Monetary (cash) account.** This is a record of a country's foreign exchange reserves/ resources from balance of payments current and capital accounts.
4. **Errors and omissions account.** This is also called a balancing item account. This part of the B.O.P account records errors and omissions which may have been made in the process of making the B.O.P account. The balancing item is added or subtracted on any side of the B.O.P account for purposes of balancing.

CAUSES OF BALANCE OF PAYMENTS DEFICITS IN LDCs/ UGANDA

1. **Low volume of exports.** The volume of exports in LDCs is generally low hence low foreign exchange earnings.
2. **Exportation of low quality products.** These are less competitive in the export markets resulting into low earnings from them.
3. **Exportation of mainly primary products such as agricultural raw materials.** These command low prices on the world market resulting into low foreign exchange earnings yet expenditure abroad is high.

4. **High propensity to import/ high preference for goods from other countries.** Most people in LDCs prefer buying goods from other countries as opposed to locally produced items. This increases the country's expenditure abroad yet earnings from abroad are low hence balance of payments deficit.
5. **Heavy expenditure on importation of military hardware.** This is due to political instability and destructive demonstrations existing in the country forcing government to spend heavily on importing fire arms yet earnings from abroad are low causing B.O.P deficit.
6. **Importation of highly priced (manufactured consumer and capital) good.** LDCs are highly dependent on imports hence high expenditure abroad leading to shortage of foreign exchange hence B.O.P deficit.
7. **High expenditure on payments/ servicing external debts.** Government is highly indebted and therefore has to service and repay external debts. This leads to high capital outflow yet earnings from abroad are relatively low hence causing shortage of foreign exchange hence B.O.P deficit.
8. **Trade restrictions in export markets.** MDCs are the major buyers of exports from LDCs but put restrictions on them e.g. total ban, quotas making it difficult to export more commodities to MDCs resulting into low foreign exchange earnings hence causing B.O.P deficit.
9. **Heavy government expenditure abroad e.g. on diplomatic missions, contributions to international organizations, etc.** a lot of government foreign exchange reserves are in such cases leading to shortage of foreign exchange hence B.O.P deficit.
10. **High level of profits and wages repatriation by foreigners working within the country.**
11. **Market flooding/ limited markets abroad.** This is due to exportation of similar products by developing economies.
12. **Prices of exports are externally determined.** Prices of exports of LDCs are dictated by MDCs and they fix low prices for those exports yet charge high prices for their commodities leading to low foreign exchange earnings causing B.O.P deficits.
13. **Limited variety of exports.** Exports of LDCs are mainly agricultural with few manufactured goods hence resulting into low earnings from abroad yet they heavily import which raises the country's expenditure abroad causing B.O.P deficit.

EFFECTS OF BALANCE OF PAYMENTS DEFICIT IN DEVELOPING COUNTRIES

NEGATIVE

1. Reduces the volume of imports.
2. Limited employment opportunities due to reduced investments.
3. Discourages investments
4. May lead to inflation due to shortage of essential goods
5. Encourages currency depreciation.
6. Retards economic growth.

7. Leads to low savings and investments.
8. Leads to depletion of foreign reserves.
9. Leads to high taxation levels in order to raise revenue for government expenditure.
10. Promotes trade protectionism which results in retaliation.

POSITIVE EFFECTS

1. Promotes regional economic cooperation.
2. Promotes import substitution industrialization strategy hence growth of the industrial sector.
3. Encourages diversification of exports.
4. Encourages improvement in quality of exports.
5. Stimulates effort to increase volume of exports
6. Promotes development of local skills to reduce dependence on imported labour expatriates.

MEASURES THAT SHOULD BE TAKEN TO IMPROVE B.O.P POSITION IN DEVELOPING COUNTRIES

1. **Use of trade restrictions** to discourage imports e.g. import quotas, import duties, total ban on some imports thereby reducing the volume of imports thus cutting down the country's expenditure abroad.
2. **Adopt import substitution industrialization strategy.** This helps to produce goods that were formerly imported so as to reduce the volume of imports hence cutting down the country's foreign exchange.
3. **Creation of peaceful, stable and conducive political climate.** This helps to reduce huge foreign exchange expenditure on military hardware thereby saving foreign exchange.
4. **Diversification of exports.** This is involves production of a variety of exports which raises the country's earnings from abroad hence improved B.O.P position.
5. **Negotiate for debt conversion and debt cancellation.** This is reduces capital outflow on debt servicing hence leading to growth in output for exports hence increasing foreign exchange earnings and it also reduces expenditure on imports.
6. **Undertake export promotion industrialization strategy.** This increases the volume of exports hence increased export earnings.
7. **Devaluation of the domestic currency.** This makes exports cheaper becoming more competitive in foreign markets thus increasing foreign exchange earnings while making imports more expensive which reduces their demand hence reduced expenditure abroad.
8. **Strengthen commodity agreements.** This helps to raise bargaining power of LDCs which increases the prices of LDCs' exports hence increased export earnings hence improving B.O.P position.
9. **Training of local manpower to reduce dependence on imported skilled labour.** This increases on output and reduces profit and wages repatriation.

10. **Restructuring foreign missions and diplomatic travels e.g. having one ambassador to serve in a number of countries thus reducing on unnecessary foreign travels.** This helps to save on foreign exchange of a country hence improving the country's B.O.P position.
11. **Improve quality of exports for example through research, adoption of better production techniques, training of labour to improve on its skills** hence producing high quality exports that command high prices on the world market hence fetching high revenues from abroad thus improving the balance of payments position.
12. **Diversify export markets mainly through regional cooperation.** This helps to widen market for the country's exports hence raising the country's foreign exchange earnings.
13. **Encourage barter trade.** This helps to minimize the use of foreign exchange and cut down foreign exchange expenditure hence improving the country's B.O.P position.

GUIDING QUESTIONS

1. a) Distinguish between **"Balance of trade"** and **"Balance of payments".** (02 marks)

b. State any **two** effects of balance of payments deficits in your country. (02 marks)

2. a) Account for the balance of payments problem in developing countries. (10 marks)

b. Suggest measures that should be taken to improve balance of payments position in developing countries. (10 marks)

3. What are the components of the balance of payments account?

COMMERCIAL POLICY

Is the deliberate government policy meant to influence and direct the value, volume and direction of trade in an economy.

INSTRUMENTS OF COMMERCIAL POLICY

- Taxation/ tariffs on imports/ import duty.
- Subsidization of local firms.
- Total ban/ trade embargo/ trade sanctions.
- Foreign exchange control.
- Quality control e.g. thorough U.N.B.S
- Administrative controls e.g. licensing, physical checks, etc.
- Import quotas.
- Liberalization of the economy.
- Devaluation of local currency.

- £ Allowing the local currency to depreciate in value.

PROTECTIONISM

Is the economic policy of restricting trade between nations, through methods such as tariff on imported goods, import quotas and a variety of other restrictive government regulations.

DIFFERENT FORMS OF PROTECTIONISM USED IN INTERNATIONAL TRADE

1. **Tariff barriers/ import duty.** This is the use of taxes on imports to limit their volume of flow into the country.
2. **Total ban/ trade embargo/ trade sanctions.** This refers to complete prohibition of importation of certain goods.
3. **Import quotas.** These are quantitative restrictions on goods being imported into the country.
4. **Quality controls.** These help to restrict low quality cheap goods capable of competing with domestically produced goods. This is achieved by setting high quality requirements imports must meet before being imported into the country. In Uganda, quality control measures are set by Uganda National Bureau of Standards (U.N.B.S).
5. **Use of tight administrative controls like licensing, tight bureaucratic processes** hence discouraging some importers/ participants in international trade.
6. **Foreign exchange control.** Trade is limited by allocating only a small amount of foreign exchange to importers so that they do not buy imports which are not essential.
7. **Subsidization of domestic firms.** Government may support local producers by giving them money to help them lower the production costs hence making their goods more competitive than the imported ones.
8. **Encouraging regional integration/ state trading.** International trade can be restricted by forming regional cooperation in which trade to non-member states is restricted and not restricted between member states.
9. **Provision of tax incentives such as tax holidays tax exemptions to local firms** to help them lower the production costs.

NOTE

1. ***A tariff is a tax/ duty imposed/ levied on either exports or imports.***
2. ***Tariff barriers are restrictions put to control international trade (free trade) by the use of taxes e.g. import and export duties.***
3. ***Non-tariff barriers are restrictions put to control international trade (free trade) by using other means other than taxation e.g. total ban/ trade embargo/ trade sanctions, administrative controls such as licensing, quality control measures, manipulation of exchange rates, provision of subsidies to local firms, etc.***

BENEFITS/ MERITS/ POSITIVE IMPACT OF PROTECTIONISM

1. Protects infant/ domestic industries from foreign competition thus enabling them to grow.
2. Discourages dumping of foreign goods by imposing heavy duties on dumped goods hence making them expensive.
3. Improves the country's balance of payments position by reducing the country's foreign exchange expenditure on imports.
4. Reduces external resource dependence/ promotes self-sufficiency. This is achieved through protecting domestic industries.
5. Raises revenue for the government through taxation by imposing tariffs on substitute imports.
6. Protects domestic employment through protecting home industries.
7. Discourages importation of demerit goods especially drugs, spirits, pornographic materials by either use of heavy tariffs on such products or even imposing a total ban on them.
8. Controls imported inflation through discouraging imports. This encourages investment in the country.
9. Encourages utilization of local resources by encouraging domestic production instead of relying on imported goods.
10. Improves the country's terms of trade through restriction of highly priced imports.
11. Encourages investment in the economy leading to increased output hence economic growth.
12. Minimizes political control by foreigners which enables the country to achieve its political objectives.

NOTE

For reasons, apply "To" e.g.

To protect infant/ domestic industries…

DEMERITS/ DANGERS/ ARGUMENTS AGAINST PROTECTIONISM

1. It subjects nationals to consumption of highly domestic priced goods.
2. It subjects the nationals to consumption of poor quality domestic goods due to absence of competition.
3. Limits the variety of goods in the domestic market hence limited consumer choices.
4. Protectionism is an expensive exercise since it calls for subsidization of local firms by the government.
5. It encourages monopoly tendency with it associated negative consequences because local producers are protected from competition from imported goods.
6. Encourages trade malpractices such as smuggling which leads to loss of government revenue.
7. Results into loss of government revenue from import duties especially where the country uses quotas and total ban which restrict importation of goods that would have been taxed.
8. Encourages retaliation from other trading partners which limits the benefits of international trade.
9. Protected industries have a tendency of remaining infant because they are always subsidized and protected by the government.
10. It encourages inefficiency in the protected firms due to absence of competition from imported goods.

FREE TRADE

Free trade is the economic policy of carrying out trade between countries without any trade barriers such as tariffs, quotas, total ban or any other variety of other restrictive government regulations.

MERITS OF FREE TRADE

1. Leads to improvement in quality of goods produced since it forces countries to carry out research and compete favourably.
2. Enables a country to enjoy low priced goods since tariffs like import duties are eliminated.
3. Helps to mobilize and raise inflow of foreign resources e.g. technological capital, foreign skills etc due to a widened market and improved investments.
4. Avails a wide variety of goods thereby widening the consumers' choices.
5. Leads to creation of more employment opportunities since more resources are exploited and the market base expands.
6. Increases foreign exchange earnings as countries freely export without restrictions hence helping to close the foreign exchange gap.
7. It encourages specialization between countries as trading partners are able to specialize in commodities where they incur the least opportunity cost.
8. Discourages trade malpractices such as smuggling.
9. Raises the level of economic growth since more resources are exploited due to a widened market.
10. Prevents rise of monopoly since goods can be imported ort exported without any restrictions.
11. Promotes international cooperation as goods and other resources can freely move to different countries without restrictions.
12. Encourages faster expansion of infant firms due to competition from foreign substitute commodities.

DEMERITS OF FREE TRADE

1. Local industries are outcompeted. This arises due to importation of low priced goods that have no restrictions exposing a lot competition to locally produced goods.
2. Results into unemployment due to domestic industries being out competed by foreign goods and technology transfers and development.
3. It encourages dumping leading to suffocation of domestic industries.
4. It results into increased external economic dependence since the economy cannot be self-sustaining hence being forced to adopt foreign decisions from other countries and having to rely on foreign resources for survival.
5. May result into imported inflation especially when the country is over relying on imports leading to low standards of living.

6. Results into low tax revenue from imports since tariffs on imported goods are eliminated.
7. Worsens the country's balance of payments position due to excessive expenditure on imported goods.
8. Results into low levels of exploitation of local resources. This is due to over importation thereby resulting into low levels of economic growth.
9. Leads to importation of undesirable goods with their negative effects on nationals since restrictions such as quality control no longer exist.
10. May worsen the country's terms of trade since imported goods in most cases are highly priced yet export commodities have low prices due to their low quality.

ASSIGNMENT

1. Why may protectionism by avoided in an economy?

Solution

A student needs to be well versed with costs of protectionism or benefits of free trade.

£ To save nationals from highly priced domestic goods.
£ To save nationals from consuming poor quality domestic goods due to absence of competition.
£ To provide a variety of goods from both foreign and domestic markets.
£ To reduce costs of administration incurred by the government in supporting local firms and enforcing protectionist policies.
£ To control domestic monopoly arising due to protectionism.
£ Fear of trade malpractices such as smuggling which leads to loss of government revenue.
£ Fear of losing revenue from taxes obtained from international trade.
£ To promote competition between domestic firms and foreign producers hence promoting growth, innovations and inventions.
£ Fear of retaliation effects/ beggar my neighbour policies which limit the benefits from international trade.
£ To increase efficiency in domestic firms due to competition from imported goods.

2. **"Protectionism rather than free trade should be adopted if countries are to benefit from international trade."** Discuss.

GUIDING QUESTIONS

1. a) What is meant by the term **"protectionism"?** (01 mark)

b) Give any **three** reasons why there is need for protectionism in your country. (03 marks)

2. a) Distinguish between trade liberalization and free trade/
Distinguish between protectionism and commercial policy (02 marks)

b) Mention any **two** forms of protectionism used in international trade. (02 marks)

3. a) Explain the methods used for restricting imports in your country. (06 marks)

b) Examine the effects of imports restrictions in your country. (14 marks)

DUMPING

This refers to the selling of commodities I external/ foreign markets at lower prices than those charged at home (local market).

REASONS FOR DUMPING

- £ To expand market for the producers.
- £ To earn foreign exchange.
- £ To dispose of surplus output at home
- £ To outcompete domestic producers thereby enjoying monopoly power.

EFFECTS OF DUMPING IN THE RECIPIENT COUNTRY

- £ Local producers are outcompeted/ closure of industries.
- £ Cheap goods are availed to consumers.
- £ There is provision of a variety of goods to consumers hence increased consumer choices.
- £ Inferior goods may be sold to consumers.
- £ Increased revenue to the government through taxation.
- £ It perpetuates the problem of external economic dependence.
- £ It leads to unemployment.
- £ Leads to underutilization of local resources.
- £ Discourages local initiatives/ investment.
- £ Distorts the balance of payments position of the country/ increased import expenditure.

DEVALUATION

This refers to the legal/ official reduction in the value of a country's currency in relation to other currencies.

OBJECTIVES OF DEVALUATION

- £ To improve B.O.P position of the country.
- £ To increase the volume of exports.
- £ To discourage dumping
- £ To encourage local production/ to protect domestic industries.
- £ To meet/ fulfill IMF conditionality.
- £ To retaliate to other countries those have devalued.

- To reduce importation by making imports expensive.

QUESTION

Given that the exchange rate is 1 £ = 1000 Ug.shs. Calculate the new exchange rate after devaluation of the shilling by 20%

Solution

Given that;

Old exchange rate; 1 £ = 1000 Ug.shs

Devaluation = 20%

$$\text{New exchange rate; } 1\ £ = \left(\frac{120}{100} \times 1000\right) \text{ Ug.shs}$$

$$1\ £ = 1200 \text{ Ug.shs}$$

HOW DEVALUATION HELPS TO IMPROVE B.O.P POSITION

After devaluation, exports become cheaper. The country exports more and therefore earns more foreign exchange.

After devaluation, the country's currency becomes of less value compared to other countries' currencies.

After devaluation, imports become more expensive. The country imports less and therefore reduces foreign exchange expenditure.

CONDITIONS NECESSARY FOR DEVALUATION TO BE SUCCESSFUL

1. **The price elasticity of demand for exports must be elastic.** In such a case, a small decrease in price resulting from devaluation leads to a very big rise in quantity demanded of exports therefore more foreign exchange being earned.
2. **The price elasticity of demand for imports must be elastic.** In such a case, a small increment in the price of imports due to devaluation leads to a very big decrease in the volume of goods imported.
3. **The supply of exports must be price elastic i.e.** there should not be supply rigidities in the production of exports.
4. **The supply of imports must be price elastic** so that an increase in the price imports leads to a drastic reduction in the supply of imports.
5. **Other competing countries producing similar goods must not devalue their currencies at the same time.** If they do, no benefits are enjoyed i.e. there should not be retaliation by other countries.
6. **There should be no inflationary tendencies in the country carrying out devaluation.** This is because even after devaluation, exports will remain expensive therefore being unattractive in the foreign markets.

7. **A country devaluating its currency should not be at full employment** so that when the demand for exports increases, the country can increase production to meet the market requirements.
8. **The country intending to devalue her currency must be the major producer or exporter of commodity/ commodities within the region.**
9. **There should be no trade restrictions in the importing countries (**countries buying exports from the devaluing country) otherwise when there are restrictions such as tariffs, total ban, quotas, etc the intended objectives of devaluation cannot be achieved.

REASONS WHY DEVALUATION MAY FAIL TO ACHIEVE ITS OBJECTIVES

1. **The demand for exports in LDCs is price inelastic.** This is majorly due to the fact that LDCs produce majorly agricultural commodities whose demand is inelastic.
2. **Demand for imports in exchange is price inelastic** meaning that even when the price for imports increases, quantity demanded remains more or less the same therefore less foreign exchange is saved.
3. **The supply of exports in exchange is also price inelastic i.e.** even when the demand for exports in foreign markets increases, LDCs cannot easily increase supply because they have a lot of supply rigidities/ difficulties.
4. **Other countries are also devaluing their currencies i.e. retaliation effect.** Therefore the exports from the devaluing country appear more expensive therefore having less demand in the foreign markets.
5. **The supply of imports in LDCs is price inelastic.** This means that supply is not highly affected even when prices increase after devaluation.
6. **There are a lot of trade restrictions in MDCs where LDCs export their commodities.** Such restrictions include quality controls, quotas and tariffs among others. This limits the demand for LDCs' exports thereby having less foreign exchange earned.
7. **LDCs are experiencing high rates of inflation** and therefore prices of exports continue to rise before and after devaluation therefore not being attractive in the foreign markets leading to low foreign exchange earned.
8. **The devaluing countries in LDCs are not the major producers or exporters in the region** therefore cannot maximize the benefits of devaluation.
9. **There is a high marginal propensity to import in LDCs** due to existence of limited economic activities and high demonstration effects therefore the demand for imports still remains high which increases the country's expenditure on imports and therefore devaluation fails to improve the country's B.O.P position.
10. **There are a lot of trade malpractices in LDCs especially smuggling** therefore commodities continue to be imported in the country using illegal means which increases foreign exchange expenditure on imports.

11. **Exportation of mainly low quality products by LDCs.** This implies that those products cannot compete favourably on the world market and have low price therefore foreign exchange earning obtained from them even when devaluation takes place is low.

ECONOMIC INTEGRATION

Refers to the coming together of two or more countries in a given region for the sake of mutual (economic) benefit of all member states

OR

Refers to the merging to various degrees the economies and economic policies of two or more countries in a given region for the mutual benefit of member states

OBJECTIVES OF ECONOMIC INTEGRATION

1. To expands markets for products of member states.
2. To increase the volume and benefits of trade by removing trade restrictions.
3. To control unnecessary competition and duplication of services in the region.
4. To increase specialization among member countries hence increased benefits of trade.
5. To increase job opportunities in the region.
6. To enable member states undertake joint development projects which may require huge capital e.g. railway networks.
7. To strengthen political and economic relationships between member states.
8. To increase the level of resource utilization/ exploitation i.e. vent for surplus theory of international trade.
9. To increase the bargaining power of member states producing similar goods on the world market.
10. To foster balanced development of the region among member states.
11. To strengthen and regulate industrial and commercial relationships.
12. To fight neo-colonialism of MDCs by reducing dependence of LDCs on developed countries.
13. To improve T.O.T of member states through trade creation.
14. To encourage industrial development in the region through widened markets and exports.
15. To increase access to foreign resources especially through the World Bank and IMF that can easily be given to integrating countries than individual countries.

STAGES OF INTEGRATION

Economic integration has different stages and they include;

1. Preference trade area (PTA)
2. Free trade area (FTA)
3. Customs union
4. Common market

5. Economic union

1. PREFERENTIAL TRADE AREA (PTA)

This is where countries reduce tariffs between or among themselves on selected commodities.

2. FREE TRADE AREA (FTA)

This is where countries eliminate all tariffs between or among themselves but continue to charge different tariffs on goods that are imported from non-member countries.

3. CUSTOMS UNION

This is where countries eliminate all tariffs between or among themselves and in addition, they adopt a common tariff structure on commodities from non-member countries.

Features of a customs union

- Free movement of goods and services among member states/ absence of internal tariffs.
- Common external tariff structure.

4. COMMON MARKET

This is where countries eliminate tariffs between or among themselves, adopt common external tariff structure and in addition, there is free movement of factors of production amongst themselves/ within the region.

Features of a common market

- Free movement of goods and services among member states/ absence of internal tariffs.
- Common external tariff structure.
- Free mobility of factors of production among member states.
- Free movement of goods and services among member states/ absence of internal tariffs.
- Common external tariff structure.

5. ECONOMIC UNION/ COMMUNITY/ FEDERATION

This is where countries eliminate tariffs between or among themselves, adopt common external tariff structure, allow free mobility of factors of production amongst themselves and in addition , countries institute joint ownership of certain enterprises like railways, banks, roads, dams, etc, all economic policies of countries are harmonized and there is establishment of a common currency.

Features of an economic union

- Free movement of goods and services among member states/ absence of internal tariffs/ free trade within the union
- Common external tariff structure.
- Free mobility of factors of production among member states.

- £ Joint ownership of certain enterprises like railway, roads, banks, dams, etc.
- £ Harmonious economic, fiscal and political policies.
- £ Use of a common currency.
- £ Strong regional institutions.

CONDITIONS NECESSARY FOR THE SUCCESS OF ECONOMIC INTEGRATION

1. **Close proximity/ geographical proximity/ nearness to each other.** The countries should be in the same region or share common borders.
2. **Political stability among the member states.** The member states should be politically stable so as to implement what they have discussed and agreed upon.
3. **Similar political and ideological policies.** Intending member countries should have same political and economic ideologies.
4. **Uniform of common currency to facilitate trade.** Intending countries should be ready to use the same currency e.g. Euro under European Union.
5. **Relatively common language/ traditions and cultures.** Intending countries should establish a common language to ease communication and facilitate trade.
6. **Relatively at the same level of development.** The countries intending to integrate must be at relatively the same level of development to ensure equal distribution of economic benefits.
7. **Ability to specialize in different commodities or services/ differences in comparative cost advantage.**
8. **All the countries intending to integrate must be free from external intervention or policies.**
9. **The countries should preferably be of equal size (market size)** so as to contribute equally to the economic development of each member country.
10. **There should be well developed infrastructure in all countries intending to integrate.**
11. **Political will or massive support.** There should be political support and commitment among people in the countries intending to integrate.

MERITS/ BENEFITS OF ECONOMIC INTEGRATION

1. **Leads to production of high quality products** due to increased competition among producers of different countries.
2. **Reduces costs of production.** Economic integration allows member countries to conduct research and collect information jointly at lower costs.
3. **It increases gains from international trade and reduces costs of duplication e.g.** one industry in one country to serve the whole group
4. **Controls imported inflation (trade creation effect).** Trade shifts from high cost non-member states to low cost member states.
5. **Creates political cooperation and understanding among member states.**

6. **Leads to increased employment opportunities** due to free mobility of factors of production and a bigger market that leads to expansion of production and investment in general.
7. **Widens consumers' choice** due to production of a variety of goods.
8. **It leads to transfer of knowledge and skills among member states.**
9. **It improves bargaining power of member states for their exports on the world market.**
10. **Promotes vent for surplus theory.** The resources formerly idle are utilized because of the widened market.
11. **Increases specialization and its advantages.**
12. **Stimulates establishment and expansion of manufacturing industries.**
13. **Provides easy access to foreign resources e.g.** financial bodies such as World Bank and IMF can easily lend to integrated countries other than individual countries.
14. **Leads to increased economic growth** due to increased production of goods as the market size expands.
15. **May lead to use of one currency** hence facilitation of trade.
16. **Enables firms among member countries to enjoy economies of scale** due to a wider market and production on a large scale.
17. **Promotes use of same services.** Economic integration leads to joint provision of infrastructure such as railway networks, roads hence reducing costs of operation.
18. **Etc.**

<u>DISADVANTAGES OF ECONOMIC INTEGRATION</u>

1. **Leads to trade diversion i.e.** countries under economic integration shift trade from low cost non-member countries to high cost member countries forcing citizens to buy expensive goods from within the region yet they would be in position to buy similar goods cheaply from non-member countries.
2. **It leads to sacrifice of national interests/ independence** especially under economic union where countries have to use the same currency and are under one leader.
3. **Leads to loss of government revenue** especially from imports from member countries since tariffs are abolished on certain commodities traded within the region.
4. **Leads to uneven distribution of industries** because free movement of goods and services may be in one direction especially from the poor to relatively richer countries but within the same union hence poor countries do not maximize the benefits of integration.
5. **It compels member countries to consume poor quality goods produced by member states** as cooperation restricts them from trading with non-member countries.
6. **It promotes misunderstandings among countries** especially when industries are not fairly distributed.
7. **All countries in the region may be producing similar goods** leading to surplus production in the region hence resource wastage.

8. **It involves high costs of staffing e.g.** employing regional coordinators, ministers from regional cooperation making it expensive to manage.
9. **Worsens international inequalities** especially for strong regional groupings which have a strong bargaining power compared to the weaker government.
10. **It leads to loss of political and economic independence** especially in the last two stages of economic integration where member states harmonious economic, fiscal and political policies.
11. **It leads to sacrifice of economies of scale in distributing of industries.** This is because countries have to specialize in certain products while giving up other products to other countries.
12. **It leads to sabotage and foreign interference** especially from developed countries which want to exercise their supremacy on LDCs by dictating prices for their exports hence struggle to weaken regional cooperation among LDCs.

FACTORS LIMITING ECONOMIC INTEGRATION IN DEVELOPING COUNTRIES

1. **They tend to produce similar goods.** This limits the market and lowers the volume of trade making the comparative advantage benefit limited.
2. **Fear of not gaining from integration.** This is due to absence of a mechanism to facilitate equitable sharing of gains of cooperation.
3. **Fear of loss of customs revenue.** This limits member states to reach certain stages of economic integration because they still want to obtain revenue through taxing imported goods.
4. **Existence of political instabilities in some countries.** Wars in some countries discourage economic activities and trade in general and sometimes those instabilities are sponsored by member states of economic integration hence hindering the success of cooperation.
5. **Difference in the level of development.** This leads to unequal distribution of benefits hence limiting economic integration.
6. **Differences in the social factors e.g. culture, religion, language, etc.** This makes it difficult to harmonize policies in their region.
7. **Conflicts among leaders.** Some heads of states are unable to sit on the same negotiating table with others mainly due to political conflicts and greed for resources of the country.
8. **Differences in currencies.** This discourages smooth running of trade among member states hence discouraging economic integration.
9. **Differences in political ideologies.** This makes it difficult to harmonize policies in their region.
10. **External interference/ sabotage.** MDCs tend to influence certain members to withdraw from economic integration hence weakening regional economic integration.
11. **Poor infrastructure among countries.** E.g. poor roads and railway networks. This limits movement of goods and factors of production among member states.

12. **Differences in economic policies.** Some countries believe in capitalism while others believe in socialism and others are mixed hence failure to adopt similar economic policies.
13. **Lack of political support/ will.** This is mainly due to ignorance of the people about the benefits of economic integration.
14. **Limited geographical proximity between countries i.e. some intending countries do not share the same borders.** This limits effective preferential treatment and construction of the necessary joint infrastructure to link all member states.
15. **Differences in the size of the market / population.** This limits equal contribution to the economic development of each member country.
16. **Difference in infrastructural development.**

NOTE

Trade creation

Is where economic integration results into a shift of trade from high cost non-member countries to low cost member countries.

Trade diversion

Is where economic integration results into a shift of trade from low cost non-member countries to high cost member countries.

Disadvantages of trade diversion

- Consumption of poor quality goods
- People are forced to buy high priced goods
- Reduced government revenue.
- Limited variety of products.

GUIDING QUESTIONS

1. a) Define the term economic integration (01 mark)

b. Give any three merits of economic integration. (03 marks)

2. a) Distinguish between a customs union and a common market. (02 marks)

b. State any two advantages of common market . (02 marks)

3. a) What are the features of an economic union? (06 marks)

b. Explain the factors that limit economic integration among developing countries. (14marks)

4. a) Explain the various forms of economic integration. (10 marks)

b. Explain the conditions necessary for the success of economic integration. (10 marks)

OTHER CONCEPTS USED IN INTERNATIONAL TRADE

FOREIGN EXCHANGE

Foreign exchange refers to currencies of other countries that a given country keeps.

FACTORS WHICH DETERMINE THE DEMAND AND SUPPLY OF FOREIGN CURRENCY

1. **Price of imports.** The higher the prices of imports, the higher the demand for foreign currency and the lower the price of imports, the lower the demand for foreign currency.
2. **Volume of imports.** High volumes of imports lead to high demand for foreign exchange to purchase to those imports and low volumes of imports lead to less demand for foreign currency.
3. **Debt servicing requirements.** When there is high demand for debt servicing requirements, the demand for foreign currency is high and when there is less debt servicing requirements, the demand for foreign currency is low.
4. **Government's external obligation.** When government has many external obligations, the demand for foreign currency is high to accomplish these external obligations and the demand is low with less external government obligations.
5. **Central bank intervention in foreign currency markets.** When the central bank intervenes through use of restrictive measures, the supply of foreign currency is low and when the central bank relaxes the policies, the supply of foreign currency is high.
6. **Price of exports.** The higher the price of exports, the higher the supply of foreign currency since the producers are going to supply more and the lower the prices of exports, the lower supply of foreign currency because lower prices of exports discourage supplies since they get less foreign exchange.
7. **Volume of exports.** The higher the volume, the higher the supply of foreign currency and the lower the volume of exports, the lower the supply of foreign currency.
8. **Need to accumulate reserves.** The higher the need to accumulate foreign reserves, the lower the supply of foreign currency and the lower the need to accumulate foreign reserves, the higher the supply of foreign currency.
9. **Level of capital inflow.** The higher the capital inflow, the higher the supply of foreign currency and the lower the capital inflow, the lower the supply of foreign currency.
10. **Level of inflow of grants/ donations.** The higher the inflow of grants/ donations, the higher the supply of foreign currency and the lower the inflow of grants, the lower the supply of foreign currency.

FOREIGN RESERVES

Foreign reserves refers to the total value of all gold, foreign currencies and special drawing rights held by a country as both reserves and a fund from which international payments can be made.

Importance/ uses of foreign reserves

- used for covering trade deficits
- used for covering balance of payments deficit
- An indicator of performance of an economy in international trade.
- Provides reserves for future payments for example meeting debt obligations.\determine the value of domestic currency.

How foreign reserves are acquired

- From a balance of payments surplus
- Capital inflow especially from foreign investors.
- Borrowing externally from the World Bank and IMF.
- Remittances of nationals living and working abroad.
- Disinvestment that is the sale of government assets abroad.

FOREIGN EXCHANGE EARNINGS

Foreign exchange earnings refer to a country's income from other countries (mainly through exportation).

Net foreign exchange earnings refer to the total sum of all foreign currency receipts less expenditure in a given fiscal year

FOREIGN EXCHANGE MARKET

Foreign exchange market is a market where foreign exchange/ foreign currencies are traded at a price that is expressed by the exchange rate.

EXCHANGE RATE

Exchange rate refers to the rate at which a country's currency is exchanged with other currencies in the foreign exchange market.

OR

This is the price of the domestic currency in terms of the foreign currency

Factors that determine the exchange rate in money market

(Factors that influence the strength of a country's currency relative to other currencies

1. **Volume of domestic output.** The higher the volume of domestic output, the stronger the currency and the lower the volume of domestic output, the weaker the currency.
2. **Volume of exports.** The higher the volume of exports, the stronger the currency and the lower the volume of exports, the weaker the currency.
3. **Rate of domestic money supply.** The higher the rate, the weaker the currency and the lower the rate, the stronger the currency.

4. **The level of foreign exchange reserves.** The higher the volume of foreign exchange reserves, the stronger the currency and the lower the volume, the, weaker the currency.
5. **The level of capital inflow and outflow.** High capital outflow leads to appreciation of domestic currency while high capital outflows lead to depreciation of the domestic currency.
6. **The rate of inflation in a country.** High inflation rates discourage investments and exports weakening the local currency while low inflation rates encourage investments and exportation making the currency strong.
7. **Political climate.** A favourable political climate encourages investments, stimulates production and inflow of foreign exchange making the currency stronger while unfavourable political climate discourages investors and production in general hence weakening the currency.
8. **Volume of imports.** The higher the volume of imports, the weaker the currency and the lower the volume of imports, the stronger the currency.

FOREIGN EXCHANGE RATE CONTROL

This is the state regulation of the rate at which the local currency can be exchanged for foreign currencies.

OBJECTIVES OF FOREIGN EXCHANGE CONTROL

1. **To raise revenue for the government.**
2. **To retaliate against another country**
3. **To protect domestic industries.**
4. **To ensure price stability/ control inflation.**
5. **To improve terms of trade.**
6. **To improve B.O.P position.**
7. **To control capital flight.**
8. **To create employment.**
9. **To discourage importation and consumption of harmful products.**
10. **To ensure stability of exchange rate.**
11. **To encourage investment.**
12. **To encourage long-term planning.**
13. **To ensure availability of foreign exchange to facilitate trade.**
14. **To acquire foreign exchange for servicing the country's external debt.**

TYPES OF FOREIGN EXCHANGE RATE SYSTEMS

There are different types of foreign exchange rate systems i.e.

1. Flexible/ floating/ free exchange rate system.
2. Fixed exchange rate system

3. Dual exchange rate system
4. Managed exchange rate system
5. Pegged exchange rate system

FLOATING EXCHANGE RATE SYSTEM

This is an exchange rate system where the rate at which the local currency is exchanged with other currencies is determined by inter-play of market forces of demand and supply of foreign currency.

Advantages

- £ It preserves the autonomy/ independence of the domestic monetary authority.
- £ It saves the country the burden of holding large official foreign exchange reserves.
- £ It is cheap to administer.
- £ It gives the most realist value of the local currency in terms of other currencies.
- £ Provides automatic mechanism for correcting B.O.P disequilibrium.
- £ It encourages investment.
- £ It leads to generation of adequate foreign exchange through exports, loans and grants.
- £ Discourages emergence of illegal or parallel foreign exchange market.

Disadvantages

- £ It encourages speculation in the foreign exchange market.
- £ It makes planning very difficult especially for export and import sectors
- £ May lead to imported inflation.
- £ It subjects a lot of uncertainties to the investors since it keeps on fluctuating hence discouraging capital inflow.
- £ It encourages the operation of parallel foreign exchange markets e.g. smuggling.

FIXED EXCHANGE RATE SYSTEM

This is an exchange rate system where the rate at which the local currency is exchanged with other currencies is fixed/ determined by the monetary authority.

Advantages

- £ It induces production and promotes economic growth.
- £ It encourages long term capital inflows
- £ It stabilizes prices in the economy i.e. it checks on inflationary tendencies.
- £ It encourages long term planning or contract trade.
- £ It helps to stabilize the value of the domestic and foreign currencies.

- £ It reduces speculation in the foreign exchange market due to limited depreciation and appreciation of currencies.
- £ It encourages exporters and importers to engage in international trade without concern about exchange rate movements of the currency to which their local currency is linked.
- £ It minimizes capital outflows.

Disadvantages

- £ It does not provide an automatic mechanism for correcting imbalances in trade and B.O.P position.
- £ It discourages foreign investors.
- £ It makes the country unable to pursue an independent monetary policy free from external influence.
- £ It requires the country to hold large official reserves of foreign exchange for the policy to succeed.
- £ It limits the amount of foreign exchange generated by the government through transactions.
- £ Requires exchange control administration which is costly (it is expensive to enforce)

PEGGED EXCHANGE RATE

Is one which is fixed/ determined by the monetary authority in relation to a particular foreign currency e.g. Ugandan shilling being pegged or fixed to US dollar like 1$ = 1000 Ug. Shs. Such that the values of other currencies are determined according to the shilling dollar relationship

NOTE

For merits and demerits of pegged exchange rate, refer to those for fixed exchange rate.

MANAGED EXCHANGE RATE SYSTEM

(Mixed/managed float/ dirty float/ adjustable peg)

This is an exchange rate system where the inter-play of market forces of demand and supply of foreign currency determine the rate at which the local currency is exchanged with other currencies but within certain limits set by the monetary authority.

Advantages

- £ It controls fluctuations of exchange rates and avoids undervaluation or overvaluation of the local currency.
- £ It safeguards imports and exports from rapid and constant fluctuations which cause losses.
- £ It ensures that there is a favourable exchange rate in the foreign exchange market.
- £ It controls the actions of speculators.
- £ The monetary authority maintains some control over the exchange rate.
- £ It regulates the flow of funds in and out of a country.

- £ It promotes international trade due to easy access to foreign exchange.
- £ It provides an automatic mechanism of correcting trade imbalance.

Disadvantages

- £ It reduces the volume and value of international trade.
- £ It is expensive for the government to administer.
- £ It worsens the debt burden of a country.
- £ It requires maintenance of large foreign reserves.
- £ It makes long term planning difficult due to uncertainty and instability in foreign exchange earnings.
- £ It encourages speculation in the foreign exchange market.
- £ It leads to depreciation of the local currency.
- £ It causes imported inflation.
- £ It leads to Balance of Payments problems.

DUAL EXCHANGE RATE SYSTEM

This is a situation where there are two official exchange rates in the country one being favourable to cater for essential or priority sectors and the other for non essential areas and each of the exchange rates is determined by the monetary authority.

OR

This is where there is co-existence of two parallel exchange rates within the country.

NOTE

1. ***In absence of "system" under exchange rate, avoid using "where, is a process, is a situation when" because all those define a system and not a rate.***

CURRENCY UNDERVALUATION

This is the fixing of the value of the country's exchange rate by the monetary authority below the equilibrium exchange rate above which it is illegal to trade/ exchange foreign currency.

An undervalued exchange rate is one fixed by the monetary authority below the equilibrium exchange rate above which it is illegal to trade foreign currency.

Effects of currency undervaluation

- Increases exportation
- Reduces imports

- Encourages domestic production.
- Reduces imported inflation.
- Improves B.O.P position.
- Worsens external debt burden

CURRENCY OVERVALUATION

This is the fixing of the value of the country's exchange rate by the monetary authority above the equilibrium exchange rate below which it is illegal to trade foreign currency.

An overvalued exchange rate is one fixed by the monetary authority above the equilibrium exchange rate below which it is illegal to trade foreign currency.

Effects of currency overvaluation

- Reduces exportation
- Increases importation
- Discourages domestic production due to reduced demand.
- Worsens Balance of Payment position.
- Reduces the external debt burden
- Leads to imported inflation.
- Promotes trade malpractices for example black market.

CURRENCY REVALUATION

This is the legal/ official increase in the value of the country's currency in relation to other currencies.

CURRENCY APPRECIATION

This is the increase in the value of a country's currency in terms of other currencies due to inter-play of market forces of demand and supply of foreign currency.

Effects of currency appreciation

- Encourages investment
- Reduces revenue from import duties
- Leads to low pay for export producers
- Exports become less competitive
- Worsens competition against local producers.
- Worsens balance of payments position
- Disorganises exporters because they are paid less in local currency.

CURRENCY DEPRECIATION

This is the fall in the value of the country's currency in terms of other currencies due to the inter-play of market forces of demand and supply of foreign currency.

OR

It is the reduction/ loss in value of domestic currency against foreign currencies under free exchange rate system.

Causes of currency depreciation

- £ Low earnings from exports on the world market.
- £ Increased importation of goods and services.
- £ Rising inflation in the domestic market.
- £ Heavy debt servicing
- £ Increase in fuel prices on the world market
- £ Decline in the service sector
- £ Increase in demand for foreign currencies.
- £ Deteriorating terms of trade.

Effects of currency depreciation

Positive

- £ It encourages foreign investment/ increases foreign capital inflow
- £ Imports become very expensive
- £ Makes exporters receive higher local currency value
- £ Increases the volume of exports

Negative

- £ Leads to rise in the price of domestic products/ leads to inflation
- £ Discourages investment
- £ Projected planning is made difficult.
- £ It encourages speculation.
- £ Worsens the external debt burden
- £ Leads to loss of confidence in the country's currency

ECONOMIC DEVELOPMENT PLANNING

This is the deliberate, conscious and continuous government effort to influence, direct and control major economic variables such as investments so as to achieve desired economic/development objectives in a country within a specified period of time.

1. **Deliberate, Conscious and Continuous Government Effort**: Economic development planning involves the intentional and sustained actions of the government to shape the economy.
2. **Influence, Direct and Control Major Economic Variables**: The government aims to actively guide and regulate important economic factors like investments, production, employment, etc. to achieve its goals.
3. **Desired Economic/Development Objectives**: The government has specific economic and developmental targets it wants to meet, such as increasing GDP, reducing poverty, improving living standards, etc.
4. **Specified Period of Time**: Economic development planning takes place within a defined timeframe, often outlined in multi-year plans or strategies.

PLANNING PROCESS

This refers to a situation where the government sets various plan objectives, formulates the plans and organises the implementation of the project design to achieve the set objectives.

A planning process involves the following;

- ✓ Plan formulation
- ✓ Getting relevant information or data
- ✓ Resource mobilisation
- ✓ Plan implementation
- ✓ Plan evaluation and revision.

DEVELOPMENT PLAN

This is a document drawn by the planning authority outlining the intended social, political and economic objectives to be achieved within a specified period of time.

CONTENTS/ COMPONENTS OF A DEVEOPMENT PLAN

- ✓ Planning machinery to be employed in the plan process.
- ✓ An analysis of a country's past development.
- ✓ Stock of resources available on which to base the plan. A realistic and viable plan should be based on the existing resources.
- ✓ Objectives to be achieved within a stated period of time.
- ✓ The duration of the plan implementation i.e. whether the plan is short term, medium term or long term.
- ✓ The coverage of the plan i.e. whether it is covering the whole economy or part of the economy or a particular project.
- ✓ Plan strategy to be employed in plan implementation.
- ✓ The source of funds needed to implement the plan i.e. internal or external sources or both.
- ✓ Key projects to be undertaken.
- ✓ Choice of technology to be used.

REASONS FOR CARRYING OUT ECONOMIC DEVELOPMENT PLANNING IN DEVELOPING COUNTRIES

1. **For proper allocation of scarce resources.**

In Developing countries, resources are scarce and therefore there is need for proper utilisation of such resources and this is done through development planning.

2. **For equitable distribution of incomes and wealth.**

This is done through use of measures such as progressive taxation, subsidization of the poor, provision of investment credit, etc and this is only possible under development planning

3. **To correct the deficiencies of price mechanism especially during periods of rapid structural changes.**

Price mechanism does not adequately provide for social and economic infrastructure which requires huge capital investment, emergencies like floods, harmonious development of all the sectors hence a need for centralised planning.

4. **To solve the unemployment problem.**

Developing countries experience wide spread unemployment and underemployment therefore through planning, private investment is stimulated and public investment is undertaken to create employment for the masses.

5. **To solicit for foreign aid.** Economic development planning enables the government to show the potential donors government planned revenue and expenditure and convince them to close the budgetary deficits through foreign aid.

6. **To relate present activities to future activities.**

Planning makes sequencing of projects possible. Through proper planning, projects that produce outputs to be used as inputs by other projects are implemented first. In this way, present activities are linked with future activities.

7. **For harmonious and consistent use of resources.**

Planning leads to harmonious use of resources by avoiding duplication of projects that have similar objectives. It also ensures consistency in the use of resources by ensuring that the plans set are in line with the available resources.

8. **To encourage public cooperation in the development process hence winning political support.**

Planning makes it possible for the members of the public to be involved in the development process of an economy by showing them their role in plan formulation and implementation. Planning also enables the government to win political support by showing the masses government programmes aimed improving their welfare as well as government successes in managing an economy.

9. **To attain and maintain price stability by influencing production levels.**

In times of inflation, measures such as reducing government planned expenditure, increasing direct taxes to reduce aggregate demand and measures to stimulate production and aggregate supply are undertaken. During a deflation, government reduces direct taxes and undertakes expansionary monetary policies to increase aggregate demand.

10. **To correct balance of payments problems.**

Planning enables government to undertake strategies that aim at improving the country's earnings abroad e.g. export promotion strategies and undertake strategies that reduce importation like adoption of import restrictions to reduce expenditure abroad thereby reducing balance of payments problems.

11. **To determine the rate of economic growth and development.**

Planning enables government to set growth targets and carryout measures of achieving them for instance by planning to offer attractive incentives to investors such as tax holidays.

12. **To reduce economic dependence/ to promote self-reliance.**

Planning enables the country to reduce dependence on external resources by raising revenue locally to avoid borrowing from abroad, training labour locally to reduce dependence on imported labour, import substitution industrialisation to reduce dependence on imports and diversification of the economy to reduce sectoral dependence.

13. To identify areas suitable for public and private investment.

Planning enables government to identify sectors which are highly profitable and attractive to private investors and those that are unprofitable but essential for a country's development such as provision of infrastructure and merits goods. The latter are indentified as suitable for public investment.

FACTORS THAT INFLUENCE THE IMPLEMENTATION OF ECONOMIC DEVELOPMENT PLANS IN DEVELOPING COUNTRIES

1. **Availability of funds from within and abroad.**

Ready availability of funds makes the implementation of plans much easier since it is very easy to obtain the required resources while limited funds make it difficult to obtain the required resources and logistics of implementation hence limiting successful plan implementation.

2. **Availability of statistical data/information.**

Readily available information on matters such as population, incomes of people, growth rates makes implementation of plans faster because sound targets are set yet limited information limits the success of plan implementation because of the inability to set sound targets and objectives.

3. **The political climate.**

A favorable political climate ensures a suitable and conducive climate for plan implementation and ensures that facilities are easily kept without any destruction hence facilitating the success of plan implementation while political instabilities destroy facilities for plan implementation and scare the plan implementers hence limiting successful plan implementation.

4. **Availability of skilled manpower.**

Readily available skilled manpower makes it easier to implement the plans since identification of viable projects and the necessary project resources is easy while limited skilled labour limits plan implementation since it is difficult to identify viable projects.

5. **The level of external/foreign influence.**

A high level of external influence on the way plans are to be implemented limits plan implementation since approvals and funding come from donors while a low level of external influence enables implementers to quickly implement the plans with limited bureaucracy hence making plan implementation more successful.

6. **The economic climate/rate of inflation.**

A high rate of inflation limits successful implementation of plans since the money value keeps on falling making the amount budgeted for inadequate while price stability ensures the success of plan implementation because of the stability in the costs of resources needed.

7. **The rate of corruption.**

High rates of corruption by the plan implementers limit the success of plan implementation because it leaves insufficient resources for establishment of projects while a high degree of accountability ensures success of plan implementation because there is limited misuse of resources meant for the establishment of projects and contracts are given to competent people.

8. **Level of development of infrastructure.**

High level of infrastructural development facilitates easy and cheaper movement of resources and movement of manpower for plan implementation hence facilitating success for plans being implemented while low level of infrastructural development makes it very expensive and very difficult for resources to be moved to implement plans hence limiting the success of plan implementation.

9. **Natural factors.**

Conducive natural factors like good climate make it easy to realise the plan objectives especially in the agricultural sector while occurrence of natural hazards like drought and floods disrupt the process of plan implementation and makes it difficult to have realistic plans for the agricultural sector.

10. **Will by the people and government.**

High degree of will by the people and the government makes plan implementation successful since the masses easily rally behind the government to ensure success of the process while limited will by the people and government leads to resistance by masses towards plan implementation hence its failure.

11. **Degree of interference by politicians.**

A high degree of interference by politicians in plan implementation limits implementation of plans because they stop the implementation of ongoing projects in order to divert resources to other projects or areas that suit their private and political interests while support by politicians in the implementation of the ongoing projects enables the plan implementers to do their work without disturbance hence facilitating the success and faster implementation of plans.

12. **The degree of responsiveness of the private sector.**

Some of the plans made by the central authority are indicative. Government provides inducements such as tax incentives to the firms to invest in given industries or sectors but because private sectors are not under

direct control of government and are profit driven, they sometimes do not respond to the inducements hence failure of indicative plans. However, plan implementation is successful where private sector firms respond positively to government inducements by investing in the desired sectors.

13. **The degree of ambitiousness of planning.**

Some plans require more resources than those that can be sourced both locally and abroad hence failure of plan implementation while plans that require minimal resources that can be sourced both locally and abroad become easier to implement hence success of plan implementation.

FACTORS LIMITING EFFECTIVE IMPLEMENTATION OF DEVELOPMENT PLANS IN DEVELOPING COUNTRIES

1. **Inadequate funds/ capital.**

Government has limited funds to be used for gathering data, hiring skilled man-power and purchasing the necessary equipment for plan formulation and implementation thereby limiting effective planning.

2. **Limited data/ information.**

Statistical data available is inaccurate and sometimes lacking due to poor record keeping and reluctance by people to give information about their bio data, incomes, expenditure and employment for purposes of privacy. Limited accurate data leads to under estimation of necessary resources for successful planning and unrealistic planning targets and objectives being set.

3. **Political instability.**

Some parts of developing countries are politically unstable and this creates an atmosphere of fear, loss of lives and property by project officials who keep away from insecure areas where plans are to be implemented.

4. **Shortage of skilled man-power.**

There is limited supply of skilled labour to identify viable projects to be undertaken, estimate project cost, set realistic project objectives as well as carrying out various technical activities in projects for example operating machines.

5. **Dependence on foreign aid which is uncertain/ inconsistent, inadequate and tied.**

Donors provide funds which are not sufficient for purchase of resources for project implementation. Conditionalities that the recipient country must meet are also set before aid is given. At times, aid is also tied to projects that are not central to the country's development leading to disagreements between donors and recipients over plan priorities hence delaying the planning process.

6. **High rate of inflation.**

High rate of inflation makes the amount budgeted for planning inadequate due to continuous increase in the general price level. Costs of resources at the time of plan implementation are much higher than at the time of plan formulation. This necessitates a review of plan costs as well as sourcing for more funds for plan implementation hence delaying planning.

7. **High levels of corruption and embezzlement of funds among planning officials.**

Corrupt planning officials fraudulently divert resources meant for projects to personal uses. This leaves insufficient resources for the planning activities like gathering data, purchase of facilities, hiring of labour, etc. This results in either poorly implemented projects or non-implementation of projects.

8. **Poorly developed infrastructure.**

Poorly developed infrastructure like bad roads, poor communication networks, etc complicate movement of project resources such as heavy machinery and labour and coordination between formulators and implementers especially in rural areas is also made difficult.

9. **Natural calamities e.g. landslides, floods, droughts, etc.**

These are difficult to control by the government leading to high degree of uncertainty especially in the agricultural sector making plan formulation and implementation difficult.

10. **Limited will or commitment by the people and government.**

Planning is also hampered by the limited will and commitment of the government officials and the public in general. People give limited attention to what is going on in their countries thinking that someone else should be responsible for the implementation of plans.

11. Interference by politicians/ political sabotage.
Politicians highly interfere in the work of the planners/ technocrats when they are formulating and implementing development plans and they sometimes force them to direct resources to other projects or areas to suit their private and political interests.
12. Non-responsive (growing) private sector.
The private sector in developing countries is growing at a high rate due to liberalization of the economies and privatisation of public enterprises. Some plans made by the central authorities are indicative but since private sector firms are not under direct control of the government and are mainly profit driven, they sometimes do not respond to government inducements to invest in the desired sectors.
13. Plans being too ambitious.
Some plans require more resources than those that can be sourced both locally and abroad hence failure of planning.

MEASURES TO IMPROVE ECONOMIC DEVELOPMENT PLANNING

QN

Account for plan failures in LDCs

Suggest measures that can be taken to enhance effective implementation of development plans in Uganda.

Solution

1. **The government should raise sufficient funds.**
This can be achieved through increasing taxes, selling government enterprises, selling government securities among others. Sufficient funds make the implementation of plans much easier since it is very easy to obtain the required resources
2. **The government should ensure proper data collection.**
Proper statistical data collection methods should be designed and masses should be educated on proper record keeping. Accurate data can reduce dangers of over estimation or under estimation of necessary resources. This can make it possible to attain successful planning.
3. **The government should ensure a stable political atmosphere.**
A stable political atmosphere can lead to proper maintenance of productive infrastructure and it can also limit diversion of resources meant for planning to pacification purposes. This can enhance effective implementation of development plans in Uganda.
4. **The government should provide skills to planners.**
The government should organise training of labour to equip it with the necessary skills needed to identify viable projects to be undertaken, estimate project costs, set realistic project objectives as well as carry out various technical activities in projects like operating machines. This can enhance effective implementation of development plans in Uganda.
5. **The government should reduce dependence on foreign aid which is inconsistent, inadequate, tied, etc.**
Donors provide inadequate funds for the purchase of resources for project implementation which can delay the planning process. There should be an in-built internal mechanism of raising public revenue to reduce reliance on foreign aid and ensure timely implementation of plan priorities.
6. **The government should fight inflation.**
This may make the amount budgeted for planning adequate due to reduced divergence between costs of resources at plan formulation and plan implementation. This can enhance effective implementation of development plans in Uganda.
7. **The government should encourage proper accountability.**
There should be an initiative to ensure that planning officials do not fraudulently divert resources meant for projects to personal use. This may leave sufficient resources for planning activities like data collection, purchase of facilities, hiring labour, etc. This can result in properly implemented projects.

8. **The government should develop infrastructure**
Improvement in infrastructure can enable easy movement of project resources such as heavy machinery and

labour. This can lead to commencement of project implementation and execution of activities on a timely basis. This can result in properly implemented projects.

9. The government should minimise dependence on nature

Modernisation of the agricultural activities should be undertaken to reduce the effects of severe natural hazards that tend to wipe out output from agriculture. This may make it possible to formulate realistic plans for the agricultural sector.

10. There should be government commitment in planning.

The government should commit sufficient resources for plan formulation and implementation.

11. The government should discourage political interference in planning.

The government should encourage politicians to support the implementation of ongoing projects by ensuring proper use of resources in various projects or areas of the country not necessarily those that suit their private and political interests.

12. The government should sensitise the private sector on her role in planning.

There should be sensitisation of the private sector firms to induce them to invest in the desired sectors of the economy for the sustainable development of the country.

13. The government should avoid over ambitious planning.

The government should identify viable projects that are within the financial means of the country. Consequently, medium term and long term development projects can become easy to formulate and implement within the resource envelope of the country.

CANONS/ PRINCIPLES OF PLANNING

1. Comprehensiveness.

A good plan should cover as many sectors as possible and it should cater for all regions of an economy. This helps to ensure that there are no lagging sectors and regions in a country thus reducing income and regional imbalance.

2. Consistency.

The aims of the plan should match with the available resources. The planners therefore have to consider the quantity and quality of the available natural, financial and human resources when determining the objectives to be achieved and the time it will take to achieve them.

The objectives should be SMART (Specific, Measurable, Achievable, Realistic, Time bound)

3. Compatibility.

The objectives of the plan should not conflict with the objectives of the already existing projects or government ideology or socio-cultural mores of the people in a country. Compatibility of a plan is essential for its acceptance by politicians and people of the country.

4. Sequence in plan implementation.

A good plan should enable the establishment of projects in a timely manner in order to create linkages between projects, sectors and the economy as a whole. Projects whose outputs are to be used as inputs by other firms should be established first. Thus short term plans should lead to medium term plans and medium term plans should bear relationship with long term plans.

For instance improving transport systems before expanding the mining sector.

5. Politically acceptable.

A good economic development plan should be accepted by all political stakeholders and the masses so as to avoid unnecessary resistance from the politicians and the general public that tends to cause delays in plan implementation.

6. Socially relevant.

A good economic development plan should address the concerns of the society for instance provision of safe water, improved health care, proper hygiene, education, poverty eradication, power generation and supply, employment creation especially among the youth, etc hence being able to stimulate economic growth and development.

The plan should address the social needs and aspirations of the society to encourage public participation.

7. **Economically feasible.**

A good plan should not be over ambitious but achievable within the targeted period given the economic, political and administrative resources of the economy.

8. **Proportionality in allocating resources.**

A good plan should follow priorities and plans should be implemented according to their importance in the economy. Sectors that contribute most to GDP should receive more resources than those that contribute little.

9. **Simplicity.**

The objectives of the plan should be very clear to all the stakeholders i.e. the plan formulators, implementers and the community as a whole.

10. **Internationally relevant.**

A good plan should be in line with donor demands such that it attracts donor funding.

11. **Optimality in the use of resources.**

A good economic development plan should aim at utilising the available resources most efficiently so to produce maximum possible output with minimum wastage. Economic growth should not be attained at the expense of the environment but at the same time resources should not remain idle.

12. **It should induce participation of the society.**

A good economic development plan should endeavor to attract the will/ participation of the masses in order to ensure faster and effective plan implementation

NOTE

Principles/ canons slightly differ from characteristics/ features in presentation

Assignment

Describe the features of a good economic development plan

Solution

A good economic development plan;

- ✓ Should be comprehensive
- ✓ Should be consistent
- ✓ Should be compatible
- ✓ Should be sequenced
- ✓ Should be politically acceptable
- ✓ Should be socially acceptable
- ✓ Should be economically feasible
- ✓ Should be proportional in allocating resources.
- ✓ Should be simple.
- ✓ Should be internationally relevant.
- ✓ Should be optimal in the use of resources.
- ✓ Should induce participation of the society.

CLASSIFICATION OF PLANNING/ PLANS

this occurs in three ways, According to who does the implementation, according to area of coverage as well as according to the time period.

1. **ACCORDING TO IMPLEMENTATION**

a) **DECENTRALISED PLANNING (BOTTOM TO TOP PLANNING)**

This is one whereby economic decision making and implementation of plans in line with set targets are undertaken by the local government/ authorities instead of the central authority.

It is also known as planning at a lower administrative level such as a region, district, county and others.

The people in a given area identify their priorities, draw their plans and implement them with assistance from the central authority where necessary.

MERITS OF DECENTRALISED PLANNING

1. **It puts the local interests of the area into consideration** because it is drawn by the local people themselves. Since people know better what they actually want, it saves the country from drawing plans that are irrelevant to the people.
2. **It encourages utilisation of local resources** due to the fact that the local people know what they have and how to exploit such resources. The exploitation of the resources is also done in the interest of the local people.
3. **Provides employment to the local people.** Decentralised planning leads to increased employment opportunities for the locals through increased projects to utilise the local resources as well as placements in positions in the local government positions.
4. **It encourages public participation in development** as people struggle to develop their home areas hence promotes the sense of belonging and commitment.
5. **Reduces bureaucratic chain** since decision making is done by local authorities not central government.
6. **Controls rural-urban migration with its negative consequences** since all areas implement their own plans and most people get employment opportunities in their own regions and hence find no need to migrate to towns.
7. **It ensures efficiency in resource allocation.** Decentralised planning does not require a very big manpower to take economic decisions and implement the plans therefore a lot of resources are not spent on a big planning machinery therefore ensuring efficiency in resource use.
8. **Decentralised planning promotes effective control of the regions** by use of the locals to control the areas on behalf of the central authority thus appropriate where the country is large.
9. **Ensures balanced regional development.** Issues of marginalising some areas are done away with since each region caters for itself.
10. **Fights inequality in income distribution** because of the increased employment opportunities for the local people.
11. **It ensures that each area takes full advantage of its priorities.** Priorities are different for different areas and therefore local authorities are able to identify the needs of the people in their region and they address them when taking economic decisions.
12. **It promotes a sense of belonging and participation in development among citizens.** Decentralized planning enables the public to participate in policy making and implementation and feel part of the development process.
13. **It is appropriate when a country is very large.**
14. It promotes specialization and division of labour (specialization by region)

DEMERITS OF DECENTRALISED PLANNING

1. **It promotes rampant corruption among the local leaders.** The local authorities use the available resources for their personal gains and some are bribed when giving contracts on different projects hence giving contracts to incompetent contractors.
2. **It promotes regional imbalance in development** as some local authorities tend to receive more resources than others.
3. **Promotes inefficiency in production** due to employment of a big administrative and support staff in local authorities hence using a lot of funds to maintain them leaving fewer resources for plan implementation.
4. **Leads to wastage of resources** as a lot of funds are used by local leaders to achieve their political ambitions instead of being used for priority areas like roads, better sanitation and safe water for the wellbeing of the community.
5. **Kills national cohesion/ integration** as different areas concentrate on only their issues. (this is because each region concentrates to address its own problems. This can reduce unity among people and hence some regions may end up suffering in case of disasters like prolonged drought, landslides, epidemics etc)
6. **Leads to duplication of resources.** Decentralised planning limits regional specialisation and thus leads to duplication of development projects as each region competes with the other.
7. **It promotes plan inconsistence i.e.** the aims of the plan not matching with the available resources. This leads to straining of the limited resources.

- **Decentralised planning may not conform to proportionality and compatibility of plans** because the planners do not have a wider perspective of the national interests. Creates conflict between local and national interests. This is because local interests may differ from national interests hence limiting development.

8. **It encourages negligence of some regions by the central authority** making them to lag behind in development.
9. **It promotes nepotism and discrimination.** This is because jobs tend to be given to some local people even without necessary qualifications.
10. **It creates political unrests where un successful regions blame the central government for their poor standards of living.**
11. It results into poor quality goods and services in some areas due to shortages of skilled man power.

Assignment

Account for the decentralized planning in LDCs/why is decentralized planning necessary in developing countries?

b) <u>CENTRALISED PLANNING (TOP TO BOTTOM PLANNING)</u>

This is one where the central authority/ state/ government plans/ allocates resources in the whole economy and it directs implementation of plans in line with the set target/ objectives.

<u>OR</u>

This is planning by the central government for the whole country.

This is done by determining the prices to be charged and allocation of factors of production among different activities in the economy.

<u>RATIONALE FOR CENTRALISED PLANNING IN AN ECONOMY</u>

1. **To minimise wastage of resources/ to ensure efficient allocation of resources.**

The central authority endeavors to allocate resources optimally than the regional planners that tend to misuse resources by duplicating projects.

2. **To ensure proper coordination in sectoral development since the private sector is still weak.**

Centralised planning encourages creation of linkages between sectors so that the development of one sector is related to the development of other sectors.

3. **To ensure equitable distribution of resources/ to fight income inequality/ to ensure balanced regional development.**

Under centralised planning, there is a possibility for resources to be distributed evenly between regions hence attaining fair/ balanced regional development and equity in income distribution.

4. **For proper sequencing of projects in the economy.**

Centralised planning makes it possible to establish projects in a timely and orderly manner one after another hence being able to create linkages.

5. **To ensure consistency of plans.**

Centralised planning ensures that planned targets are in line with the available resources. This is because central planners are conscious of the national natural resources.

6. **To ensure proportionality and compatibility of plans.**

Centralised planning allocates resources according to priority and also ensures that the objectives of the plan do not conflict with the already existing projects or government ideology or socio-cultural mores of the people in a country.

7. **For easy mobilisation of resources/ foreign aid**

Centralised planning enables government to indicate to the donors the set plans and the available resources together with shortfalls that induce the donors to offer their help.

8. **To allow regional specialisation and thus avoid duplication of development projects.**

Through centralised planning, the government ensures that each region undertakes activities which it can do best thereby avoiding duplication and wastage of resources.

9. **To minimize divergence between social costs and private benefits.**

Through centralised planning, divergence between private benefits and social costs such as pollution and over exploitation of resources are avoided through regulated exploitation of resources for example through licensing.

10. To solve the problem of shortage of manpower at local/ lower levels.

Through centralised planning, government organises training of labour to equip it with the necessary skills needed to identify viable projects to be undertaken, estimate project costs, set realistic project objectives as well as carry out various technical activities in projects like operating machines at the local levels

11. For political support.

Planning enables the government to win political support by showing the masses government programmes aimed improving their welfare as well as government successes in managing an economy.

12. To ensure price stability.

It times of inflation, measures such as reducing government planned expenditure, increasing direct taxes to reduce aggregate demand and measures to stimulate production and aggregate supply are undertaken. During a deflation, government reduces direct taxes and undertakes expansionary monetary policies to increase aggregate and demand.

13. To solve the unemployment problem.

Through centralised planning, private investment is stimulated and public investment is undertaken to create employment for the masses.

14. To promote self-reliance.

Centralised planning enables the country to reduce dependence on external resources by raising revenue locally to avoid borrowing from abroad, training labour locally to reduce dependence on imported labour, import substitution industrialisation to reduce dependence on imports and diversification of the economy to reduce sectoral dependence.

15. To achieve a pre-determined rate of economic growth.

Centralised planning enables government to set growth targets and carryout measures of achieving them for instance by planning to offer attractive incentives to investors such as tax holidays.

16. To identify areas suitable for public and private investment.

Centralised planning enables government to identify sectors which are highly profitable and attractive to private investors and those that are unprofitable but essential for a country's development such as provision of infrastructure and merits goods. The latter are indentified as suitable for public investment.

17. To relate present and future trends and targets.

Planning makes sequencing of projects possible. Through proper planning, projects that produce outputs to be used as inputs by ot her projects are implemented first. In this way, present activities are linked with future activities.

18. To correct deficiencies of price mechanism especially during situations of rapid situational changes.

Price mechanism does not adequately provide for social and economic infrastructure which requires huge capital investment, emergencies like floods, harmonious development of all the sectors hence a need for centralised planning.

19. To protect national interests.

DEMERITS OF CENTRALISED PLANNING

1. **It limits consumer sovereignty.** This is because consumer needs may not be catered for while undertaking centralised planning.
2. **It encourages bureaucracy or red tape** since consultations and approvals have to be made from different departments and approving institutions e.g. cabinet, parliament causing delays in decision making.
3. **It distorts the working of price mechanism.** Resource allocation is done by the central authority instead of through market forces of demand and supply hence inefficiency in production.
4. **It kills individual/ private institutions.** This is because plan formulation and implementation is in the hands of the central authority instead of allowing the private individuals to participate in economic decision making and plan implementation.

5. **It promotes political dictatorship.** Centralised planning makes the government of the day to formulate and implement plans that are politically biased and motivated and prolong their stay in power hence promoting political dictatorship.
6. **It is costly in term s of formulation, implementation and evaluation** because it is meant to cover the whole economy.
7. **It is associated with high levels of corruption and embezzlement of public resources** since there are so many officials involved and monitoring cash flow becomes difficult.
8. **Leads to wastage of resources** in form of production of commodities that are not so much needed by the consumers.
9. **Low quality output is produced** due to absence of competition.
10. **Low quantity of output is produced** hence low economic growth rate.

c) **DIRECTIVE PLANNING/IMPERATIVE/AUTHORITARIAN/SOCIALIST**

This is one where the central planning authority plans, directs, and orders the implementation of the plan in line with pre-determined targets and economic policies

OR

This is one where the allocation of resources is done through administrative directives issued by the central authorities.

Demerits of directive planning

- It is expensive i.e. requires a lot of capital
- It involves bureaucracy or red tape
- It does not provide incentives for the private sector.
- Denies people the freedom of choosing economic activities.
- Shortages of goods on the market due to inaccurate estimates
- Limited variety of goods and services are produced
- There is limited consumer sovereignty
- Limited innovations.
- Production of poor-quality goods
- Results into high rates of corruption

The difference between indicative and directive planning

- Directive planning is a top-down, command-and-control approach, where the government directly dictates economic activities.
- Indicative planning is a more flexible, advisory approach, where the government provides guidelines and incentives for economic actors to align with the broader development objectives.

d) **INDICATIVE PLANNING/CAPITALIST PLANNING**

This a planning process where the government draws plan targets and provides (conducive) political, social and economic policies to guide the private sector but it does not participate in plan implementation

2. ACCORDING TO COVERAGE

a) COMPREHENSIVE/ MACRO PLANNING

This is one intended to cover the whole/ entire economy

OR

This is one intended to cover all sectors of an economy.

NB

Comprehensive/ macro plan.

This is one that covers the whole/ entire economy.

OR

This is one that covers all the sectors of an economy.

A comprehensive plan therefore caters for the public and private sectors, the agricultural, industrial and tertiary

sectors all working hand in hand to bring about development of a country as a whole.

Merits of comprehensive planning

- It promotes equity in income distribution.
- Creates more employment opportunities.
- It improves balance of payments position
- Reduces dependence on imports in the long run.
- It increases the utilisation of natural resources
- It promotes inter-sectoral linkages in an economy
- Promotes balanced region development
- Increases government tax revenue due to widened tax base.
- Increases output hence economic growth
- Encourages public participation in the development process
- Promotes infrastructural development
- Controls inflation.

NOTE

For reasons or rationale; Apply:

- To
- For
- ing.

For example

- To distribute incomes equitably
- To solve the unemployment problem/ to provide employment opportunities
- Etc.

Demerits of comprehensive planning

- It is very expensive or costly.
- Results in over taxation of the citizens.
- Necessitates borrowing which results into heavy debt burden.
- Leads to over production band The term "overproduction band" refers to a range or band within which the production levels of a particular good or commodity are considered acceptable or desirable, rather than being strictly limited to a fixed target. (if government wants to produce a given amount of output, not too much not too little, it sets a band or a range rather than setting a strict number) hence wastage of resources
- Leads to quick depletion of resources.
- Leads to heavy losses because some projects fail to take off.
- May be inflationary in the short run due to excessive government expenditure
- Strains government planning machinery

Limitations to comprehensive planning in developing countries

- Inadequate funds to undertake investments in all the sectors of an economy
- Inadequate skilled manpower needed to do comprehensive planning
- Inadequate information about the different sectors
- Political instability
- Over ambitious plans
- Corruption by plan officials
- Interference by politicians.

b) MICRO PLANNING

This is one intended to cover one or a few sectors of an economy. It may be partial or sectoral.

Partial planning is one intended to cover part of an economy.

OR

This is one intended to cover a few sectors of an economy.
Sectoral planning is one intended to cover a particular/ specific sector of an economy.
Micro plan
This is one that covers one or a few sectors of an economy. It may be partial or sectoral.
Partial plan
This is one that covers part of an economy.
OR
This is one that covers a few sectors of an economy.
Sectoral plan
This is one that covers a particular/ specific sector of an economy.
For example the plan may cover only the industrial sector or agricultural sector.

Merits of micro planning

- It encourages specialisation among sectors and parts of an economy
- It helps to pull up lagging sectors and lagging areas of an economy i.e. through linkages.
- It leads to efficient utilisation of limited resources.
- It is suitable for developing countries that have limited capital.
- It minimises over production and wastage of resources.

Demerits of micro planning

- It limits the rate of employment creation.
- Leads to regional imbalances in development
- Worsens income inequality problem
- It limits inter-sectoral linkages in an economy.
- Widens income/ wealth inequalities
- Leads to underutilisation of the available resources
- Causes shortages on the market
- Limits consumer choice/ reduces variety of output
- Limits economic growth
- Limits government tax revenue
- Leads to economic dependence especially sectoral dependence and its negative consequences.
- Some sectors that may not be catered for during the planning process end up lagging behind as far as development is concerned.
- The plans may identify a wrong sector or less productive sector that may not benefit all the masses thereby leading to wastage of resources.

3. ACCORDING TO TIME FRAME

a) Short term/ operative/ annual plans
These are plans in which targets are set to cover a period of one year or even less. For example the National budget.

b) Medium term plans
These are plans in which targets are set to cover a period between two and nine years.

c) Long term (perspective) plan
This is one whose targets and objectives are set to cover a long period of time like ten years or more.

PERSPECTIVE PLANNING

This refers to long term planning covering a period of ten years or more.

Factors that limit perspective planning in Uganda

- Limited information or data
- Natural hazards
- Limited skilled labour
- Limited government commitment
- Difficulty in identifying viable projects
- Limited financial resources

- Corruption
- Non-responsive private sector
- Political instability
- High rates of inflation
- Over ambitious planning
- Political interference
- Conservatism.

MANPOWER PLANNING

This is the long-term projection of manpower supply and manpower demand so as to strike a balance between future supply and demand for labour so as to achieve the objectives of development.

In otherwords, man power planning is the efforts by the government to balance the supply of labour and demand for labour.

Manpower problems faced in Uganda

- High level of unemployment and underemployment
- Discrimination in the labour market
- Limited supply of skilled labour
- Increased use of child labour
- Misuse/ misplacement of labour
- High cost of training labour
- Low/ poor remuneration
- High rates of brain drain
- Negative attitude towards work
- Poor working conditions
- Poor health of many workers
- Imbalanced supply of skilled labour in different fields.

THE ROLE OF PLANNING IN THE DEVELOPMENT OF AN ECONOMY

POSITIVE ROLES

1. Minimizes wastage of scarce resources.
2. Determines the rate of economic growth.
3. Ensures equitable distribution of income and wealth.
4. Corrects deficiencies of price mechanism.
5. Helps in mobilizing resources/ attracts foreign aid.
6. Helps in identifying areas suitable for public and private investment.
7. Maintains price stability.
8. Corrects B.O.P problems.
9. Encourages public participation in the development process as well as soliciting for political support.
10. Ensures consistent and harmonious use of resources.
11. Helps to relate the present and future trends.

NEGATIVE ROLES

1. Distorts the working of price mechanism especially centralised planning.
2. It kills individuals'/ private initiatives.
3. It encourages bureaucracy and its related negative consequences.
4. Planning is very expensive/ costly for instance plan formulation, implementation, monitoring and evaluation.
5. It may lead to wastage of resources especially over ambitious plans i.e. plans far beyond the means.
6. Limits consumer sovereignty especially centralised planning which does not allow consumers to freely participate directly in plan formulation.
7. Corruption becomes rampant especially decentralised planning where implementation is done by the local authorities.

8. Promotes political dictatorship especially centralised planning whereby the central authority comes up with policies aimed at keeping themselves in power as resources tend to be channeled in areas where the government has much support.

GUIDING QUESTIONS

1. a) What is meant by **economic development planning**? (01 mark)
   b) Give any **three** factors that affect the implementation of development plans in Uganda. (03 marks)
   UNEB 2013 P220/1
2. a) Define the term **economic development planning**. (01 marks)
   b) Mention any **three** problems encountered in economic development planning in developing countries. (03 marks)
   UNEB 2003 P220/1
3. a) What is meant by **economic planning**? (02 marks)
   b) Differentiate between a **comprehensive plan** and a **partial plan**. (02 marks)
   UNEB 2000 P220/1
4. a) What is meant by **economic planning**? (02 marks)
   b) Distinguish between **comprehensive planning** and **perspective planning**. (02 marks)
   uneb 1998 p220/1
5. a) Define economic **planning**. (01 mark)
   b) State **three** pre-requisites for success of economic planning in Ugan`da. (03 marks)
   KEB 2018 P220/2
6. a) What is meant by the term **economic planning**? (01 mark)
   b) Give **three** conditions for the success of economic development planning in an economy. (03 marks)
   MEC 20I7 P220/1
7. a) What is meant by **decentralised economic planning**? (01 mark)
   b) State any **three** merits of decentralised economic planning. (03 marks)
   UNEB 2008 P220/2
8. a) What is meant by the term **decentralised economic planning**? (01 mark)
   b) Mention **three** motives of decentralised planning in Uganda. (03 marks)
   KEB 2016 P220/2
9. a) Differentiate between **decentralised planning** and **centralised planning**. (02 marks)
   b) Give **two** constraints to decentralised planning in Uganda. (02 marks)
   UTEC 2015 P220/2
10. a) Differentiate between **directive planning** and **centralised planning**. (02 marks)
    b) Give any **two** limitations of centralised planning in developing countries. (02 marks)
    MEC 2016 P220/1
11. a) Distinguish between **centralised planning** and **indicative planning**. (02 marks)
    b) Give **two** factors that limit centralised planning in Uganda. (02 marks)
    KEB 2018 P220/2
12. a) Distinguish between **directive planning** and **comprehensive planning**. (02 marks)
    b) Give **two** importances of planning in Uganda. (02 marks)
    MEC 2017 P220/2
13. a) What is meant by the term **comprehensive plan**? (01 mark)

b) Give any **three** merits of a comprehensive plan in an economy. (03 marks)
WKS 2014 P220/1

14. a) Define the term **comprehensive planning**. (01 mark)
b) State any **three** objectives of comprehensive planning in Uganda. (03 marks)
KEB 2018 P220/2

15. a) What is meant by **comprehensive planning**? (01 mark)
b) Mention **three** factors that limit comprehensive planning in developing countries. (03 marks)
UMTA 2017 P220/1

16. a) Distinguish between **comprehensive planning** and a **perspective plan**. (02 marks)
b) Mention any **two** demerits of comprehensive planning in Uganda. (02 marks)
KEB 2016 P220/2

17. a) Differentiate between **comprehensive planning** and **perspective planning**. (02 marks)
b) Mention **two** characteristics of a good development plan. (02 marks)
NBTA 2015 P220/1

18. a) Distinguish between a **comprehensive plan** and a **perspective plan.** (02 marks)
b) State **two** merits of a perspective plan. (02 marks)
KEB 2018 P220/1

19. a) Differentiate between **partial planning** and **perspective planning.** (02 marks)
b) Mention any **two** demerits of partial planning in an economy. (02 marks)
UNEB 2015 P220/1

20. a) Distinguish between **partial planning** and **comprehensive planning**. (02 marks)
b) State any **two** constraints to economic development planning in Uganda. (02 marks)
UNEB 2007 P220/2

21. a) Distinguish between **partial planning** and **comprehensive planning.** (02 marks)
b) State any **two** reasons for comprehensive planning in Uganda. (02 marks)
MEC 2015 P220/2

22. a) Distinguish between **partial planning** and **sectoral planning**. (02 marks)
b) Outline **two** advantages of sectoral planning in an economy. (02 marks)
KEB 2016 P220/1

23. a) Distinguish between a **partial plan** and a **comprehensive plan**. (02 marks)
b) Mention any **two** merits of a comprehensive plan. (02 marks)
UNEB 2002 P220/1

24. a) Distinguish between a **sectoral plan** and a **comprehensive plan**. (02 marks)
b) State any **two** obstacles to the effective implementation of economic development plans in Uganda. (02 marks)
UNEB 2009 P220/2

25. a) Distinguish between **comprehensive planning** and **sectoral planning**. (02 marks)
b) Mention any **two** demerits of sectoral planning in Uganda. (02 marks)
WKS 2017 P220/2

26. a) What is meant by **perspective planning**? (01 mark)
b) Mention **three** factors that limit **perspective** planning in Uganda. (03 marks)
KSPA 2015 P220/2

27. a) Define the term **perspective plan**. (01 mark)
b) Mention any **three** problems faced in formulating a perspective plan. (03 marks)
UNEB 1999 P220/1

28. a) What is meant by a **perspective plan**? (01 mark)
    b) Give **three** qualities of a good plan. (03 marks)
KEB 2018 P220/1

29. a) What is meant by a **perspective plan**? (01 mark)
b) Outline **three** causes of failure of perspective plans in less developed countries. (03 marks)
WKS 2016 P220/1

30. a) Differentiate between **perspective planning** and **indicative planning**. (02 marks)
b) Mention **two** constraints to economic development planning in Uganda. (02 marks)
WKS 2014 P220/2

31. What are the manpower problems faced by developing countries? (04 marks)
KEB 2016 P220/1

SECTION B

1. a) What is **economic development planning**? (04 marks)
   b) Why does Uganda carry out economic planning? (16 marks)
UNEB 2000 P220/2

2. a) What is meant by the term **economic development planning**? (04 marks)
b) Examine the factors that can limit effective implementation of development plans in an economy. (16 marks)
KSPA 2015 P220/1

3. a) Why is it necessary for Uganda to prepare a national development plan? (10 marks)
   b) Examine the pre-requisites for successful planning in Uganda. (10 marks)
JJEB 2016 P220/2

4. a) Why is it necessary to formulate an economic development plan in a country? (08 marks)
   b) Explain the factors that limit the successful implementation of economic development plans in developing countries. (12 marks)
UNEB 2014 P220/1

5. a) Why is there need for development planning in Uganda? (10 marks)
   b) What factors limit effective implementation of development plans in developing countries? (10 marks)
UNEB 2001 P220/2
UNEB 1998 P220/2

6. a) Account for economic development planning in Uganda. (10 marks)
b) Discuss the factors limiting successful planning in Uganda. (10 marks)
JJEB 2015 P220/2

7. a) Examine the rationale for economic development planning in Uganda. (10 marks)
b) Discuss the limitations to successful planning in Uganda. (10 marks)
JJEB 2017 P220/2

8. a) What are the benefits of economic development planning? (08 marks)
b) Explain the factors that influence the implementation of economic development plans in Uganda. (12 marks)
UNEB 2015 P220/2

9. a) Describe the pre-requisite for successful planning in developing countries. (10 marks)
   b) Explain the factors that limit successful planning in developing countries. (10 marks)
UTEC 2015 P220/1

10. a) What are the elements of a good economic development plan? (10 marks)
b) What are the reasons for undertaking development planning? (10 marks)
KEB 2018 P220/1

11. a) Describe the features of a good economic development plan. (10 marks)
b) Account for the failure by developing countries to effectively implement economic development plans. (10 marks)
UNEB 2008 P220/1

12. a) Describe the features of a good economic development plan. (06 marks)
b) Suggest measures that can be taken to enhance effective implementation of development plans in Uganda. (14 marks)
WKS 2016 P220/2

13. a) Describe the features of a good economic development plan. (08 marks)
b) Examine the merits and demerits of decentralised planning in an economy. (12 marks)
WKS 2017 P220/1

14. a) What are the features of a good economic development plan? (06 marks)
b) Explain the challenges faced in implementing economic development plans. (14 marks)
UNSE 2015 P220/1

15. a) Explain the qualities of a good economic development plan. (10 marks)
b) Account for the frequent failure to effectively implement economic development plans in developing countries. (10 marks)
KEB 2018 P220/1

16. a) Differentiate between **decentralised planning** and **centralised planning**. (04 marks)
b) Account for the existence of decentralised planning in developing countries. (16 marks)
uneb 1998 p220/1

17. a) Discuss the merits of decentralised planning in Uganda. (10 marks)
b) Explain the difficulties faced in the implementation of economic development plans in Uganda. (10 marks)
UMTA 2017 P220/2

18. a) What is meant by **centralised planning**? (04 marks)
b) Explain the rationale for centralised planning inn an economy. (16 marks)
UNEB 2012 P220/1

19. a) Differentiate between **centralised planning** and **decentralised planning.** (04 marks)
b) Suggest measures that should be taken to improve implementation of economic development plans in Uganda. (16 marks)
KEB 2018 P220/2

20. a) Distinguish between **centralised planning** and **indicative planning**. (04 marks)
b) Explain the factors that limit the successful implementation of economic development plans in developing countries. (16 marks)
UNEB 2005 P220/2

21. a) Distinguish between **centralised planning** and **indicative planning**. (04 marks)
b) What are the factors that influence the effectiveness of economic development planning in developing countries? (16 marks)
UNEB 2002 P220/1

22. a) Distinguish between a **comprehensive plan** and a **partial plan**. (04 marks)
b) Examine the role of planning in an economy. (16 marks)

UNEB 2004 P220/2

23. a) Distinguish between **partial planning** and **decentralised planning**. (04 marks)

b) Why is development planning necessary in an economy? (16 marks)

UNEB 2010 P220/1

24. a) Distinguish between a **sectoral plan** and a **comprehensive plan**. (04 marks)

b) Explain the importance of economic development planning in an economy. (16 marks)

UNEB 2005 P220/1

25. a) Define the term **perspective planning**. (04 marks)

b) Explain the factors limiting economic development planning in developing countries. (16 marks)

UNEB 2009 P220/1

26. a) Differentiate between **a perspective plan** and **a comprehensive plan.** (04 marks)

b) Suggest measures that should be adopted to improve economic development planning in Uganda. (16 marks)

UNEB 2016 P220/2

27. a) Distinguish between perspective **planning** and **comprehensive planning.** (04 marks)

b) Discuss the factors influencing the effectiveness of development planning in LDCs. (16 marks)

KEB 2018 P220/1